



Final Report

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

VOLUME 1

© Commonwealth of Australia 2019

ISBN:

978-1-920838-64-5 (print)

978-1-920838-65-2 (online)

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

1 February 2019

His Excellency General the Honourable Sir Peter Cosgrove AK MC (Retd)
Governor-General of the Commonwealth of Australia
Government House
CANBERRA ACT 2600

Your Excellency

In accordance with the Letters Patent issued to me on 14 December 2017,
I have made inquiries and now provide the Final Report of the
Royal Commission into Misconduct in the Banking, Superannuation
and Financial Services Industry.

Yours sincerely

[Signed]

Kenneth M Hayne
Commissioner

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Glossary

Term	Definition
accrued default amount (ADA)	An amount of superannuation accumulated in a situation where (a), the member has not given the fund's trustee any direction about how the amount is to be invested, or (b), the amount is invested in the fund's 'default' investment option.
anti-hawking provisions	Provisions set out in Sections 736, 992AA and 992A of the <i>Corporations Act 2001</i> (Cth) that prohibit offering financial products for issue or sale during, or because of, an unsolicited meeting or telephone call with a retail client.
Australian Credit Licence (ACL)	A licence issued under the <i>National Consumer Credit Protection Act 2009</i> (Cth) that authorises a licensee to engage in particular credit activities.
Australian financial services licence (AFSL), Australian financial services licensee	A licence under the <i>Corporations Act 2001</i> (Cth) that authorises a person who carries on a financial services business to provide financial services. A licensee is the person who provides the services.
authorised deposit-taking institution (ADI)	A body corporate authorised under the <i>Banking Act 1959</i> (Cth) to carry on a banking business in Australia.
Bank Bill Swap Rate (BBSY)	An interest rate used as a benchmark when pricing financial products.
Banking Executive Accountability Regime (BEAR)	A piece of legislation set out in Part IIAA of the <i>Banking Act 1959</i> (Cth) and enacted in February 2018, the BEAR establishes accountability obligations for authorised deposit-taking institutions (ADIs) and their senior executives and directors. It is administered by APRA.
buyer of last resort (BOLR)	Arrangements whereby a licensee or an authorised representative acquires the business of another representative. The purchase price is determined using a specific formula.

Term	Definition
conflicted remuneration	Any benefit, whether monetary or non-monetary, given to a financial services licensee , or their representatives, who provides financial product advice to retail clients that, because of the nature of the benefit or the circumstances in which it is given could reasonably be expected to influence the choice of financial product recommended by the licensee or representative or could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative: see Section 963A of the <i>Corporations Act 2001</i> (Cth).
enforceable undertaking (EU)	An undertaking enforceable in a court. Issued under the <i>Australian Securities and Investments Commission Act 2001</i> (Cth) and the <i>National Consumer Credit Protection Act 2009</i> .
external dispute resolution (EDR)	An independent service for resolving disputes between consumers and providers of financial products and services, as an alternative to the court system.
financial product	Under the <i>Corporations Act 2001</i> (Cth), a facility through which, or through the acquisition of which, a person makes a financial investment, manages financial risk and/or makes non-cash payments.
financial services entity	Defined by the Letters Patent as (among other things) ‘an ADI (authorised deposit-taking institution) within the meaning of the <i>Banking Act 1959</i> ’, ‘a person or entity required by section 911A of the <i>Corporations Act 2001</i> to hold an Australian financial services licence , or who is exempt from the requirement to hold such a licence by virtue of being an authorised representative’, and ‘a person or entity that acts or holds itself out as acting as an intermediary between borrowers and lenders’.

Term	Definition
Financial Services Guide (FSG)	A guide that contains information about the entity providing financial advice, and explains the services offered, the fees charged and how the person or company providing the service will deal with complaints.
financial services licensee	An individual or business that has been granted an Australian financial services licence (AFSL) by ASIC.
Future of Financial Advice (FoFA)	A 2012 package of legislation intended to improve the trust and confidence of Australian retail investors in the financial services sector and ensure the availability, accessibility and affordability of high quality financial advice.
grandfathering arrangements, grandfathered commission	Grandfathering arrangements allow for commissions to continue to be paid to intermediaries who sold financial products prior to the Future of Financial Advice (FoFA) reforms that would otherwise be classified as conflicted remuneration . This source of revenue is known as a grandfathered commission.
group life insurance	Life insurance where a group of people (for example, members of a superannuation fund) are covered by the one contract.
Household Expenditure Measure (HEM)	A measure of what families spend on different types of household items, calculated quarterly by the Melbourne Institute of Applied Economic and Social Research.
mortgage aggregator	An intermediary between mortgage brokers and lenders. Mortgage aggregators have contractual arrangements with lenders that allow brokers operating under the aggregator to arrange loans from those lenders.
mortgage broker	An intermediary between borrowers and lenders of home loans.

Term	Definition
MySuper products	Low-cost, simple superannuation products for members who make no active choice about their superannuation.
registrable superannuation entity (RSE)	A category of superannuation entity, regulated by APRA, that includes regulated superannuation funds, approved deposit funds and pooled superannuation trusts, but does not include self-managed superannuation funds (SMSFs).
successor fund transfer (SFT)	Where a member's benefits are transferred to a successor fund. This is one of the few situations where benefits can be transferred without the member's consent and is subject to strict regulation.
third party guarantor	A person or business other than the borrower who guarantees to pay back a loan if the borrower does not.
Tier 1 Capital	Capital against which losses can be written off while an authorised deposit-taking institution (ADI) continues to operate and can absorb losses should the ADI ultimately fail.
trail commission	A regularly recurring commission to an intermediary, such as a broker, based on a proportion of the current or average loan balance and payable periodically after the loan is made/drawn. Distinct from a commission that is paid up front.
vertical integration	A description of the relationship between entities where financial advice, platforms and funds management are controlled by a single entity.

Abbreviations

ABA	Australian Bankers' Association (now Australian Banking Association)
ABARES	Australian Bureau of Agricultural and Resource Economics and Sciences
ACBF	Aboriginal Community Benefit Fund
ACCC	Australian Competition and Consumer Commission
ACL	Australian Credit Licence
ADA	accrued default amount
ADI	authorised deposit-taking institution
AFA	Association of Financial Advisers
AFCA	Australian Financial Complaints Authority
AFSL	Australian financial services licence
APRA	Australian Prudential Regulation Authority
ASBFEO	Australian Small Business and Family Enterprise Ombudsman
ASIC	Australian Securities and Investments Commission
AUSTRAC	Australian Transaction Reports and Analysis Centre
BEAR	Banking Executive Accountability Regime
BOLR	buyer of last resort
DRE	dual-regulated entity
EDR	external dispute resolution

EU	enforceable undertaking
FASEA	Financial Adviser Standards and Ethics Authority
FoFA	Future of Financial Advice (legislation reforms)
FOS	Financial Ombudsman Service
FPA	Financial Planning Association of Australia
FSC	Financial Services Council
FSG	Financial Services Guide
HEM	Household Expenditure Measure
IDR	internal dispute resolution
KPI	Key Performance Indicator
LVR	loan-to-value ratio
PDS	product disclosure statement
RE	responsible entity
RSE	registrable superannuation entity
SFT	successor fund transfer
SME	small and medium enterprises
SMSF	self-managed superannuation fund

Key references

Cooper Review, Final Report	Super System Review: Final Report (30 June 2010)
Murray Inquiry, Final Report	Financial System Inquiry Final Report (November 2014)
Ramsay Review, Final Report	Final Report: Review of the Financial System External Dispute Resolution and Complaints Framework (April 2017)
Ramsay Review, Supplementary Final Report	Supplementary Final Report: Review of the Financial System External Dispute Resolution and Complaints Framework (September 2017)
Sedgwick Review, Report	Retail Banking Remuneration Review: Report (19 April 2017)
Wallis Inquiry, Final Report	Financial System Inquiry Final Report (March 1997)

Legislation

ASIC Regulations 2001 (Cth)

Australian Crime Commission Act 2002 (Cth) (the ACC Act)

Australian Prudential Regulation Authority Act 1998 (Cth) (the APRA Act)

Australian Prudential Regulation Authority Amendment Act 2003 (Cth)

Australian Securities and Investments Commission Act 2001 (Cth) (the ASIC Act)

Australian Small Business and Family Enterprise Ombudsman Act 2015 (Cth)

Banking Act 1959 (Cth) (the Banking Act)

Competition and Consumer Act 2010 (Cth)

Consumer Insurance (Disclosure and Representations) Act 2012 (UK)

Corporate Law Reform Act 1992 (Cth)

Corporations Act 1989 (Cth)

Corporations Act 2001 (Cth) (the Corporations Act)

Corporations Amendment (Financial Advice Measures) Act 2016 (Cth)

Corporations Amendment (Financial Advice) Regulation 2015 (Cth)

Corporations Amendment (Revising Future of Financial Advice)
Regulation 2014 (Cth)

Corporations Regulations 2001 (Cth)

Fair Work Act 2009 (Cth)

Farm Business Debt Mediation Act 2017 (Qld)

Farm Debt Mediation Act 1994 (NSW)

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Financial Services and Markets Act 2000 (UK)

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Income Tax Assessment Act 1997 (Cth)

Insurance Act 1973 (Cth) (the Insurance Act)

Insurance Contracts Act 1984 (Cth) (the Insurance Contracts Act)

Insurance Contracts Amendment Act 2013 (Cth)

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Life Insurance Act 1995 (Cth) (the Life Insurance Act)

National Consumer Credit Protection Act 2009 (Cth) (the NCCP Act)

National Consumer Credit Protection Regulations 2010 (Cth)
(the NCCP Regulations)

Occupational Superannuation Standards Act 1987 (Cth) (the OSSA Act)

Privacy Act 1988 (Cth)

Public Governance, Performance and Accountability Act 2013 (Cth)

Retirement Savings Accounts Act 1997 (Cth)

Royal Commissions Act 1902 (Cth)

Superannuation Guarantee (Administration) Act 1992 (Cth)

Superannuation Guarantee (Administration) Regulations 2018 (Cth)

Superannuation Industry (Supervision) Act 1993 (Cth) (the SIS Act)

Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2005 (Cth)

Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012 (Cth).

Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012 (Cth)

Superannuation Legislation (Trustee Obligations and Prudential Standards) Act 2012 (Cth)

Superannuation Safety Amendment Act 2004 (Cth)

Superannuation Legislation (Trustee Obligations and Prudential Standards) Act 2012 (Cth)

Superannuation Safety Amendment Act 2004 (Cth)

Preface

This is the *Final Report* of the results of my inquiry, and the recommendations arising out of my inquiry, into the matters described in the Letters Patent dated 14 December 2017. It is to be read with the *Interim Report* I submitted to His Excellency the Governor General on 28 September 2018.

In Chapter 1 of my *Interim Report*, I refer to the establishment of the Commission and set out the Commission's Terms of Reference. For ease of reference I have included the Letters Patent in Volume 3 of this Report.

I describe in Chapter 1 of the *Interim Report*, and need not repeat in this Report, the first steps taken in appointing staff, counsel and solicitors; the initial inquiries I made of financial services entities, industry associations, consumer advocacy groups and regulatory authorities about the matters that were to be the subject of inquiry; and the steps taken to gather submissions and information from the public. As is recorded elsewhere in this Report, members of the public submitted more than 10,000 complaints about financial services entities by using the Commission's web form. In addition, there were many thousands of telephone calls and emails to the Office of the Royal Commission, some asking for help in making a complaint, some asking about the work of the Commission and some offering comments on the work that was being, or had been, done.

As also explained in Chapter 1 of the *Interim Report*, it was evident at the outset of the Commission's work that not every case could be investigated or examined in the course of public hearings. To investigate, let alone hear evidence about, every case would have taken many years. Choices had to be made. The cases that were chosen were selected as reasonably illustrative of the kinds of conduct about which members of the public had complained. Inevitably, those not chosen are disappointed.

Much of the work of the Commission has been done outside the hearing room. Choosing case studies required solicitors and counsel assisting to examine in detail many more cases of alleged relevant conduct than those taken as case studies in hearings. Many hours were spent, hundreds of complaints and thousands of documents were examined, before choosing what cases would be the subject of public hearings.

Other work done outside the hearing room included the preparation of background and research papers. Some of those papers were published in Volume 3 of the *Interim Report*; the balance of them appear in Volume 3 of this Report.

The *Interim Report* sets out the findings I made in respect of case studies considered during the first four rounds of the Commission's public hearings.

I conducted three other rounds of public hearings:

- between 6 August 2018 and 17 August 2018 – concerning superannuation;
- between 10 September 2018 and 21 September 2018 – concerning insurance; and
- between 19 November 2018 and 30 November 2018 – taking evidence from some CEOs, board chairs and the heads of ASIC and APRA concerning policy and other questions that I had raised in my *Interim Report*.

This Report sets out, in Volume 2, the findings I make in respect of case studies considered during the rounds of hearings concerning superannuation and insurance.

Behind the whole of the Commission's work, and this *Final Report*, lies the work of very many people: as advisers or consultants, as members of the staff of the Office of the Royal Commission, as Solicitors Assisting the Commission, and as Counsel Assisting the Commission. Their names are set out in Volume 3. I am deeply grateful to every one of them for all that they have done so willingly, diligently and skilfully.

1. Introduction

1 This report

The central task of the Commission has been to inquire into, and report on, whether any conduct of **financial services entities** might have amounted to misconduct and whether any conduct, practices, behaviour or business activities by those entities fell below community standards and expectations. The conduct identified and described in the Commission's *Interim Report* and the further conduct identified and described in this Report includes conduct by many entities that has taken place over many years causing substantial loss to many customers but yielding substantial profit to the entities concerned. Very often, the conduct has broken the law. And if it has not broken the law, the conduct has fallen short of the kind of behaviour the community not only expects of financial services entities but is also entitled to expect of them.

This *Final Report* seeks to take what has been learned in respect of each part of the financial services industry that has been examined and identify:

- issues;
- causes; and
- responses and recommendations.

1.1 Four observations

Those analyses, taken together, will reveal the importance of four observations about what has been shown by the Commission's work: the connection between conduct and reward; the asymmetry of power and information between financial services entities and their customers; the effect of conflicts between duty and interest; and holding entities to account.

Each of those observations should be explained.

First, in almost every case, the conduct in issue was driven not only by the relevant entity's pursuit of profit but also by individuals' pursuit of gain,

whether in the form of remuneration for the individual or profit for the individual's business. Providing a service to customers was relegated to second place. Sales became all important. Those who dealt with customers became sellers. And the confusion of roles extended well beyond front line service staff. Advisers became sellers and sellers became advisers.

The conduct identified and condemned in this *Final Report* and in the *Interim Report* can and should be examined by reference to how the person doing the relevant acts, or failing to do what should have been done, was rewarded for the conduct.

Rewarding misconduct is wrong. Yet incentive, bonus and commission schemes throughout the financial services industry have measured sales and profit, but not compliance with the law and proper standards. Incentives have been offered, and rewards have been paid, regardless of whether the sale was made, or profit derived, in accordance with law. Rewards have been paid regardless of whether the person rewarded *should* have done what they did.

Second, entities and individuals acted in the ways they did because they could. Entities set the terms on which they would deal, consumers often had little detailed knowledge or understanding of the transaction and consumers had next to no power to negotiate the terms. At most, a consumer could choose from an array of products offered by an entity, or by that entity and others, and the consumer was often not able to make a well-informed choice between them. There was a marked imbalance of power and knowledge between those providing the product or service and those acquiring it.

Third, consumers often dealt with a financial services entity through an intermediary. The client might assume that the person standing between the client and the entity that would provide a financial service or product acted for the client and in the client's interests. But, in many cases, the intermediary is paid by, and may act in the interests of, the provider of the service or product. Or, if the intermediary does not act for the provider, the intermediary may act only in the interests of the intermediary.

The interests of client, intermediary and provider of a product or service are not only different, they are opposed. An intermediary who seeks to 'stand in

more than one canoe' cannot.¹ Duty (to client) and (self) interest pull in opposite directions.

Chapter 7 of the *Corporations Act 2001* (Cth) (the Corporations Act), and the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act) (but not the *Superannuation Industry (Supervision) Act 1993* (Cth) – the SIS Act), speak of 'managing' conflicts of interest.² But experience shows that conflicts between duty and interest can seldom be managed; self-interest will almost always trump duty. The evidence given to the Commission showed how those who were acting for a client too often resolved conflicts between duty to the client, and the interests of the entity, adviser or intermediary, in favour of the interests of the entity, adviser or intermediary and against the interests of the client. Those persons and entities obliged to pursue the best interests of clients or members too often sought to strike some compromise between the interests of clients or members and their own interests or the interests of a related third party (such as the person's employer, or the entity's owner). A 'good enough' outcome was pursued instead of the *best* interests of the relevant clients or members. (Notions of best interests and conflicts between duty and interest are further examined below in connection with **mortgage brokers**, financial advice and superannuation.)

Fourth, too often, financial services entities that broke the law were not properly held to account. Misconduct will be deterred only if entities believe that misconduct will be detected, denounced and justly punished. Misconduct, especially misconduct that yields profit, is not deterred by requiring those who are found to have done wrong to do no more than pay compensation. And wrongdoing is not denounced by issuing a media release.

The Australian community expects, and is entitled to expect, that if an entity breaks the law and causes damage to customers, it will compensate those affected customers. But the community also expects that financial services entities that break the law will be held to account. The community

¹ *Re Minister for Immigration and Multicultural and Indigenous Affairs; Ex parte Ame* (2005) 222 CLR 439, 448.

² The SIS Act requires trustees to give priority to the duties to and interests of the beneficiaries over the duties to, or the interests of, others. See s 52(2)(d).

recognises, and the community expects its regulators to recognise, that these are two different steps: having a wrongdoer compensate those harmed is one thing; holding wrongdoers to account is another.

Some may see what has emerged from the work of the Commission only through the lens of public accountability for what has happened. And public accountability is critically important. But it cannot be the only focus. It is necessary to look to the future as well as to the past.

The responses and recommendations made in this Report will attract varied responses. Those who oppose change will appeal to real or supposed difficulty in altering present arrangements. Reference will be made to change bringing ‘unintended consequences’. That argument is easily made because it has no content; the ‘consequences’ feared are not identified.

But choices must now be made. The arrangements of the past have allowed conduct of the kinds and extent described here and in the *Interim Report* of the Commission. The damage done by that conduct to individuals and to the overall health and reputation of the financial services industry has been large. Saying sorry and promising not to do it again has not prevented recurrence. The time has come to decide what is to be done in response to what has happened. The financial services industry is too important to the economy of the nation to allow what has happened in the past to continue or to happen again.

1.2 Primary responsibility

There can be no doubt that the primary responsibility for misconduct in the financial services industry lies with the entities concerned and those who managed and controlled those entities: their boards and senior management. Nothing that is said in this Report should be understood as diminishing that responsibility. Everything that is said in this Report is to be understood in the light of that one undeniable fact: it is those who engaged in misconduct who are responsible for what they did and for the consequences that followed.

Because it is the entities, their boards and senior executives who bear primary responsibility for what has happened, close attention must be given to their culture, their governance and their remuneration practices.

1.3 Key questions

In its written submission in response to the *Interim Report*, Treasury identified the key questions emerging from the *Interim Report* as:³

- To what extent can the law be simplified so that its intent is met, rather than merely its terms being complied with, and how can this be done?
- Should the approach to addressing conflicts of interest change from managing conflicts to removing them, either by banning all or some forms of **conflicted remuneration** and sales or profit-based remuneration and/or changing industry structures?
- What can be done to improve compliance with the law (and industry codes), and the effectiveness of the regulators, to deter misconduct and ensure that grave misconduct meets with proportionate consequences?

Treasury submitted that a fourth key question should be added:⁴

- What more can be done to achieve effective leadership, good governance and appropriate culture within financial services firms so that firms ‘obey the law, do not mislead or deceive, are fair, provide fit for purpose service with care and skill, and act in the best interests of their clients’?

Treasury submitted that answers to these four questions ‘would form the pillars of any comprehensive policy response to what the Commission has publicly exposed’.⁵

I agree. These are the pillars of the policy responses to be made. And, as is explained in the body of the Report, some particular changes to the law are necessary to improve protections for consumers against misconduct, to provide adequate redress and to address asymmetries of power and information between entities and consumers.

³ Treasury, Interim Report Submission, 1 [2].

⁴ Treasury, Interim Report Submission, 1 [3]. See also, FSRC, *Interim Report*, vol 1, 290.

⁵ Treasury, Interim Report Submission, 1 [4].

1.4 Extending the Commission

Why deal with these issues now? Why make my *Final Report* now? Why not extend the work of the Commission? Many suggested that I seek an extension of the time by which my *Final Report* was due to allow for further public hearings.

I did not seek any extension of time for this *Final Report* for the reasons I gave in the Introduction to the *Interim Report*. As I said there:⁶

The Letters Patent require me to inquire into, and report on, whether any conduct by financial services entities, including banks and their associated entities, might have amounted to misconduct and whether any conduct, practices, behaviour or business activities by those entities fall below community standards and expectations. I must execute those tasks conscious of the fact that the banking system is a central artery in the body of the economy. Defects and obstructions in the artery can have very large effects. Likewise, prolonged injections of doubt and uncertainty can affect performance.

I concluded then, and remain of the view, that these reasons oblige me to execute my tasks promptly and do so in ways that would achieve two related purposes: to identify properly the underlying causes of conduct of the kinds referred to in the Terms of Reference; and to prompt proper consideration of how best to avoid recurrence of similar conduct.

One reason often given for proposing to extend the work of the Commission was to give more persons who had been affected by relevant misconduct the chance to give evidence of those events. Throughout the work of the Commission I have paid close regard, and given great significance, to the Commission conducting a public inquiry so that there might be public exposure of misconduct and the vindication those affected by misconduct derive from its being exposed. All of the many public submissions made to the Commission were read and considered, and many were considered repeatedly.

⁶ FSRC, *Interim Report*, vol 1, 1.

Not every complaint that was made could be publicly examined. There were too many to do that. Hence, choices had to be made and, inevitably, the choices that were made will have disappointed those not chosen.

But the cases that were the subject of case studies were chosen as being reasonably illustrative of kinds of conduct and general issues that could be seen as emerging from the very active public engagement with the Commission's work and from the Commission's own investigations. The case studies provided a sufficiently broad and firm platform for drawing the conclusions that are expressed in this Report. Multiplying examples would not have altered the breadth or depth of that platform to any useful extent. And, as I point out more than once in this Report, every financial services entity, whether examined in a case study or not, must look at its own conduct and the way in which it governs itself.

The decision not to seek an extension was taken recognising that the Commission could provide no remedy to those who complained that they had been affected by misconduct. The most that could be done was to provide them with a public platform to voice their complaint. I recognise the importance of a Royal Commission in giving public voice to the issues and concerns that prompted its establishment. But the decision not to seek extension was also taken recognising the central importance that the health of the financial system has for the nation's economy and thus for every member of this society. For me, these wider considerations were determinative.

It is time to grapple with the key questions identified. And it is necessary, therefore, to state plainly the principles and general rules that underpin the answers that are to be given.

1.5 Underlying principles and general rules

In my *Interim Report* I asked many questions. As I said at that time, I sought to provoke informed and useful debate about the issues that have emerged in the course of the Commission's inquiries.

Many of those questions were explored in the course of the final round of the Commission's public hearings and in the many submissions made to the Commission. Submissions were received from financial services entities; the Australian Prudential Regulation Authority (APRA); the

Australian Securities and Investments Commission (ASIC); Treasury; those who have been affected by the conduct that has been the subject of the Commission's inquiries; other interested parties given leave to appear at some of the Commission's hearings (including the Finance Sector Union and consumer bodies such as CHOICE and the Consumer Action Law Centre); industry associations (including the Australian Banking Association (ABA) bodies representing financial advisers, mortgage brokers and others); academics; and members of the public more generally.

The focus of this Report must be on issues, causes and responses. I will deal separately with the various sectors of the financial services industry. More particularly I will deal separately with:

- banking;
- financial advice;
- superannuation; and
- insurance.

Some more general issues extend across all sectors of the financial services industry. They are issues about

- culture, governance and remuneration; and
- regulators.

The responses to the issues that are identified in each of those separate areas are informed by some underlying principles. It is useful, therefore, to begin by stating those principles.

1.5.1 Underlying principles

At their most basic, the underlying principles reflect the six norms of conduct I identified in the *Interim Report*:

- obey the law;
- do not mislead or deceive;
- act fairly;

- provide services that are fit for purpose;
- deliver services with reasonable care and skill; and
- when acting for another, act in the best interests of that other.

These norms of conduct are fundamental precepts. Each is well-established, widely accepted, and easily understood.

Of course, when these norms are stated in the terms I have, it will be said that borderline cases can be identified. And applying the norms to some of those borderline cases may not be easy. But real or imagined cases testing the boundaries of a rule do not show that the rule has no content. Debate about whether the wire runs one side or the other of one or more fence posts must not obscure the size of the field the fence encloses.

The six norms of conduct I have identified are all reflected in existing law. But the reflection is piecemeal.

The general obligations of **Australian financial services licence** (AFSL) holders, stated in section 912A of the Corporations Act, and the general obligations of **Australian Credit Licence** (ACL) holders, stated in section 47 of the NCCP Act, stand out.

First, both provisions impose an overarching obligation to ‘do all things necessary to ensure’ that the financial services or credit activities authorised by the licence are provided ‘efficiently, honestly and fairly’.⁷ Understood properly, this requirement would embrace all six norms.

Second, both provisions oblige licence holders to comply with, in the case of AFSL holders, the financial services laws and, in the case of ACL holders, the credit legislation.⁸ That is, licence holders must obey the law.

Third, both provisions oblige licence holders to maintain their own competence to provide the licenced services and to ensure that their representatives are both adequately trained and competent to provide

⁷ Corporations Act s 912A(1)(a); NCCP Act s 47(1)(a).

⁸ Corporations Act s 912A(1)(c); NCCP Act s 47(1)(d).

those services.⁹ That is, they are required to have the *capacity* to deliver services with reasonable care and skill.

As the law now stands, breach of these general obligations carries no penalty. They are licence conditions enforceable only indirectly, by threatening withdrawal of the licence.

That said, the requirement that an AFSL holder acts honestly is expressed further in section 1041G of the Corporations Act, which makes it an offence to engage in dishonest conduct in relation to a **financial product** or financial service. But the offence relates only to conduct in relation to a financial product or financial service, and Divisions 3 and 4 of Part 7.1 of the Corporations Act are given over to defining what is, and is not, a financial product, and when a person provides a financial service.

The more particular norms I state about not misleading or deceiving and acting fairly are reflected in the provisions of the *Australian Securities and Investment Commission Act 2001* (Cth) (the ASIC Act) about misleading or deceptive conduct,¹⁰ false or misleading representations,¹¹ unconscionable conduct¹² and unfair contract terms.¹³ And the requirement to provide services that are fit for purpose and deliver services with reasonable care and skill are also reflected in the ASIC Act.¹⁴ But some of those provisions apply generally and some apply only to dealings with consumers. And the unconscionable conduct and consumer protection provisions use definitions of ‘financial product’ and ‘financial service’ that differ from those provided by Chapter 7 of the Corporations Act.¹⁵

The sixth norm – when acting for another, act in the best interests of that other – is reflected in the financial advice sector by the best interests duty imposed by section 961B of the Corporations Act, together with the

⁹ Corporations Act s 912A(1)(e) and (f); NCCP Act s 47(1)(e) and (f).

¹⁰ ASIC Act s 12DA.

¹¹ ASIC Act s 12DB.

¹² ASIC Act ss 12CA–12CC.

¹³ ASIC Act ss 12BF–12BM.

¹⁴ ASIC Act ss 12EA–12ED.

¹⁵ ASIC Act ss 12BAA, 12BAB.

associated obligation provided by section 961J to give priority to the client's interests over other interests.

The norms are dealt with differently in respect of superannuation and insurance. In superannuation, they find their most prominent reflection in the SIS Act, in the best interests covenant and associated covenants by **registrable superannuation entity** (RSE) licensees and directors of trustees.¹⁶ And those covenants also provide direct reflection of the norm that a person or entity acting for another, must act in the best interests of that other.

In insurance, all of the norms may be seen as embodied in the duty of utmost good faith imposed on each party to an insurance contract by section 13 of the *Insurance Contracts Act 1984* (Cth) (the Insurance Contracts Act).

As I say, the six norms of conduct I have set out are reflected in existing law, but the reflection is piecemeal.

1.5.2 General rules

The six norms of conduct I have identified support, and in some cases entail, some general rules:

- the law must be applied and its application enforced;
- industry codes should be approved under statute and breach of key promises made to customers in the codes should be a breach of the statute;
- no financial product should be 'hawked' to retail clients;
- intermediaries should act only on behalf of, and in the interests of, the party who pays the intermediary;
- exceptions to the ban on conflicted remuneration should be eliminated;

¹⁶ SIS Act ss 52, 52A.

- culture and governance practices (including remuneration arrangements) both in the industry generally and in individual entities, must focus on non-financial risk, as well as financial risk.

Why these general rules?

Apply and enforce the law

The first general rule, that the law must be applied and its application enforced, requires no development or explanation. It is a defining feature of a society governed by the rule of law.

The conduct identified and criticised in the Commission's *Interim Report* and in this Report has been of a nature and extent that shows that the law has not been obeyed, and has not been enforced effectively. It also points to deficiencies of culture, governance and risk management within entities. Too often, entities have paid too little attention to issues of regulatory, compliance and conduct risks. And the risks of regulatory or other non-compliance and of misconduct are the risks of departure from the first general rule of 'obey the law'. What consequences follow, and whether this amounts to effective enforcement of the law, bears directly upon the nature and extent of the regulatory, compliance and conduct risks that entities must manage.

Industry codes

Industry codes are expressed as promises made by industry participants. If industry codes are to be more than public relations puffs, the promises made must be made seriously. If they are made seriously (and those bound by the codes say that they are), the promises that are set out in the code, and are intended to govern the particular relations between the provider and the acquirer of a financial product or financial service, must be kept. This must entail that the promises can be enforced by those to whom the promises are made: the customer who acquires the product or service, and the guarantors of loans to individuals and small businesses.

Hawking

‘Hawking’ company securities, by making unsolicited approaches to potential buyers, has long been unlawful.¹⁷ The practice has long been unlawful because it too readily allows the fraudulent or unscrupulous to prey upon the unsuspecting.¹⁸ There is no real check on what is said to the target and often the target is not able to check the truth of what is said. The asymmetry of power and information between the provider of the product and service and the acquirer is very large. Even if the ‘hawker’ is not fraudulent or unscrupulous (and, too often, cases examined in evidence showed that the hawker was at least unscrupulous) the acquirer is nevertheless ‘unsuspecting’. The potential acquirer who has not sought out the product or service comes to the encounter unprepared to look critically at whatever is said. The potential acquirer often does not know what questions to ask.

Hawking financial products and managed investment products is now generally prohibited.¹⁹ But there are some exceptions. Other than the provisions relating to offers *not* made to retail clients and offers made under an eligible employee share scheme,²⁰ however, there is no immediately apparent basis for thinking that the exceptions are areas where the fraudulent or unscrupulous may not yet prey upon the unsuspecting. And the evidence given to the Commission points firmly against maintaining exceptions to the general prohibition, at least in respect of superannuation and insurance products, other than the two exceptions mentioned: offers *not* made to retail clients and offers made under an eligible employee share scheme.

For the avoidance of doubt, it should also be made plain that a solicited meeting, or telephone call, to discuss one type of financial product must not

¹⁷ The 1926 Report of the UK Company Law Amendment Committee chaired by Mr Wilfrid Greene KC (Cmnd 2657) recommended that the offering from house to house of shares, stock, bonds, debentures or debenture stock or similar securities either for subscription or sale should be made an offence. Hawking company securities has long been an offence under Australian company law. See now Corporations Act s 736.

¹⁸ United Kingdom, Report of the UK Company Law Amendment Committee (Cmnd 2657), 48 [92].

¹⁹ Corporations Act ss 992A and 992AA.

²⁰ Corporations Act ss 992A(3A) and (3B).

be used for the unsolicited offering of some other type of product. (In that regard, common forms of banking products, like transaction accounts and credit card accounts should be treated as together forming the one kind of product. But each superannuation product and each insurance product is, and should be treated as, a distinct product type.)

Intermediaries

In the *Interim Report*, I pointed out how difficult it may be to decide for whom intermediaries act and to whom a particular intermediary may owe duties and responsibilities.²¹ As I indicated then, the difficulties may be acute in the case of mortgage brokers. But the difficulties are not confined to home lending. Point-of-sale negotiation of credit arrangements (by car dealers, white goods retailers and the like) presents similar difficulties.

The point is much more important than a dry point of legal analysis. For whom the intermediary acts determines what duties the intermediary owes and to whom they owe them.

The general rule that should apply throughout the financial services industry is that an intermediary who is paid to act as intermediary:

- acts for the person who *pays* the intermediary;
- owes the person who pays a duty to act *only in the interests* of that person; and
- ordinarily owes the person who pays a duty to act in the *best* interests of that person.

The particular working out of these principles, especially with respect to mortgage brokers and the home lending market, is dealt with in the chapter about banking.

Conflicted remuneration

The definition of ‘conflicted remuneration’ in the Corporations Act shows why the practice should be prohibited.

²¹ FSRC, *Interim Report*, vol 1, 56–9.

Section 963A of the Corporations Act defines ‘conflicted remuneration’ as any benefit (whether monetary or non-monetary) given to a **financial services licensee** or a representative of the licensee, who provides financial product advice to persons as retail clients, that, because of the nature of the benefit or the circumstances in which it is given, could have either or both of two effects:

- it could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients; or
- it could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.

That is, as I said in the *Interim Report*, ‘the very hinge about which the conflicted remuneration provisions turn is that the payment is one that “could reasonably be expected to influence the choice of financial product recommended to retail clients”’.²²

For **grandfathered commissions**, the time when the initial advice was given and the initial conflict arose has passed. The influence of the commission has already done its work once. But the problem remains. The influence continues. Advisers have an incentive to keep their clients in products with grandfathered commissions rather than advise them to move to better products. There can be, and is, no justification for maintaining the grandfathering provisions.

Culture and governance

After the Global Financial Crisis (GFC), financial services entities and regulators, in Australia and elsewhere, gave close attention to financial risk. Until recently, however, too little attention has been given in Australia to regulatory, compliance and conduct risks. Too little attention has been given to the evident connections between compensation, incentive and remuneration practices and regulatory, compliance and conduct risks. The very large reputational consequences that are now seen in the Australian financial services industry, especially in the banking industry, stand as the clearest demonstration of the pressing urgency for dealing with these

²² FSRC, *Interim Report*, vol 1, 92.

issues. As the Group of Thirty (G30) said in November 2018, ‘getting culture and conduct right is not a supervisory requirement. It is necessary for banks’ and banking’s economic and social sustainability’.²³

1.5.3 Making change carefully and simply

Treasury,²⁴ and many of the entities that made submissions,²⁵ urged the need for caution before recommending change. This is undeniably right.

As I said in the *Interim Report*, adding a new layer of regulation will not assist. It will add to what is already a complex regulatory regime. No doubt the financial services industry is itself complicated. That may be said to explain why the regulatory regime is as complicated as it is. But closer attention will show that much of the complication comes from piling exception upon exception, from carving out special rules for special interests. And, in almost every case, these special rules qualify the application of a more general principle to entities or transactions that are not different in any material way from those to which the general rule is applied.

History shows, as Treasury submitted, that legislative simplification can be a long and difficult task. Programs to simplify the law relating to income taxation and to reform corporate law have extended over many years – well beyond the life of a single Parliament. And I do not doubt that simplifying the law that relates to the financial services industry would be a large task. But there are two parts of that task that can inform, and I consider should inform, what is done in response to this Report.

First, it is time to start reducing the number and the area of operation of special rules, exceptions and carve outs. Reducing their number and their area of operation is itself a large step towards simplification. Not only that,

²³ G30, *Banking Conduct and Culture: A Permanent Mindset Change*, November 2018, Foreword, v.

²⁴ Treasury, Interim Report Submission, 1 [4]–[5].

²⁵ See, eg, AMP, Interim Report Submission, 7 [34]; ANZ, Interim Report Submission, 2 [11]; CBA, Interim Report Submission, 41 [223]; Westpac, Interim Report Submission, 2 [6]; NAB, Interim Report Submission, 17 [50]; Mortgage Choice, Interim Report Submission, 3 [3].

it leaves less room for ‘gaming’ the system by forcing events or transactions into exceptional boxes not intended to contain them.²⁶

Second, it is time to draw explicit connections in the legislation between the particular rules that are made and the fundamental norms to which those rules give effect. Drawing that connection will have three consequences. It will explain to the regulated community (and the regulator) *why* the rule is there and, at the same time, reinforce the importance of the relevant fundamental norm of conduct. Not only that, drawing this explicit connection will put beyond doubt the purpose that the relevant rule is intended to achieve. And, the further consequence will be to highlight the fact that exceptions and carve outs like grandfathered commissions constitute a departure from applying the relevant fundamental norm. Emphasising the fact of departure may assist in reducing both the number and the extent of these qualifications.

In their submissions, some entities used the undoubted need for care in recommending change as a basis for saying that there should be *no* change. The ‘Caution’ sign was read as if it said ‘Do Not Enter’.

An assertion was necessarily implicit in the submissions that sought to maintain some aspect of the present regime unchanged: that doing nothing about those matters would carry less cost than making *any* change to the rules under consideration. But rarely, if ever, was the submission developed beyond the point of bare assertion. Rarely, if ever, was there explicit examination of, or comparison between, the costs of doing nothing and the costs and consequences of changing the rules. The rules that govern grandfathered commissions provide a useful example.

Two grounds have often been given for maintaining the present rules about grandfathered commissions without modification: orderly transition and constitutional infirmity.

If the provisions were made to allow orderly transition within the industry, that time has now passed. How much longer is the transition to take? For all the suggestions that it will ‘wither on the vine’, the charging and receipt of

²⁶ For example, the preservation of grandfathered commissions during a successor fund transfer by potentially treating the succeeding RSE licensee as a ‘platform operator’: see the NULIS Nominees (Australia) Ltd case study discussed in vol 2 of this Report.

grandfathered commissions remained alive and well until some of the larger participants in the industry (especially the banks) sensed the wind of change may be blowing and found it best to bend now by phasing it out rather than have the wind grow to such intensity that it snap off this branch of their activities.

Whenever change is mooted, someone will suggest that changing the permitted forms of remuneration would lead to constitutional difficulties because it would amount to an acquisition of property otherwise than on just terms. As I said in the *Interim Report*, two points must be made.²⁷ First, where would be the acquisition? Who would acquire anything? What proprietary benefit or interest would accrue to any person?²⁸ Second, if the point is good, it was good at the time when most forms of conflicted remuneration were prohibited. Yet no-one sought then to challenge the validity of the relevant provisions and the **Future of Financial Advice** (FoFA) ban on conflicted remuneration has now operated for more than five years without challenge.

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 free advice about, or recommendation of, financial products from the influence of the adviser's personal financial advantage.

A third point is sometimes made in attempting to justify preserving grandfathered commissions. It is said that prohibiting this form of remuneration once and for all will carry with it unintended consequences and the advice industry will be disrupted.

Generalised fears of this kind should not be heeded.

'Disruption' and similar terms can be used, and in some submissions to the Commission were used, as little more than pejorative synonyms for 'change'. As the Treasury submissions show, however, it is always necessary to identify the nature and the extent of the consequences that will or may follow from the change under consideration before speaking of the change as 'disruptive'. Without identifying those consequences, 'disruption' has no useful content.

²⁷ FSRC, *Interim Report*, vol 1, 95.

²⁸ Cf *JT International SA v The Commonwealth* (2012) 250 CLR 1.

If an exception to the rules prohibiting grandfathered commissions is to be preserved, the exception must be closely and cogently justified. Saying only that there may be ‘disruption’ or ‘unintended consequences’ is nothing but a naked appeal to fear of the future. And it seeks to graft some exception onto the body of law intended to give effect to a coherent set of policy objectives without any attempt to identify the competing policy objectives.

Creating exceptions that depart from underlying principles has consequences. Those consequences are amply demonstrated by the grandfathering arrangements made in respect of FoFA. ‘Temporary’ or ‘transitional’ carve outs departing from principle too often become (and in this case did become) entrenched. Carve outs and exceptions are too often exploited (and in this case have been exploited) for purposes having nothing to do with the stated purpose of their creation. Creating carve outs and exceptions impedes, and may even prevent (and in this case did prevent) achieving fully the intended policy objectives that inform the body of the law. Instead, the law is (and here it was) made more complex; it is (and here it was) made harder not only for regulators to administer but also for the regulated community, and the public more generally, to understand.

2 Recommendations

In the succeeding chapters of this Report, I make a number of recommendations. It is desirable to set them out here and to do that:

- first, by reference to subject matter, recording the recommendations in the order in which they are considered in the body of the Report; and
- second, restating the recommendations but reordering them by reference to the key questions identified above, and then by reference to the more particular changes that must be made to protect consumers against misconduct, to provide adequate redress and to address asymmetries of power and information.

2.1 Reading the recommendations

All of the recommendations set out below are to be read and understood in the light of what is said in the body of the Report. In particular, each recommendation is to be read in light of the reasons given for making it and what is said about other steps regulators, entities and the industry more generally can, and should, take in response to the conduct and events referred to in the *Interim Report* and this Report.

3 Recommendations by subject matter

3.1 Banking

Consumer lending: Direct lending

Recommendation 1.1 – The NCCP Act

The NCCP Act should not be amended to alter the obligation to assess unsuitability.

Consumer lending: Intermediated home lending

Recommendation 1.2 – Best interests duty

The law should be amended to provide that, when acting in connection with home lending, mortgage brokers must act in the best interests of the intending borrower. The obligation should be a civil penalty provision.

Recommendation 1.3 – Mortgage broker remuneration

The borrower, not the lender, should pay the mortgage broker a fee for acting in connection with home lending.

Changes in brokers' remuneration should be made over a period of two or three years, by first prohibiting lenders from paying trail commission to mortgage brokers in respect of new loans, then prohibiting lenders from paying other commissions to mortgage brokers.

Recommendation 1.4 – Establishment of working group

A Treasury-led working group should be established to monitor and, if necessary, adjust the remuneration model referred to in Recommendation 1.3, and any fee that lenders should be required to charge to achieve a level playing field, in response to market changes.

Recommendation 1.5 – Mortgage brokers as financial advisers

After a sufficient period of transition, mortgage brokers should be subject to and regulated by the law that applies to entities providing financial product advice to retail clients.

Recommendation 1.6 – Misconduct by mortgage brokers

ACL holders should:

- be bound by information-sharing and reporting obligations in respect of mortgage brokers similar to those referred to in Recommendations 2.7 and 2.8 for financial advisers; and
- take the same steps in response to detecting misconduct of a mortgage broker as those referred to in Recommendation 2.9 for financial advisers.

Consumer lending: Intermediated lending for vehicles and other consumer goods

Recommendation 1.7 – Removal of point-of-sale exemption

The exemption of retail dealers from the operation of the NCCP Act should be abolished.

Access to banking services

Recommendation 1.8 – Amending the Banking Code

The ABA should amend the Banking Code to provide that:

- banks will work with customers:
 - who live in remote areas; or
 - who are not adept in using English,to identify a suitable way for those customers to access and undertake their banking;
- if a customer is having difficulty proving his or her identity, and tells the bank that he or she identifies as an Aboriginal or Torres Strait Islander person, the bank will follow AUSTRAC's guidance about the identification and verification of persons of Aboriginal or Torres Strait Islander heritage;
- without prior express agreement with the customer, banks will not allow informal overdrafts on basic accounts; and
- banks will not charge dishonour fees on basic accounts.

Lending to small and medium enterprises

Recommendation 1.9 – No extension of the NCCP Act

The NCCP Act should not be amended to extend its operation to lending to small businesses.

Recommendation 1.10 – Definition of 'small business'

The ABA should amend the definition of 'small business' in the Banking Code so that the Code applies to any business or group employing fewer than 100 full-time equivalent employees, where the loan applied for is less than \$5 million.

Recommendation 1.11 – Farm debt mediation

A national scheme of farm debt mediation should be enacted.

Recommendation 1.12 – Valuations of land

APRA should amend Prudential Standard APS 220 to:

- require that internal appraisals of the value of land taken or to be taken as security should be independent of loan origination, loan processing and loan decision processes; and
- provide for valuation of agricultural land in a manner that will recognise, to the extent possible:
 - the likelihood of external events affecting its realisable value; and
 - the time that may be taken to realise the land at a reasonable price affecting its realisable value.

Recommendation 1.13 – Charging default interest

The ABA should amend the Banking Code to provide that, while a declaration remains in force, banks will not charge default interest on loans secured by agricultural land in an area declared to be affected by drought or other natural disaster.

Recommendation 1.14 – Distressed agricultural loans

When dealing with distressed agricultural loans, banks should:

- ensure that those loans are managed by experienced agricultural bankers;
- offer farm debt mediation as soon as a loan is classified as distressed;
- manage every distressed loan on the footing that working out will be the best outcome for bank and borrower, and enforcement the worst;
- recognise that appointment of receivers or any other form of external administrator is a remedy of last resort; and
- cease charging default interest when there is no realistic prospect of recovering the amount charged.

Enforceability of industry codes

Recommendation 1.15 – Enforceable code provisions

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 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.

Recommendation 1.16 – 2019 Banking Code

In respect of the Banking Code that ASIC approved in 2018, the ABA and ASIC should take all necessary steps to have the provisions that govern the terms of the contract made or to be made between the bank and the customer or guarantor designated as ‘enforceable code provisions’.

Processing and administrative errors

Recommendation 1.17 – BEAR product responsibility

After appropriate consultation, APRA should determine for the purposes of section 37BA(2)(b) of the Banking Act, a responsibility, within each ADI subject to the BEAR, for all steps in the design, delivery and maintenance of all products offered to customers by the ADI and any necessary remediation of customers in respect of any of those products.

3.2 Financial advice

Ongoing fee arrangements

Recommendation 2.1 – Annual renewal and payment

The law should be amended to provide that ongoing fee arrangements (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; 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.

Lack of independence

Recommendation 2.2 – Disclosure of lack of independence

The law should be amended to require that a financial adviser who would contravene section 923A of the Corporations Act 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.

Quality of advice

Recommendation 2.3 – Review of measures to improve the quality of advice

In three years' time, there should be a review by Government in consultation with ASIC of the effectiveness of measures that have been implemented by the Government, regulators and financial services entities to improve the quality of financial advice. 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. Unless there is a clear justification for retaining that provision, it should be repealed.

Conflicted remuneration

Recommendation 2.4 – Grandfathered commissions

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

Recommendation 2.5 – Life risk insurance commissions

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.

Recommendation 2.6 – General insurance and consumer credit insurance commissions

The review referred to in Recommendation 2.3 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; and
- the exemptions for non-monetary benefits set out in section 963C of the Corporations Act.

Professional discipline of financial advisers

Recommendation 2.7 – Reference checking and information sharing

All 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 ABA in its 'Financial Advice – Recruitment and Termination Reference Checking and Information Sharing Protocol'.

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.

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; and
- where there is sufficient information to suggest that an adviser has engaged in misconduct, tell affected clients and remediate those clients promptly.

Recommendation 2.10 – A new disciplinary system

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; and
- allows clients and other stakeholders to report information about the conduct of financial advisers to the disciplinary body.

3.3 Superannuation

Trustees' obligations

Recommendation 3.1 – No other role or office

The trustee of an 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.

Recommendation 3.2 – No deducting advice fees from MySuper accounts

Deduction of any advice fee (other than for intra-fund advice) from a MySuper account should be prohibited.

Recommendation 3.3 – Limitations on deducting advice fees from choice accounts

Deduction of any advice fee (other than for intra-fund advice) from superannuation accounts other than MySuper accounts should be prohibited unless the 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.

‘Selling’ superannuation**Recommendation 3.4 – No hawking**

Hawking of superannuation products should be prohibited. That is, the unsolicited offer or sale of superannuation should be prohibited except to those who are not retail clients and except for offers made under an eligible employee share scheme.

The law should be amended to make clear that contact with a person during which one kind of product is offered is unsolicited unless the person attended the meeting, made or received the telephone call, or initiated the contact for the express purpose of inquiring about, discussing or entering into negotiations in relation to the offer of that kind of product.

Nominating default funds

Recommendation 3.5 – One default account

A person should have only one default account. To that end, machinery should be developed for ‘stapling’ a person to a single default account.

Recommendation 3.6 – No treating of employers

Section 68A of the SIS Act should be amended to prohibit trustees of a regulated superannuation fund, and associates of a trustee, doing any of the acts specified in section 68A(1)(a), (b) or (c) where the act may reasonably be understood by the recipient to have a substantial purpose of having the recipient nominate the fund as a default fund or having one or more employees of the recipient apply or agree to become members of the fund.

The provision should be a civil penalty provision enforceable by ASIC.

Regulation

Recommendation 3.7 – Civil penalties for breach of covenants and like obligations

Breach of the trustee’s covenants set out in section 52 or obligations set out in section 29VN, or the director’s covenants set out in section 52A or obligations set out in section 29VO of the SIS Act should be enforceable by action for civil penalty.

Recommendation 3.8 – Adjustment of APRA and ASIC’s roles

The roles of APRA and ASIC with respect to superannuation should be adjusted, as referred to in Recommendation 6.3.

Recommendation 3.9 – Accountability regime

Over time, provisions modelled on the BEAR should be extended to all RSE licensees, as referred to in Recommendation 6.8.

3.4 Insurance

Manner of sale and types of products sold: Hawking

Recommendation 4.1 – No hawking of insurance

Consistently with Recommendation 3.4, which prohibits the hawking of superannuation products, hawking of insurance products should be prohibited.

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’; and
- put beyond doubt that the consumer protection provisions of the ASIC Act apply to funeral expenses policies.

Specific steps in respect of particular products: Add-on insurance

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.

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.

Pre-contractual disclosure and representations

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

Part IV of the Insurance Contracts Act 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).

Recommendation 4.6 – Avoidance of life insurance contracts

Section 29(3) of the Insurance Contracts Act 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.

Unfair contract terms

Recommendation 4.7 – Application of unfair contract terms provisions to insurance contracts

The unfair contract terms provisions now set out in the ASIC Act should apply to insurance contracts regulated by the Insurance Contracts Act. 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 should operate independently of the unfair contract terms provisions.

Claims handling

Recommendation 4.8 – Removal of claims handling exemption

The handling and settlement of insurance claims, or potential insurance claims, should no longer be excluded from the definition of ‘financial service’.

Status of industry codes

Recommendation 4.9 – Enforceable code provisions

As referred to in Recommendation 1.15, the law should 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 Financial Services Council, 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’.

Recommendation 4.10 – Extension of the sanctions power

The Financial Services Council and the Insurance Council of Australia should amend section 13.10 of the Life Insurance Code of Practice and section 13.11 of the General Insurance Code of Practice 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.

External dispute resolution

Recommendation 4.11 – Co-operation with AFCA

Section 912A of the Corporations Act should be amended to require that AFSL holders take reasonable steps to co-operate 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.

Recommendation 4.12 – Accountability regime

Over time, provisions modelled on the BEAR should be extended to all APRA-regulated insurers, as referred to in Recommendation 6.8.

Group life policies

Recommendation 4.13 – Universal terms review

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.

Recommendation 4.14 – Additional scrutiny for related party engagements

APRA should amend Prudential Standard SPS 250 to require RSE licensees that engage a related party to provide group life insurance, or who enter into a contract, arrangement or understanding with a life insurer by which the insurer is given a priority or privilege in connection with the provision of life insurance, 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.

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.

3.5 Culture, governance and remuneration

Remuneration

Recommendation 5.1 – Supervision of remuneration – principles, standards and guidance

In conducting prudential supervision of remuneration systems, and revising its prudential standards and guidance about remuneration, APRA should give effect to the principles, standards and guidance set out in the Financial Stability Board's publications concerning sound compensation principles and practices.

Recommendations 5.2 and 5.3 explain and amplify aspects of this Recommendation.

Recommendation 5.2 – Supervision of remuneration – aims

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.

Recommendation 5.3 – Revised prudential standards and guidance

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.

Recommendation 5.4 – Remuneration of front line staff

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.

Recommendation 5.5 – The Sedgwick Review

Banks should implement fully the recommendations of the Sedgwick Review.

Culture and governance

Recommendation 5.6 – Changing culture and governance

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; and
- determine whether the changes it has made have been effective.

Recommendation 5.7 – Supervision of culture and governance

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.

3.6 Regulators

Twin peaks

Recommendation 6.1 – Retain twin peaks

The ‘twin peaks’ model of financial regulation should be retained.

ASIC’s enforcement practices

Recommendation 6.2 – ASIC’s approach to enforcement

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.

Superannuation: Conduct regulation

Recommendation 6.3 – General principles for co-regulation

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.

Recommendation 6.4 – ASIC as conduct regulator

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.

Recommendation 6.5 – APRA to retain functions

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.

The BEAR: Co-regulation

Recommendation 6.6 – Joint administration of the BEAR

ASIC and APRA should jointly administer the BEAR. ASIC should be charged with overseeing those parts of Divisions 1, 2 and 3 of Part IIAA of the Banking Act that concern consumer protection and market conduct matters. APRA should be charged with overseeing the prudential aspects of Part IIAA.

Recommendation 6.7 – Statutory amendments

The obligations in sections 37C and 37CA of the Banking Act should be amended to make clear that an ADI and accountable person must deal with APRA and ASIC (as the case may be) in an open, constructive and co-operative way. Practical amendments should be made to provisions such as section 37K and section 37G(1) so as to facilitate joint administration.

Recommendation 6.8 – Extending the BEAR

Over time, provisions modelled on the BEAR should be extended to all APRA-regulated financial services institutions. APRA and ASIC should jointly administer those new provisions.

Co-ordination and information sharing

Recommendation 6.9 – Statutory obligation to co-operate

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.

Recommendation 6.10 – Co-operation memorandum

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.

Governance

Recommendation 6.11 – Formalising meeting procedure

The ASIC Act should be amended to include provisions substantially similar to those set out in sections 27–32 of the APRA Act – dealing with the times and places of Commissioner meetings, the quorum required, who is to preside, how voting is to occur and the passing of resolutions without meetings.

Recommendation 6.12 – Application of the BEAR to regulators

In a manner agreed with the external oversight body (the establishment of which is the subject of Recommendation 6.14 below) each of APRA and ASIC should internally formulate and apply to its own management accountability principles of the kind established by the BEAR.

Recommendation 6.13 – Regular capability reviews

APRA and ASIC should each be subject to at least quadrennial capability reviews. A capability review should be undertaken for APRA as soon as is reasonably practicable.

Oversight**Recommendation 6.14 – A new oversight authority**

A new oversight authority for APRA and ASIC, independent of Government, should be established by legislation to assess the effectiveness of each regulator in discharging its functions and meeting its statutory objects.

The authority should be comprised of three part-time members and staffed by a permanent secretariat.

It should be required to report to the Minister in respect of each regulator at least biennially.

3.7 Other important steps**External dispute resolution****Recommendation 7.1 – Compensation scheme of last resort**

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.

ASIC Enforcement Review Taskforce Government Response

Recommendation 7.2 – Implementation of recommendations

The recommendations of the ASIC Enforcement Review Taskforce made in December 2017 that relate to self-reporting of contraventions by financial services and credit licensees should be carried into effect.

Simplification so that the law's intent is met

Recommendation 7.3 – Exceptions and qualifications

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

Recommendation 7.4 – Fundamental norms

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.

4 Recommendations: Answering the key questions

As I have already said, I think it useful to restate and reorder what I have set out above so that the reader can see the way in which particular recommendations fit together.

Restated and reordered below, the recommendations seek to answer, in these ways, the key questions:

- How can the law be simplified so that its intent is met?
- How should the approach to conflicts of interest and conflicts between duty and interest change?
- What can be done to improve compliance and the effectiveness of the regulators? and
- What more can be done to achieve effective leadership, good governance and appropriate culture so that financial services entities obey the basic norms of behaviour that underpin the proper regulation of the financial services industry?

Some recommendations respond to more than one question. Then there are some (not listed below) that make more particular recommendations, including some directed to preserving the existing law or to monitoring and responding to market changes resulting from the recommendation.²⁹

With that in mind, the restatement and reordering is as follows.

4.1 Simplifying the law so that its intent is met

A general recommendation is that, as far as possible, exceptions and qualifications to generally applicable norms of conduct in legislation governing financial services entities should be eliminated (Recommendation 7.3).

²⁹ See Recommendations 1.1, 1.4 and 1.9.

In this way, the first, and essential, step to take is to reduce exceptions and carve outs.

The more complicated the law, the harder it is to see unifying and informing principles and purposes. Exceptions and limitations encourage literal application and focusing on boundary-marking and categorisation. Boundary-marking and categorisation may promote uncertainty. Removing exceptions and limitations encourages understanding and application of the law in accordance with its purposes. That is, 'its intent is met, rather than merely its terms complied with'.³⁰ Like cases are more evidently treated alike. Uncertainty may be reduced.

Several recommendations propose the removal of exceptions and limitations in the existing law and industry codes. They relate to:

- the point-of-sale exemption for retail dealers under the NCCP Act (Recommendation 1.7);
- grandfathered commissions (Recommendation 2.4);
- life risk and general insurance commissions (Recommendations 2.5, 2.6 and 4.4);
- funeral expenses policies (Recommendation 4.2);
- insurance claims handling and settlement (Recommendation 4.8); and
- the definition of 'small business' in the 2019 Banking Code of Practice (Recommendation 1.10).

Next, 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 (Recommendation 7.4). By drawing explicit connections in the legislation between the particular rules that are made and the fundamental norms to which those rules give effect, the regulated community and the public more generally will better understand what the rules are directed to achieving.

³⁰ Treasury, Interim Report Submission, 1 [2].

The recommendation that mortgage brokers owe borrowers a best interests duty (Recommendation 1.2) gives mortgage brokers the same duty to their clients as financial advisers owe their clients.

The further recommendation that mortgage brokers be subject to and regulated by the same laws as financial advisers (Recommendation 1.5) will ensure consistent treatment of advisers.

4.2 Conflicts

Where possible, conflicts of interest and conflicts between duty and interest should be removed. There must be recognition that conflicts of interest and conflicts between duty and interest should be eliminated rather than 'managed'.

Several recommendations deal with conflicts of interest or conflicts between duty and interest. They include the recommendations:

- that mortgage brokers owe borrowers a best interests duty (Recommendation 1.2);
- about financial advisers disclosing any lack of independence (Recommendation 2.2);
- about conflicted remuneration with respect to:
 - grandfathered commissions (Recommendation 2.4);
 - mortgage brokers (Recommendation 1.3);
 - life risk insurance products (Recommendation 2.5);
 - general insurance and consumer credit insurance products (Recommendation 2.6); and
 - add-on insurance products (Recommendation 4.4);
- about superannuation trustees (Recommendation 3.1); and
- about related party engagements for group life insurance through superannuation (Recommendation 4.14).

4.3 Regulators and compliance

The recommendations seek to improve the effectiveness of the regulators in deterring misconduct and ensuring that there are just and appropriate consequences for misconduct.

Some recommendations seek to increase the ways in which the regulators can enforce the law by recommending that:

- the BEAR be extended to other APRA-regulated institutions (Recommendations 3.9, 4.12 and 6.8);
- APRA determine a new responsibility under the BEAR for bank products (Recommendation 1.17);
- the breach of trustee and director covenants and obligations under the SIS Act should be subject to civil penalties (Recommendation 3.7); and
- the ASIC Enforcement Review Taskforce recommendations be carried into effect (Recommendation 7.2).

Some recommendations relate to the governance and performance of APRA and ASIC. These include the recommendations about:

- a new oversight authority (Recommendation 6.14);
- both APRA and ASIC formulating and applying to their own management and accountability principles of the kind set out in the BEAR (Recommendation 6.12);
- formalising ASIC's meeting procedures (Recommendation 6.11); and
- regular capability reviews of each of APRA and ASIC, including an immediate capability review of APRA (Recommendation 6.13).

Other recommendations re-adjust the roles of APRA and ASIC to reflect better the twin peaks model (Recommendation 6.1). They include recommendations about:

- co-regulation of superannuation (Recommendations 3.8, 6.3, 6.4 and 6.5);

- joint administration of the BEAR in both its present form (Recommendations 6.6 and 6.7) and its extension to other APRA-regulated institutions (Recommendations 3.9, 4.12 and 6.8); and
- co-operation and information sharing between APRA and ASIC (Recommendations 6.9 and 6.10).

Some recommendations relate to ASIC's operations, including:

- ASIC's approach to enforcement (Recommendation 6.2); and
- the need for ASIC to undertake, or play a part in, reviews relating to the quality of advice by, and commissions paid to, financial advisers (Recommendations 2.3, 2.5 and 2.6).

Other recommendations seek to increase compliance with the law by:

- establishing a new disciplinary system for financial advisers (Recommendation 2.10);
- extending the sanctions power under the Life Insurance Code of Practice and the General Insurance Code of Practice (Recommendation 4.10); and
- requiring co-operation with external dispute resolution processes (Recommendation 4.11).

4.4 Culture, governance and remuneration

Because primary responsibility for misconduct in the financial services industry lies with the entities concerned and those who manage and control them, effective leadership, good governance and appropriate culture within the entities are fundamentally important. And culture, governance and remuneration are closely connected. But it now must be accepted that regulators have an important role to play in supervision of these matters. Supervision must extend beyond financial risk to non-financial risk and that requires attention to culture, governance and remuneration.

Some recommendations relate to APRA's prudential supervision of APRA-regulated institutions and the content of its prudential standards and guidelines and recommend:

- APRA's giving effect to the Financial Stability Board's publications concerning sound compensation principles and practices (Recommendation 5.1); and
- APRA using supervision, prudential standards and guidance to:
 - promote and encourage sound management by APRA-regulated institutions of not only financial risk but also misconduct, compliance and other non-financial risks (Recommendations 5.2 and 5.3); and
 - take steps (identified in Recommendation 5.7) to encourage entities to give proper attention to sound management of conduct risk and improving entity governance.

Other recommendations urge:

- all financial services entities to review the design and implementation of remuneration systems for front line staff at least once each year (Recommendation 5.4);
- banks to implement fully the recommendations of the Sedgwick Review (Recommendation 5.5); and
- all financial services entities to assess, as often as reasonably possible, the entity's culture and governance, identify any problems, deal with them and determine whether the changes have been effective (Recommendation 5.6).

There are also other ways in which the recommendations seek to address culture. These are by requiring AFSL holders to:

- take steps (identified in Recommendation 2.9) in cases where they detect a financial adviser has engaged in misconduct;
- reference check and share information relating to termination of financial advisers (Recommendation 2.7); and
- report 'serious compliance concerns' (Recommendation 2.8).

Equivalent recommendations are made in respect of ACL holders when dealing with mortgage brokers (Recommendation 1.6).

Then there are the more particular recommendations to increase protections.

4.5 Increasing protections

There are recommendations that seek to change, or add to, the law, or industry codes of conduct, in ways that will increase protections to consumers from misconduct or conduct that falls below community standards and expectations. Those recommendations are:

- about making some provisions of industry codes enforceable (Recommendations 1.15, 1.16 and 4.9) to give certainty and enforceability to the terms of the contract between a financial services entity and its client or a guarantor;
- that the ABA amend the Banking Code (in the ways identified in Recommendation 1.8) to improve access to banking;
- about the enactment of a national scheme of farm debt mediation (Recommendation 1.11);
- about the valuation of land (Recommendation 1.12), the charging of default interest (Recommendation 1.13) and how banks should deal with distressed agricultural loans (Recommendation 1.14);
- that ongoing fee arrangements (whenever made) must be expressly renewed by the client each year (Recommendation 2.1);
- prohibiting advice fees from being deducted from MySuper accounts (Recommendation 3.2) and limiting deduction of advice fees from choice accounts (Recommendation 3.3);
- prohibiting hawking of superannuation products (Recommendation 3.4) and insurance products (Recommendation 4.1);
- that a person should have only one default superannuation account (Recommendation 3.5);
- about the trustee's conduct in influencing the way employers choose default superannuation funds (Recommendation 3.6);

- that a deferred sales model be established for the sale of add-on insurance (Recommendation 4.3);
- that ASIC impose a cap on add-on insurance commissions (Recommendation 4.4);
- about the duties relating to, and remedies flowing from, misrepresentations and non-disclosures in insurance (Recommendations 4.5 and 4.6);
- to apply unfair contract terms to insurance contracts (Recommendation 4.7);
- increasing scrutiny of related party engagements for insurers of superannuation members through group life policies (Recommendation 4.14), attributing statuses to members of group life policies that are fair and reasonable (Recommendation 4.15) and recommending that a review be undertaken to determine the practicability of legislating universal terms in MySuper group life policies (Recommendation 4.13); and
- establishing a compensation scheme of last resort (Recommendation 7.1).

These recommendations seek to improve the law to protect consumers from the misconduct and conduct that fell below community standards and expectations identified by the Commission. They are recommendations for changes that will reduce the chance that conduct of the kinds identified will happen again, or happen again with the same effect for consumers.

2. Banking

Introduction

In this part of the Report I will deal with conduct and issues relating to what may loosely be described as ‘traditional’ banking services. In the *Interim Report*, I pointed out¹ that the traditional business of banking comprised lending, deposit taking and the provision of transaction services.²

Bank-owned entities have played a prominent role in matters that are the subject of this Report in connection with financial advice, superannuation and insurance. Chief among these issues has been the charging of fees for no service. I will deal separately with those sectors of the industry and then, at the end of the Report, draw together what I consider to be overarching issues, causes and recommendations about culture, governance, and the management and control of regulatory, compliance and conduct risks in the various sectors of the industry.

In dealing with the conduct and issues that have emerged in connection with ‘traditional’ banking services it is important to deal separately with direct lending under the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act), with intermediated home and automotive lending (and associated issues), with access to banking services, with lending to small and medium enterprises, with the enforceability of the 2019 Banking Code and with what the banks referred to as ‘processing’ or ‘administrative’ errors.

¹ FSRC, *Interim Report*, vol 1, 74.

² Malcolm Edey and Brian Gray, ‘The Evolving Structure of the Australian Financial System’ (Paper presented at The Future of the Financial System Conference, H C Coombs Centre for Financial Studies, Kirribilli, 8–9 July 1996) 8–9 <www.rba.gov.au/publications/confs/1996/pdf/conf-vol-1996.pdf>.

1 Direct lending under the NCCP Act

Direct lending is a core business of banks. The issues that emerged during the Commission in relation to direct lending were of two kinds: issues about compliance with existing norms of conduct (both statutory and voluntarily assumed under the Banking Code), and issues about whether those norms (the law or the Banking Code) should be changed.

The most convenient starting point is the provisions that now govern direct lending by banks.

1.1 The existing provisions

Four sets of provisions are relevant:

- the responsible lending provisions of the NCCP Act;
- the responsible lending provisions of the Banking Code;
- the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act); and
- the unfair contract terms provisions of the ASIC Act.

Little needs to be said about the last two sets of provisions beyond emphasising the need for their application and enforcement. Together, the consumer protection provisions and the unfair contract terms provisions give detailed content to three of the six basic norms of conduct I have identified in the Introduction. Those three norms are: act fairly; provide services that are fit for purpose; and deliver services with reasonable care and skill.

The ASIC Act prohibits misleading conduct in relation to financial services.³ It prohibits unconscionable conduct in connection with the supply or possible supply of financial services to a person other than a listed public company.⁴ It implies terms of due care and skill, and fitness for purpose into contracts

³ ASIC Act ss 12DA, 12DB, 12DC, 12DF.

⁴ ASIC Act ss 12CA, 12CB.

for the supply of financial services where the services under the contract were acquired for use or consumption in connection with a small business.⁵

Since 2015, the ASIC Act has provided that unfair terms in standard form small business contracts for financial services and financial products are void.⁶

As will be seen, however, the responsible lending provisions of both the NCCP Act and the Banking Code give important further content to these norms. It is necessary to say more about the responsible lending provisions.

Lending to consumers,⁷ as distinct from lending for a business purpose, is governed by the NCCP Act. The NCCP Act obliges credit licensees to assess whether the proposed credit contract or increase in credit limit will be unsuitable for the consumer.⁸ The Act also obliges the licensee to make the inquiries and verification prescribed in section 130. The inquiries required by section 130(1)(a) and (b) are reasonable inquiries about the consumer's 'requirements and objectives in relation to the credit contract' and 'about the consumer's financial situation'. The verification required is 'reasonable steps to verify the consumer's financial situation'.⁹ Section 133 then prohibits a licensee entering, or increasing the credit limit of, an unsuitable credit contract.

At all relevant times, the industry code of practice (known, until its latest iteration, as the Code of Banking Practice) has provided that a bank that has subscribed to, or is bound by, the Banking Code and is considering the provision to a person covered by the Banking Code of a new loan or an increase to a loan limit will exercise the care and skill of a diligent and prudent banker. The diligent and prudent banker provision has applied to

⁵ ASIC Act s 12ED, read with the definition of 'small business' in s 12BC(2).

⁶ ASIC Act s 12BF.

⁷ Section 5 of Sched 1 of the NCCP Act (the National Credit Code) provides that the National Credit Code applies to the provision of credit to a natural person or a strata corporation, wholly or predominantly for personal, domestic or household purposes, or to purchase, renovate or improve residential property for investment purposes. (Other applications of the National Credit Code need not be noticed here.) The definition provisions of the NCCP Act then engage and apply the provisions made by s 5 of the National Credit Code.

⁸ NCCP Act ss 128–129.

⁹ NCCP Act s 130(1)(c).

lending to small businesses (as ‘small business’ has been defined by successive iterations of the Banking Code). A new code, the 2019 Banking Code of Practice (the 2019 Banking Code), has been approved by ASIC and will come into operation on 1 July 2019.

1.2 Compliance with existing provisions

1.2.1 The NCCP Act

When dealing with particular case studies in the *Interim Report*, I concluded that there had been conduct that might amount to a contravention of the NCCP Act. Those conclusions recognise that the relevant provisions of the NCCP Act hinge on two distinct prohibitions:

- first, the requirement, by section 128, not to enter a credit contract unless the prescribed inquiries and verification have been made; and
- second, the requirement, by section 133, not to enter a credit contract or increase a credit limit if the contract is unsuitable.

The first requirement looks to what a credit licensee must do *before* entering a contract; the second looks to whether, according to the prescribed criteria, the contract that is made *is* unsuitable.

The conduct identified in the Commission’s hearings pointed towards banks tending to conflate the two requirements into a single inquiry about serviceability of the loan. This conflation was most apparent in connection with unsolicited offers made by banks of overdraft limits or credit card limit increases. Offers of these kinds were made according to the bank’s assessment, from the customer’s past history, of whether the customer was likely to be able to service the amount of credit being offered. But, as I pointed out in the *Interim Report*, and note further below, the NCCP Act obliges a licensee to make reasonable inquiries about a consumer’s objectives and requirements, to make reasonable inquiries about a consumer’s financial situation and to take reasonable steps to verify the consumer’s financial situation.¹⁰

¹⁰ FSRC, *Interim Report*, vol 1, 23–30.

Both income and expenditure must be considered in first inquiring about, and then verifying, the customer's financial situation. I said in the *Interim Report* that I consider that verification means doing more than taking the customer at his or her word. I do not consider this to be a novel proposition.¹¹

Since the first round of the Commission's hearings, a number of banks have altered their lending processes and procedures by introducing additional inquiries about a borrower's financial situation and by taking some further steps to verify that situation. These changes may in part be responses to concerns expressed by the Australian Prudential Regulation Authority (APRA) as a result of the targeted reviews undertaken in 2016 and 2017.¹² Those reviews identified a number of deficiencies in the processes that banks used to verify borrower expenses, including insufficient controls to verify information and a significant rate of default to the **Household Expenditure Measure** (HEM), which I discuss further below.

By way of just three examples of such changes, CBA has now introduced mandatory expense breakdowns, it has updated standardised serviceability calculators and systems to identify customer commitments with other financial institutions, and it has increased the number of expense fields in its application forms.¹³ ANZ has introduced a more detailed breakdown of living expenses for home loan applications,¹⁴ and is moving towards using digital tools to capture and categorise data about a customer's current expenditure.¹⁵ As I said in the *Interim Report*, since March 2018, Westpac has expanded the number of expense categories included in its home loan application process from six to 13, and made some categories mandatory.¹⁶

¹¹ See, eg, *ASIC v Cash Store Pty Ltd (in liquidation)* [2014] FCA 926.

¹² See, eg, Exhibit 1.87, 28 April 2017, KPMG Targeted Review; Exhibit 1.190, May 2017, Westpac Targeted Review; Exhibit 1.197, May 2017, PWC Report for CBA as Part of the APRA Targeted Review.

¹³ Exhibit 7.2, Witness statement of Matthew Comyn, 14 November 2018, 59–60 [216]–[217] and 61–3 [221].

¹⁴ Exhibit 7.121, Witness statement of Shayne Elliott, 16 November 2018, 8 [41]–[47].

¹⁵ Exhibit 7.121, Witness statement of Shayne Elliott, 16 November 2018, 8 [45].

¹⁶ FSRC, *Interim Report*, vol 1, 26.

Benchmarks

In the *Interim Report*, I said that using a statistical measure of ‘the median spend on absolute basics’ plus the 25th percentile spend on discretionary basics¹⁷ as a default measure of household expenditure does not constitute verification of a borrower’s expenditure. I remain of that view.

It is necessary for me to say something about two developments relating to benchmarks that followed the *Interim Report*.

First, in November 2018, Perram J of the Federal Court refused to accept a proposal made jointly by ASIC and Westpac to resolve proceedings brought by ASIC alleging that Westpac had contravened section 128 of the NCCP Act.¹⁸ The parties proposed that the Court impose a civil penalty of \$35 million on Westpac for contravening the NCCP Act in assessing the suitability of home loans for customers in the period between 12 December 2011 and March 2015.¹⁹ Westpac had used the HEM in its assessment of the loan applications.²⁰

In his reasons for refusing to make the orders the parties had proposed, Perram J said that the conduct expressed in a declaration proposed by the parties was not conduct that ‘could possibly be a contravention’ of section 128.²¹

I observe that the Statement of Agreed Facts filed by the parties for the purposes of the application determined by Perram J said nothing at all about ‘verification in accordance with section 130’ (as mentioned in section 128(d)) and nothing about the operation of section 130(1)(c) requiring a licensee, for the purposes of section 128(d), to take ‘reasonable steps to verify the consumer’s financial situation’.

¹⁷ As measured by the HEM. See, FSRC, *Interim Report*, vol 1, 27–8.

¹⁸ *ASIC v Westpac Banking Corporation* [2018] FCA 1733.

¹⁹ *ASIC v Westpac Banking Corporation* [2018] FCA 1733, [1], [3].

²⁰ *ASIC v Westpac Banking Corporation* [2018] FCA 1733, [5].

²¹ *ASIC v Westpac Banking Corporation* [2018] FCA 1733, [29]. The declaration sought was to the effect that Westpac contravened the requirements of s 128 of the NCCP Act ‘by reason of ... the use within its Serviceability Calculation Rule of the HEM Benchmark rather than Declared Living Expenses of customers’.

The proceedings remain undetermined and, absent some different agreement being reached and resulting in final orders disposing of the proceeding, await trial and judgment. That being so, it would not be right for me to offer any view about the conclusions reached by Perram J or to say anything at all about the reasons that have been published. At the time of writing, the proceedings between ASIC and Westpac remain on foot and may well go to trial.²² The court processes must play out without commentary from me. **If the court processes were to reveal some deficiency in the law's requirements to make reasonable inquiries about, and verify, the consumer's financial situation, amending legislation to fill in that gap should be enacted as soon as reasonably practicable.**

The second development to notice is that banks are reducing their reliance on the HEM.²³ During the seventh round of hearings, Mr Matthew Comyn, the CEO of CBA, told the Commission:²⁴

[W]e're doing a better job of discovering what a customer's declared living expenses figure actually is, and, therefore, HEM as the prudent floor is being relied on less and less. I would certainly like to see it in the 50s very soon. I'm very confident it's going to be at that level very soon. As it gets towards 50 per cent, given the nature of the way the HEM benchmark is designed ... just mathematically, somewhere around 40 or 50 per cent should be largely reflective of the underlying expenditure.

In this comment, Mr Comyn rightly acknowledged that, by improving processes for inquiries and verification, banks' reliance upon the HEM or other benchmarks is likely to reduce. This is unsurprising, but important. It is important because it underscores the point that while the HEM can have some utility when assessing serviceability – that is to say, in assessing whether a particular consumer is likely to experience substantial hardship as a result of meeting their obligation to repay a line of credit²⁵ – the measure should not, and cannot, be used as a substitute for inquiries

²² See *ASIC v Westpac Banking Corporation (No 2)* [2018] FCA 1984, [1], [9].

²³ See, eg, Exhibit 7.121, Witness statement of Shayne Elliott, 16 November 2018, 8 [43]; Transcript, Shayne Elliott, 29 November 2018, 7333–4.

²⁴ Transcript, Matthew Comyn, 19 November 2018, 6593–4.

²⁵ See, eg, Westpac, Interim Report Submission, 21.

or verification. As ASIC rightly indicates in its Regulatory Guide relating to responsible lending conduct:²⁶

[u]se of benchmarks is not a replacement for making inquiries about a particular consumer's current income and expenses, nor a replacement for an assessment based on that consumer's verified income and expenses.

I consider that the steps that I have referred to above – steps taken by banks to strengthen their home lending practices and to reduce their reliance on the HEM – are being taken with a view to improving compliance with the responsible lending provisions of the NCCP Act. If this results in a 'tightening' of credit, it is the consequence of complying with the law as it has stood since the NCCP Act came into operation.

In saying this, I think it important to refer to a number of aspects of Treasury's submissions in response to the Commission's *Interim Report*. Treasury indicated that '[t]here is little evidence to suggest that the recent tightening in credit standards, including through APRA's prudential measures or the actions taken by ASIC in respect of [responsible lending obligations], has materially affected the overall availability of credit'.²⁷ Rather, Treasury considered that 'to the extent that firms are correcting lax credit assessment practices, there has likely been an improvement in the credit quality of marginal borrowers'.²⁸ As Treasury also said, finding that 'some lenders have not consistently undertaken reasonable inquiries to verify the financial position of potential borrowers, suggests that not all possible information (including quality of information) relevant for differentiating between the quality of borrowers has been fully utilised across the industry'.²⁹ But, taken together, Treasury said that the considerations it took into account (including the Reserve Bank's analysis indicating that most borrowers in the home mortgage market comfortably meet existing serviceability criteria) 'suggest that the housing market has the capacity to absorb some adjustment in the application of lending standards necessary to meet the requirements of existing [responsible lending obligations]

²⁶ ASIC, Regulatory Guide 209, November 2014, 37 [209.104]–[209.105].

²⁷ Treasury, Interim Report Submission, 34 [174] (footnote omitted).

²⁸ Treasury, Interim Report Submission, 34 [174].

²⁹ Treasury, Interim Report Submission, 34 [176].

without imposing unwarranted risks to macroeconomic outcomes'.³⁰ Put another way, **if 'appropriately managed, ensuring the industry consistently meets the requirements of existing laws will likely enhance rather than detract from macroeconomic performance'**.³¹ To my mind, these are important observations.

'Not unsuitable'

Consumer advocacy groups urged me to recommend that the NCCP Act be amended to require lenders to determine whether a loan contract (or credit limit increase) was 'suitable' for the consumer (as distinct from 'not unsuitable').³² I do not favour that proposal.

The double negative 'not unsuitable' does seem clumsy and, at first sight, may be thought no different in substance from the lender being required to determine that the loan is 'suitable' for the borrower. But there is an important practical difference between the two tests. The 'not unsuitable' test may be described as directed to avoiding harm. By contrast, asking about suitability invites attention to whether there is benefit to the borrower. The inquiries and verification required by the NCCP Act put the lender in a position where it can assess whether making the loan is unsuitable because it is likely that the consumer will be unable to comply with the consumer's financial obligations under the loan or could only comply with them by enduring what section 133(2) refers to as 'substantial hardship'. Those inquiries and verification are not suited to assessing what, if any, benefit the consumer will gain by borrowing.

I am not persuaded that the test should be changed.

I also consider that the NCCP Act, in its current form, sufficiently regulates the making of unsolicited offers of credit to consumers. Unsolicited offers of credit card limit increases are regulated by Division 4 of Part 3-2B of the NCCP Act. As already noted, the Act requires credit licensees to make reasonable inquiries about a consumer's requirements and objectives and

³⁰ Treasury, Interim Report Submission, 35 [177].

³¹ Treasury, Interim Report Submission, 35 [177].

³² FRLC, Interim Report Submission, 11–12; CALC, Interim Report Submission, 20–1 [84]–[89]; Consumer Credit Legal Service WA, Interim Report Submission, 18–19 [3.42]–[3.48].

about the consumer's financial situation *before* making a credit contract. As I explained in connection with some of the case studies discussed in the *Interim Report*, most unsolicited offers of credit to consumers will occur in circumstances in which the credit licensee would find it hard, if not impossible, to show compliance with those requirements, if only because it is not for the lender to impose its judgment of what the consumer requires or 'needs' and it is not for the lender to impose its judgment of what objectives the consumer could have (even should have) in taking up a proffered line of credit.³³

Subject to these matters, there was little or no debate about the terms of the NCCP Act. And, as will be apparent from what I have said, I am not persuaded that the terms of the NCCP Act should be amended to alter the obligation to assess unsuitability. My conclusions about issues relating to the NCCP Act can be summed up as 'apply the law as it stands'.

Recommendation 1.1 – The NCCP Act

The NCCP Act should not be amended to alter the obligation to assess unsuitability.

1.2.2 The responsible lending provisions of the Banking Code

Again, there was little or no debate about the way in which the Banking Code framed the lender's responsible lending obligation – to 'exercise the care and skill of a diligent and prudent banker'.³⁴ I see no reason to alter this formulation of the obligation. I discuss the enforceability of this and other provisions of the Code below.

2 Intermediated home lending

Two distinct forms of intermediated lending were examined: home lending through **mortgage brokers** and lending for motor vehicles, whitegoods and

³³ FSRC, *Interim Report*, vol 2, 72–3; see also 106–7 and 113–14 concerning unsolicited offers of credit card limit increases.

³⁴ 2019 Banking Code cl 49.

furniture through point-of-sale exceptions to the NCCP Act. They must be dealt with separately.

2.1 Home lending through mortgage brokers

As I said in the *Interim Report*, almost every person buying a house in Australia will borrow a large part of the cost. Many Australians have home loans with one of the major lenders.³⁵ At the time of the *Interim Report*, home loans were, and they remain, the largest asset on the books of **authorised deposit-taking institutions** (ADIs).³⁶

The mortgage broking industry is a key distribution channel for home loans, accounting for more than half of all residential home loans settled.³⁷ Reliance on the broker channel among the larger banks is varied. Approximately 40% of all CBA loans come through the broking channel,³⁸ while for ANZ the amount is around 55%.³⁹ Because of their smaller physical branch presence, smaller lenders are more dependent upon brokers to compete in the home loan market.⁴⁰ But brokers are not the only means by which smaller banks deal in that market. Most home loans made by Bendigo and Adelaide Bank are made through the bank's network of community owned branches.⁴¹ The branch receives a share of the revenue produced by the loan.⁴² In addition to this, Bendigo and Adelaide Bank lends to 'mortgage managers' who make home loans to customers at a rate higher than the rate charged to the manager by the bank.⁴³

Consideration of lending arranged through mortgage brokers must begin by recognising two facts. First, borrowers look to mortgage brokers for advice about how to finance what is, for many borrowers, the most valuable asset

³⁵ FSRC, *Interim Report*, vol 1, 30.

³⁶ FSRC, *Interim Report*, vol 1, 30.

³⁷ FSRC, *Interim Report*, vol 1, 32.

³⁸ Transcript, Matthew Comyn, 19 November 2018, 6558.

³⁹ Transcript, Shayne Elliott, 28 November 2018, 7281.

⁴⁰ ACCC, *Residential Mortgage Price Inquiry Final Report*, November 2018, 10, 58.

⁴¹ Transcript, Robert Johanson, 29 November 2018, 7381.

⁴² Transcript, Robert Johanson, 29 November 2018, 7381.

⁴³ Transcript, Robert Johanson, 29 November 2018, 7381.

they will buy in a single transaction.⁴⁴ And brokers not only give advice about what they think is best for the borrower, they submit the loan application on the borrower's behalf and, to the extent the terms are negotiable, negotiate the terms of the loan for the borrower.

Second, as already noted, it is not easy to determine for whom a mortgage broker acts. The lender pays the broker, not the borrower. Typically, the lender pays a commission, both an upfront commission and a **trail commission**.⁴⁵ For the lender, the broker is a channel for distributing the lender's products including, but not always limited to, the lender's home loan products. The lender seeks to foster relationships with brokers that will encourage the broker to recommend that lender's products. The lender seeks to treat the broker as *its* broker, and have the broker treat it as the broker's preferred lender. Yet, at the same time, the lender provides in its contracts with brokers and **mortgage aggregators** that they act for the borrower, not the lender.⁴⁶

Not only do borrowers look to mortgage brokers for advice about mortgages, the brokers themselves and the Mortgage and Finance Association of Australia (MFAA, an industry association) publicly emphasise both the skills and help that brokers can offer to clients in securing the best outcome for the client.⁴⁷ As ASIC reported in March 2017, the three main reasons consumers then gave for using a mortgage broker were to 'Access a wider range of loans', to 'Get a better interest rate/deal', and because the 'Broker is knowledgeable/an expert'.⁴⁸

Yet, despite brokers playing this advisory role, the *Corporations Act 2001* (Cth) (the Corporations Act) provisions about providing financial product advice to retail clients do not apply to giving advice about a residential home loan. Those provisions do not apply because a mortgage that secures

⁴⁴ See Transcript, Matthew Comyn, 19 November 2018, 6561; Transcript, Shayne Elliott, 29 November 2018, 7338.

⁴⁵ FSRC, *Interim Report*, vol 1, 32.

⁴⁶ FSRC, *Interim Report*, vol 1, 57.

⁴⁷ See, eg, MFAA, *Your Broker Behind You* (20 December 2018) MFAA <www.mfaa.com.au/yourbrokerbehindyou>.

⁴⁸ ASIC, Report 516, 16 March 2017, 176.

obligations under a credit contract (not otherwise expressly included by operation of some particular sections of Chapter 7 of the Corporations Act) is not a ‘financial product’ for the purposes of Chapter 7 of the Act.⁴⁹ Hence, making a recommendation or stating an opinion about a mortgage is not giving ‘financial product advice’.⁵⁰ And it is not considered to be personal advice, even though the broker would be expected to consider the borrower’s objectives, financial situation and needs.⁵¹ It follows that the best interests duty that the Corporations Act imposes on those who provide personal advice to a retail client⁵² does not apply to a mortgage broker.

Internal papers prepared by CBA when the Sedgwick Review⁵³ was considering broker and other remuneration compared the fees received by a mortgage broker with the fees charged by a financial adviser for personal financial advice to a retail client. The fees charged by a broker were said to be higher than the fees charged for financial advice (the figures quoted were about \$6,600 compared with \$2,300).⁵⁴ No doubt the two tasks differ. The financial adviser must reduce the advice to writing, as a Statement of Advice; the broker need not. The broker will take the information provided by the client and turn that into a loan application that the broker will submit. But the difference between the fees is striking. And it is all the more striking when it is recalled, as it must be, that home loans are not complicated financial products.

For the purposes of the NCCP Act, a mortgage broker who suggests a particular home loan, or helps a borrower obtain the loan, will be a ‘credit assistance’ provider, a ‘credit representative’, or a ‘representative’ of the credit licensee that will be the lender.⁵⁵ A mortgage broker thus engages

⁴⁹ Corporations Regulations 2001 (Cth) reg 7.1.06(1)(f).

⁵⁰ Corporations Act s 766B(1).

⁵¹ Corporations Act s 766B(3).

⁵² Corporations Act Pt 7.7A Div 2.

⁵³ An independent review into remuneration practices in retail banking commissioned by the ABA in 2016. The Sedgwick Review is considered further in the chapter on culture, governance and remuneration.

⁵⁴ Exhibit 7.15, 12 April 2017, Email Comyn to Narev, 3 [4.3.1]; Transcript, Matthew Comyn, 19 November 2018, 6579–85.

⁵⁵ NCCP Act ss 8, 64 and Pt 2-3.

in a credit activity and must hold an **Australian Credit Licence** (ACL) or be an employee or credit representative of a mortgage aggregator (or other entity) that holds an ACL.⁵⁶ The holder of an ACL must do all things necessary to ensure that the credit activities authorised by the licence are engaged in efficiently, honestly and fairly, and they must have in place ‘adequate arrangements to ensure that clients ... are not disadvantaged by any conflict of interest that may arise wholly or partly in relation to credit activities engaged in by the licensee or its representatives’.⁵⁷ But if a broker does suggest a particular home loan to a borrower, the broker is not bound by a statutory best interests duty.⁵⁸ Is there then a gap between what a borrower *expects* a broker to do and what a borrower can *require* the broker to do? If there is a gap, does it matter? That must be determined in light of the ways in which the broker channel of home loan origination has been shown to be operating. Two particular matters should be noted: first, the nature and extent of misconduct identified in the course of the Commission’s work and second, what is known about outcomes for customers whose home loans have been arranged through an intermediary.

2.1.1 Misconduct

Use of any intermediary, be it an introducer, a mortgage broker or a mortgage aggregator, means that there is an additional level at which the intended relationship between lender and borrower can be distorted in some way. The lender is isolated, even insulated, from what the intermediary does with the borrower.⁵⁹ The intermediary may pass on information to the lender that is wrong; the intermediary may join forces with either the would-be borrower or with one or more employees of the lender to deceive the lender. Examples of these kinds of conduct were examined in the Commission’s work and are the subject of case studies discussed in the *Interim Report*.⁶⁰

⁵⁶ NCCP Act s 29.

⁵⁷ NCCP Act s 47(1)(a) and (b).

⁵⁸ I say ‘statutory’ best interests duty because there may be cases where the general law would impose a duty on a broker to act in the interests of, and only in the interests of, the intending borrower. But that would depend entirely on the facts of the particular case.

⁵⁹ FSRC, *Interim Report*, vol 2, 24.

⁶⁰ FSRC, *Interim Report*, vol 2, 1–14, 16–32, 32–41, 43–51.

Cases where the use of a broker (or other intermediary) results in the lender receiving incomplete or false information on which to assess the proposed loan are of most immediate relevance.

When the Commission first took evidence about these issues in March 2018, it was evident that in many cases brokers assembling information about a loan applicant's financial situation either did not make sufficient inquiries, or did not seek sufficient verification of what they were told, about these matters.⁶¹ The fact that so many home loan applications then proceeded with the lender assuming that the borrower's living expenses were equal to the HEM, not as the borrower declared them to be, could lead only to the conclusion that the broker had not taken effective steps to inquire about the borrower's expenses or to verify the expense information the borrower had given.

The fact that the broker is paid only if a loan application succeeds stands as an obvious motive for that kind of conduct. It is in the broker's financial interests to have the lender approve the loan. And, as both the NAB Introducer home loans and the Aussie Home Loans broker misconduct case studies showed, payments by banks to intermediaries have induced some to engage in other forms of dishonest conduct.

Since the Commission took evidence on these matters, lenders have changed their processes and procedures to capture the financial situation of loan applicants more accurately. I am not able to say how effective those changes have been. NAB has reduced the numbers of 'introducers' it uses.⁶² CBA is selling the Aussie Home Loans business.⁶³ But the financial incentive (being paid commission by the lender) for brokers to secure approval of home loan applications remains. And because the amount paid varies with the amount of the loan, it is an incentive to brokers to have the borrower take as large a loan as the borrower can afford, regardless of whether the borrower needs to borrow, or is wise to borrow, that sum.

Even when the amount of commission paid, and to be paid, to the broker is disclosed, the immediate sting of the payment is not felt by the borrower

⁶¹ See, eg, FSRC, *Interim Report*, vol 2, 24–6.

⁶² Exhibit 7.80, Witness statement of Andrew Thorburn, 19 November 2018, 10 [32(a)].

⁶³ Transcript, Matthew Comyn, 19 November 2018, 6560.

because it is the lender that pays the commission. On reflection, the borrower may recognise that the cost of commission, like all other costs of the lender, will affect the price that is charged for the loan. But there is not that immediate and direct connection that would be observed if the fees charged by the broker for the work done were charged to the borrower, either directly or by paying the fees out of the amount borrowed.

2.1.2 Customer outcomes

In the *Interim Report*, I noted what CBA, Australia's largest home lender, had said to the Sedgwick Review, and what had been found by ASIC, about broker remuneration driving undesirable customer outcomes.⁶⁴

In its submission to the Sedgwick Review in February 2017, CBA said that 'the use of loan size linked with upfront and trail commissions for third-parties, can potentially lead to poor customer outcomes'.⁶⁵

In its March 2017 report, ASIC found that:

- broker loans were reliably associated with higher leverage, even for customers with an identical estimate of risk;
- loans written through brokers have a higher incidence of interest-only repayments, have higher debt-to-income levels, higher loan-to-value ratios and higher incurred interest costs compared with loans negotiated directly with the bank; and
- over time, higher leverage means broker customers have an increased likelihood of falling into arrears, pay down their loans more slowly and on average pay more interest than customers who dealt directly with the bank.⁶⁶

ASIC's findings were consistent with, indeed appear to have been based on, work CBA had done in October and November 2016 looking into consumer outcomes for borrowers who used brokers. CBA made a five-year longitudinal study of those outcomes and presented the results of that work

⁶⁴ FSRC, *Interim Report*, vol 1, 59–60.

⁶⁵ FSRC, *Interim Report*, vol 1, 60.

⁶⁶ ASIC, Report 516, 16 March 2017, 14 [51]–[52].

to ASIC.⁶⁷ These consequences are consistent not only with value-based commissions driving the results observed, but also with the payments being made by *lenders* rather than borrowers driving the results. If there are other causes of the results, they are, at least, less obvious.

Value-based commissions paid by lenders to mortgage brokers are a form of **conflicted remuneration**. That is, value-based commissions are a form of remuneration that can reasonably be expected to influence the choice of mortgage, the amount to be borrowed, and the terms on which the amount is borrowed. The evidence from CBA showed that the size of commissions has an effect on which lender the broker recommends to the borrower.⁶⁸ The size of commissions also affects the size and terms of the loan. On their face, the outcomes demonstrated by CBA's work and described in their submission to the Sedgwick Review, and confirmed by ASIC, constitute the realisation, in fact, of the expected effect.

It is evident that, after CBA had made its study of customer outcomes, it gave very close consideration to changing the terms on which it would offer to deal with brokers. In his then capacity as head of Retail Banking Services within CBA, Mr Comyn was on the edge of announcing a change to a fixed fee model, paid by the lender, but did not proceed.⁶⁹ He decided that other lenders would not follow CBA's lead without regulatory compulsion, and that, if CBA changed, it would suffer commercial detriment (by losing custom from brokers) for no real benefit for consumers.⁷⁰

⁶⁷ Exhibit 7.10, November 2016, CBA Slide Pack of November 2016 Concerning Customer Outcomes; Exhibit 7.11, November 2016, CBA Slide Pack Customer Outcomes Update of November 2016; Exhibit 7.12, 31 October 2016, Memorandum of Commonwealth Executive Committee and Slide Pack of October 2016; Transcript, Matthew Comyn, 19 November 2018, 6563–5.

⁶⁸ Exhibit 7.10, November 2016, CBA Slide Pack of November 2016 Concerning Customer Outcomes; Exhibit 7.11, November 2016, CBA Slide Pack Customer Outcomes Update of November 2016; Exhibit 7.12, 31 October 2016, Memorandum of Commonwealth Executive Committee and Slide Pack of October 2016; Transcript, Matthew Comyn, 19 November 2018, 6563–5.

⁶⁹ Transcript, Matthew Comyn, 19 November 2018, 6585.

⁷⁰ Transcript, Matthew Comyn, 19 November 2018, 6585.

2.1.3 More recent changes

After CBA made its submission to the Sedgwick Review and the report of that review was published, and after ASIC published its report about broker remuneration, the Combined Industry Forum (CIF), composed of industry bodies and financial services entities, considered, and published reports about, changing broker remuneration. And the submissions made to the Commission in response to the *Interim Report* have also considered these issues.

In December 2017, the CIF released a report setting out reforms to broker remuneration agreed upon by its members.⁷¹ The changes included paying commissions based on the amount of funds actually drawn down by a customer (rather than the size of the loan approved), ceasing volume and campaign-based commissions, limiting the value and availability of rewards such as entertainment and overseas trips, and developing a mortgage broking industry code.⁷²

In July 2018, the CIF reported that its members had eliminated volume-based commissions and mooted the adoption of a ‘customer first’ duty.⁷³ These proposals reflected some, but not all, of the recommendations the Productivity Commission had made about broker remuneration in its report on competition in the Australian financial system.⁷⁴

As I said in the *Interim Report*, the CIF reforms announced are limited. While the perverse incentives created by volume-based commissions, which reward brokers for the number of customers placed with a lender, are to be removed, upfront and trail commissions based on loan value will remain. While basing those commissions on funds *drawn down* will remove an incentive for brokers procuring a loan larger than the borrower will *use*,

⁷¹ CIF, *Response to ASIC Report 516*, December 2017.

⁷² CIF, *Response to ASIC Report 516*, December 2017, 4–5.

⁷³ CIF, *Working Towards a Better Mortgage Broking Industry for Customers*, July 2018, 12, 18.

⁷⁴ Productivity Commission, Report 89, 29 June 2018, 331. The Commission recommended: banning trail commissions; requiring upfront commissions to be based on funds drawn; banning volume-based commissions and payments and campaign-based commissions; and limiting the clawback period to two years.

the change will not deal with the more basic problem of borrowers being encouraged to borrow more than they *need*.⁷⁵

Nor has it been made clear what would be the content of a ‘customer first’ duty. On its face, it appears to differ from the duty to act in the best interests of the client that the Corporations Act imposes on financial advisers. Rather, it appears to be a duty to give preference to the client’s interests in cases where the client’s interests and the broker’s interests do not coincide. That is an obligation, however, that is markedly narrower than a best interests duty. And it has not been explained why the duty a mortgage broker owes to a borrower should differ from the duty a financial adviser owes to a retail client.⁷⁶

Further, the reforms proposed by the CIF would not alter the basic structure of brokers’ remuneration – lenders paying value-based upfront and trail commissions in respect of loans made. It is those elements of the structure that drive poor customer outcomes.

It is important to recognise, as the Productivity Commission has in its report on competition in the Australian financial system, that ‘a credible rationale based on consumer interests for the structure of broker remuneration’ has not been identified.⁷⁷ Rather, and as the Productivity Commission also said, ‘a particular set of remuneration arrangements [has] become entrenched in the mortgage broking industry as a matter of convention’.⁷⁸ Entrenched convention may provide a sufficient explanation for current practice. But, however deeply entrenched may be the convention, it provides no answer to the more fundamental and telling observations: first, that the remuneration arrangements have *no credible rationale* based on consumer interests; and second, that they actually *work against* consumer interests.

Yet ASIC, and others, submitted that ‘it is too early to determine whether these changes to remuneration [suggested by the CIF] go far enough, and

⁷⁵ FSRC, *Interim Report*, vol 1, 62–3.

⁷⁶ FSRC, *Interim Report*, vol 1, 63.

⁷⁷ Productivity Commission, Report 89, 29 June 2018, 329.

⁷⁸ Productivity Commission, Report 89, 29 June 2018, 330.

whether a complete prohibition on conflicted remuneration is necessary'.⁷⁹ And both banks and brokers have resisted change⁸⁰ even though documents produced to the Commission showed that in recent years, senior and experienced bankers had favoured moving to a system where brokers charged borrowers a fee for the services the broker provided.⁸¹

Brokers will undoubtedly say that the views of the bankers should be discounted. It will be said that bankers are doing no more than trying to advance the interests of banks; however, the same proposition can be applied with no less force to the views of brokers. Arguments for or against change should all be approached with a proper degree of scepticism. And, when viewed in that light, I consider that the arguments for change are compelling.

In discussing those arguments for change it is useful to begin by considering trail commissions.

2.2 Trail commissions

Trail commissions are valuable to brokers and brokerage businesses. Because they are valuable, brokers and brokerage businesses resist any change to trail commissions. But it is necessary to look not only at how trail commissions are valuable to those that receive them, but *why* they are valuable to both the party receiving the payments and the party making them.

The chief value of trail commissions to the recipient, to put it bluntly, is that they are money for nothing.

Why should a broker, whose work is complete when the loan is arranged, continue to benefit from the loan for years to come? It cannot be that they are deferred payment of fees earned earlier when the amount paid as trail depends upon the length of the life of the loan. And it cannot be that they

⁷⁹ ASIC, Interim Report Submission, 29 [129].

⁸⁰ See, eg, Finance Brokers Association of Australia, Interim Report Submission, 1–2, 11–12; Mortgage Choice, Interim Report Submission, 9–10; Aussie Home Loans, Module 1 Policy Submission, 6–7; Westpac, Interim Report Submission, 8–9; Regional Banks, Interim Report Submission, 15–17; NAB, Interim Report Submission, 49 [205].

⁸¹ Exhibit 7.9, October 2016, Emails between Comyn and Narev, 4.

are a fee for providing continuing services given there is no obligation for the broker to do so and no evidence of it being done.⁸²

It is said that trail commissions stand as an incentive for brokers not to 'switch' borrowers in and out of different mortgage arrangements. It is said that the payment of trail commissions somehow keeps the broker 'in touch' with the borrower. But how and why the payment of trail commission is *necessary* to achieving either of these results has not been satisfactorily explained. Problems arising from unnecessary 'switching' or 'churning' of home loans are more effectively addressed by providing for 'clawback' of commissions or fees (repayment of commissions or fees if the borrower defaults, or the loan is paid out within a short period). In this connection, **I note, and if commission payments were to remain, I would support, the recommendation made by the Productivity Commission to prohibit commission clawbacks from being passed on to borrowers.**⁸³

As the Aussie Home Loans broker misconduct case study showed, brokers are astute to do nothing that will interfere with the continued flow of trail commissions.⁸⁴ Why would they? In the examples considered in that case study, possible adverse effects on borrowers were not seen as reason enough to risk disturbing the overall flow of trail commissions by asking whether the misconduct identified in relation to particular loans might have occurred in connection with other loans the broker had negotiated.⁸⁵

On the other side of the ledger, the chief value of trail commissions to the lenders that pay them is that they represent another force binding the broker to the lender. Their payment contributes to the lenders being able to treat brokers as the lenders' sales channel. As the Productivity Commission found, 'trail commissions have the effect of aligning the broker's interests with those of the lender, rather than those of the borrower'.⁸⁶ I agree. It is unsurprising, then, that lenders would not want to be seen as standing apart from industry practice by advocating some change to existing arrangements.

⁸² Productivity Commission, Report 89, 29 June 2018, 42, 328.

⁸³ Productivity Commission, Report 89, 29 June 2018, 331.

⁸⁴ FSRC, *Interim Report*, vol 2, 40–2.

⁸⁵ FSRC, *Interim Report*, vol 2, 40–1.

⁸⁶ Productivity Commission, Report 89, 29 June 2018, 329.

2.3 Best interests duty

If, *in practice*, brokers were to act in the best interests of borrowers, poor customer outcomes of the kinds identified by CBA in its submissions to the Sedgwick Review, and by ASIC in its March 2017 report, would be reduced. If, *in practice*, brokers were to act in the best interests of borrowers, there would be fewer cases where brokers act in ways that see lenders given wrong or incomplete information about the financial situation of loan applicants. (I emphasise the words ‘in practice’ because it will later be necessary to look at what can reasonably be expected to occur.) But the first, and in my view essential, step to take is to bring the law into line with what consumers expect. They expect brokers to act in their best interests. Brokers should be obliged to do so.

I consider that the law should be amended to provide that, when acting in connection with home lending, mortgage brokers must act in the best interests of the intending borrower.

As ASIC submitted, the content of the duty is best expressed ‘as a broad statement of principle’.⁸⁷ ASIC’s proposed drafting of the obligation as ‘to act in the best interests of the consumer [I might prefer ‘loan applicant’] in the selection and arranging of loans’ goes a long way to capturing the heart of the relevant ideas.⁸⁸

Imposing this obligation would give statutory recognition to what borrowers currently expect of brokers. It is not an obligation that should affect the practices of lenders and, accordingly, it is not a change that should affect the price or the availability of credit, whether to consumers, small business borrowers or others. Nor should the obligation apply to aggregators, who have no direct relationship with the borrower and play no role in the selection or recommendation of the loan.⁸⁹

⁸⁷ ASIC, Interim Report Submission, 29 [130].

⁸⁸ ASIC, Interim Report Submission, 29 [130].

⁸⁹ See, eg, NAB, Interim Report Submission, 49 [208].

The best interests obligation must be enforceable. Because it is a provision of the same kind and quality as the obligations on holders of an **Australian financial services licence (AFSL)** and holders of an ACL – to do all things necessary to ensure that the licensed activities are engaged in ‘efficiently, honestly and fairly’⁹⁰ – the best interests obligation should be enforceable by civil penalty. The maximum penalty prescribed should be at the level proposed by the ASIC Taskforce Review.⁹¹

Recommendation 1.2 – Best interests duty

The law should be amended to provide that, when acting in connection with home lending, mortgage brokers must act in the best interests of the intending borrower. The obligation should be a civil penalty provision.

2.4 Do more?

Many will say that enacting the obligation and then seeing how it operates in practice is all that should now be done in connection with intermediated home lending. It will be argued that to do more than this would be needlessly disruptive. In particular, it will be said that it will diminish the competitive benefits that broker intermediation has introduced into the home loan market by allowing more effective competition from the small to medium lenders whose branch networks are not as extensive as those of the four biggest banks. A further point, made by Mr Shayne Elliott, the CEO of ANZ, was that moving to *borrowers* paying brokers a fee for service may penalise smaller borrowers because, for them, it would be uneconomic to go to a broker.⁹²

Three points must be considered.

First, the present system of remunerating mortgage brokers is conflicted remuneration. It can reasonably be expected to influence the broker’s recommendations about choice of lender, amount to be borrowed, and

⁹⁰ NCCP Act s 47(1)(a); Corporations Act s 912A(1)(a).

⁹¹ ASIC Taskforce Review, Final Report, December 2017, 58.

⁹² Transcript, Shayne Elliott, 29 November 2018, 7339–41.

terms on which the amount is borrowed. And the influence is in favour of the party paying the commission – that is, the lender.⁹³

Second, as already noted, a borrower who engages a mortgage broker looks to the broker for advice. The advice the borrower wants is what the broker thinks will be best for the borrower. And, if there is scope for negotiation with the lender, the borrower wants the broker to strike the deal that is best for the borrower. In all these activities, the borrower rightly wants and expects the broker's undivided loyalty. Yet, as has been noted in the introduction to this Report and will be developed in the chapter about financial advice, all too often advisers have preferred their own interests against the interests over clients, despite having an obligation to pursue the best interests of their clients. The evidence given to the Commission showed how often those retained to give financial advice to a client resolved conflicts between their duty to the client and their interests (or the interests of some related entity) in favour of their own financial interests or those of the entity they represent, and against the interests of the client. Advisers facing a conflict between self-interest and duty have too often sought to strike some compromise between the two competing forces rather than, as the law has required, to give priority to the interests of the client or member. That is, a 'good enough' outcome has been pursued instead of the *best* interests of the relevant clients or members. The short answer is: duties do not always overcome human biases, particularly when those biases are subconscious.⁹⁴

All this being so, why would mortgage brokers behave differently? Furthermore, in the face of experience of how the **Future of Financial Advice** (FoFA) reforms have operated, how can it be said that prescribing a best interests duty by itself will have the desired effect?

Third, it is said that changing to a system where the borrower, not the lender, pays the broker would reduce the number of borrowers using brokers. It is said that abolishing trail commissions would adversely affect the profitability, and thus the viability, of brokerage businesses. In either event, it is said that brokers will go out of business and the competitive

⁹³ Productivity Commission, Report 89, 29 June 2018, 323.

⁹⁴ See Sunita Sah, *FSRC Research Paper: Conflicts of Interest and Disclosure*, 7 November 2018, 6.

pressures that the broker channel introduces into the home lending market will be diminished. In particular, it is said that this will happen because smaller lenders rely on brokers to compete.

There are at least three unspoken premises for these arguments. First, the arguments assume that borrowers do not see, and will not see, enough advantage in using a broker if the remuneration arrangements change in a way that makes the cost of the service apparent, and charge that cost to the borrower. That is, the borrower will not be able to see that the benefit of using a broker outweighs the cost. The Commission was repeatedly told that borrowers like using the services of brokers.⁹⁵ At present, in addition to purporting to act for borrowers, brokers are providing a distribution service to lenders and being paid commission by lenders. It would seem to follow that the price paid to brokers reflects the value to the lender of the distribution service provided to the lender rather than the value of the service provided by a broker to the borrower. If borrowers pay a transparent price for the service provided to them then the market will determine that price based on the value of the service to borrowers.

Second, each argument appears to assume that the cost of using the brokerage service cannot be capitalised in the loan and repaid over the life of the loan. The cost that would be capitalised (even if calculated as the amount now paid as upfront commission plus a net present value of the likely income stream from trail commission) would be but a fraction of the amount most borrowers would borrow and would not be an amount likely to affect serviceability requirements or calculations.

Third, the argument assumes that mortgage brokers are contributing significantly to competition in the home loan market. Recent reports raise doubts about this assumption. The Productivity Commission found that while the pro-competitive effects of brokers in the market were significant and obvious in the 1990s, they have since declined.⁹⁶ ASIC's report concluded that brokers have the *potential* to play a valuable role as a distribution

⁹⁵ Transcript, Matthew Comyn, 19 November 2018, 6560–1; Exhibit 7.121, Witness statement of Shayne Elliott, 16 November 2018, 24 [147]; MFAA, Interim Report Submission, 5; Loan Market Group, Interim Report Submission, 6–7.

⁹⁶ Productivity Commission, Report 89, 29 June 2018, 301.

channel for lenders without a branch network and thus exert downward pressure on home loan pricing by forcing lenders to compete more strongly with each other for business.⁹⁷ But ASIC found that remuneration and ownership structures can inhibit the consumer and competition benefits that can be achieved by brokers.⁹⁸ ASIC also observed that smaller lenders were less able to access or remunerate brokers than larger lenders.⁹⁹ Rather than competing on the basis of who is offering the best product at the best price, lenders are competing on the basis of who can offer higher commissions to aggregators and brokers. And the Australian Competition and Consumer Commission (the ACCC)'s inquiry into Residential Mortgage Pricing found that, while *some* of the seven non-major banks that were considered have a heavy reliance on brokers and aggregators to gain market share,¹⁰⁰ the big four banks focus largely on each other in setting variable interest rates for their main brands and do not appear to have meaningful regard to the pricing decisions of smaller lenders.¹⁰¹ What is clear from the review is that there are challenges to competition in the home loan market that go beyond distribution.

So long as brokers are seen by borrowers to be acting on their behalf, the problem that present remuneration arrangements are conflicted remains unsolved by the remuneration changes proposed by the CIF.

I therefore recommend steady but deliberate movement towards changing the existing remuneration arrangements for brokers, so that the borrower, not the lender, should pay the mortgage broker a fee for acting in connection with home lending.

Changes in brokers' remuneration should be made over a period of two or three years. I would begin with trail commissions. There should come a time within about 12 or 18 months (no greater precision is possible) when

⁹⁷ ASIC, Report 516, 16 March 2017, 9 [22].

⁹⁸ ASIC, Report 516, 16 March 2017, 9 [23].

⁹⁹ ASIC, Report 516, 16 March 2017, 17 [72].

¹⁰⁰ ACCC, *Residential Mortgage Price Inquiry Final Report*, November 2018, 10.

¹⁰¹ ACCC, *Residential Mortgage Price Inquiry Interim Report*, March 2018, 28.
That finding appears undisturbed by the findings in the ACCC's Final Report:
ACCC, *Residential Mortgage Price Inquiry Final Report*, November 2018, 50.

lenders are prohibited from paying trail commission to mortgage brokers in respect of new loans. Existing trail commissions would stand unaffected. No doubt, as Mr Robert Johanson, the Chair of Bendigo and Adelaide Bank, emphasised, it would be necessary to distinguish between trail commissions and the revenue-sharing arrangements that Bendigo makes with its community-owned outlets.¹⁰² It is and should remain a matter for the lender to determine whether it shares the revenue it receives from the borrower with another party. But trail commissions are not a share of revenue earned by the lender.

Within a *further* 12 to 18 month period, lenders should be prohibited from paying any other commissions to mortgage brokers. Lest there be any doubt about it, my intention would be that the fee payable to a broker in respect of advising about, procuring or negotiating loans after that date would be payable by the borrower, and, if the lender agrees, could be paid out of the principal sum advanced to the borrower under the loan agreement. How the fee is fixed is best left to the market to determine. It could be a fixed amount, a stepped fee, a value-based fee or some combination.

When mortgage brokers are no longer paid by lenders, it may well be that lenders dealing directly with borrowers should be required to charge a fee to recover the costs that would be avoided if the loan were to be originated through a broker, but which are incurred if originated directly. This would be in order to prevent lenders competing unfairly with brokers. I explain this fee further below.

As noted above, CBA assumed in its internal deliberations that the fee charged by a broker on an average loan was about \$6,600 and would reduce to around \$2,310, in line with the market guidance on the price for complex financial advice.¹⁰³ (The assumed rate of commission was 0.6 to 0.7% of loan value.) It should not be assumed, however, that the upfront fee will necessarily be regressive and work to the disadvantage of borrowers of smaller amounts. ANZ's modelling concluded this would happen because if the upfront commission presently paid was paid by the borrower as a flat fee, the cost to the borrower would be higher for any loan less than

¹⁰² Transcript, Robert Johanson, 29 November 2018, 7381.

¹⁰³ Exhibit 7.15, 12 April 2017, Emails Comyn to Narev, 3 [4.3.1].

\$419,000 (approximately).¹⁰⁴ This was based on ANZ's current commission rate of around 0.55% and a hypothetical flat fee of \$2,302. But this ignores the fact that brokers currently provide their services in respect of smaller loans for an upfront payment that is, on average, significantly less than \$2,302. Based on ANZ's figures, brokers earned around \$550 upfront for a loan of \$100,000. In any case, this figure reflects the value of the broker to the lender as distributor. It does not reflect the value of the service to the borrower.

Changes of the kind that I have described above were introduced in the Netherlands in 2013. The mortgage broking industry continued without significant adverse consequences to its own operations, the market generally or individual participants. Mortgage brokers offered different remuneration arrangements including charging an hourly rate for advice and flat fees.¹⁰⁵ Furthermore, to 'create a level playing field' between direct and intermediated lending, lenders were required to identify their costs of providing advice and other services to borrowers who did not use a broker and expressly charge a fee to recover those costs from those borrowers.¹⁰⁶

There is, therefore, readily available experience to be drawn on to move to a mortgage broking system where borrowers who choose to use a broker pay the broker a fee for the service. The result would be that within a period of two to three years brokers would no longer receive conflicted remuneration. No longer would the remuneration arrangements within the industry be such as can reasonably be expected to influence the choice of lender, the amount to be borrowed, or the terms on which the amount is borrowed.

Changes of the kind I propose will give brokers the incentive to give borrowers value for money. In particular, the changes will induce brokers to search out the best deals available. To do that, they will have to look beyond the entities with which they may have become accustomed to dealing. And brokers will also have the incentive to offer, or continue to offer, services that borrowers cannot derive from the direct lending channel and for which borrowers are willing to pay.

¹⁰⁴ Exhibit 7.158, 7 December 2018, Letter from Shayne Elliott to Commissioner Hayne, 1.

¹⁰⁵ ASIC, Report 516, 16 March 2017, 45 [222].

¹⁰⁶ See Background Paper No 30, 25.

I acknowledge that the changes I propose are significant. They are responsive to the current state of the residential mortgage market. But the residential mortgage market is constantly changing and will change further as a result of what I have proposed. It is important that adjustments can be made as the market continues to evolve.

A Treasury-led working group should be established to monitor the changes and make adjustments as necessary. That group should include representatives of the ACCC and APRA. The working group should pay particular attention to:

- the effect of the changes on interest rates;
- the effect of the changes on competition between lenders;
- the effect of the changes on competition between lenders and brokers; and
- developments in the residential mortgage market that mean that the changes that I have proposed should be re-evaluated.

As I have indicated, it may be that to create a level playing field between banks and brokers, banks should be required to charge a fee to direct customers based on the costs that are incurred by the bank when there is no broker. I recognise that suggesting that banks charge an additional fee will be difficult for some to understand. But, if brokers are to charge a fee for their services, then it may be necessary for the purposes of maintaining competition, for banks also to be required to do so when directly originating a loan. The fee should reflect no more than the costs incurred by the bank when originating a loan without the assistance of a broker. If only brokers end up charging a fee, customers may cease to use their services, which would eliminate any potential benefit that brokers can have on competition in the residential mortgage market. Both the fee charged by the broker and the fee charged by the bank should be able to be capitalised into the loan.

Although I have explained what I think may well be necessary in order to create a level playing field, this is a matter that ought to be considered by the Treasury-led working group and should form part of their consideration of the effect of the changes on competition between lenders and brokers.

Assuming that such a fee is required, the Treasury-led working group or the ACCC should be responsible for monitoring the fees set by banks and ensuring that they charge no more than the additional cost to the bank of making a loan to the borrower through its proprietary lending channel rather than through a broker.

I expect that new forms of intermediation will emerge in the home lending market. For example, I expect that comparison and transaction sites of the kind now so familiar in connection with travel and accommodation may become more common. The ACCC's survey of residential mortgage borrowers found an increase in borrower preferences for online residential mortgage applications, suggesting that online originations may become more important in future.¹⁰⁷ As I have said above, as these changes occur in the market, it will be for the working group to assess whether the new model requires adjustment.

Recommendation 1.3 – Mortgage broker remuneration

The borrower, not the lender, should pay the mortgage broker a fee for acting in connection with home lending.

Changes in brokers' remuneration should be made over a period of two or three years, by first prohibiting lenders from paying trail commission to mortgage brokers in respect of new loans, then prohibiting lenders from paying other commissions to mortgage brokers.

Recommendation 1.4 – Establishment of working group

A Treasury-led working group should be established to monitor and, if necessary, adjust the remuneration model referred to in Recommendation 1.3, and any fee that lenders should be required to charge to achieve a level playing field, in response to market changes.

2.5 Brokers as advisers

There is a further issue to consider. But none of the recommendations made so far depends upon how this final issue is considered or resolved.

¹⁰⁷ ACCC, *Residential Mortgage Price Inquiry Final Report*, November 2018, 58.

That is, implementation of the other changes that have been proposed does not depend on, and should not be delayed by, debate about this further issue.

The further issue to be considered is presented by the very point at which the debate about mortgage brokers begins. Consumers go to mortgage brokers for advice. The advice the consumer seeks is about what ordinary parlance would see as a financial product – a secured home loan. And the transaction about which the consumer seeks advice is very important to the consumer. For many it will be the most important and the most expensive capital acquisition they make.

Why not regulate mortgage brokers in precisely the same way as any other person who is to provide personal advice to a retail client? Why not treat mortgage brokers as financial advisers?

I know that doing this would bring with it the requirement to provide written statements of advice. I know that it would bring with it the educational requirements expected of other financial advisers.

But what reasonable answer can be given to the observation that the special and distinct treatment of mortgage brokers is no more than yet another carve out from, or exception to, generally applicable rules stated in the law because they are seen as necessary to the proper conduct of provision of financial services in Australia? None is evident to me. I consider that **after a sufficient period of transition, mortgage brokers should be subject to and regulated by the law that applies to entities providing financial product advice to retail clients.**

Before leaving this topic, I make two further observations about bringing the framework for mortgage brokers into line with that for financial advisers.

The first observation relates to the steps that a lender or aggregator should take after identifying that a mortgage broker has engaged in misconduct. Consistently with what I say in the chapter concerning financial advice, when a lender or aggregator detects that a broker has engaged in misconduct in respect of a particular loan, it should always take steps to assess whether the broker may have acted poorly in respect of other loans. The evidence before the Commission showed that entities have not always done this. The result is that the damage done by a broker may not come to light until long after the event. That works to the detriment of both the

affected clients and the entity itself. It is necessary in principle, and better in practice, for lenders and aggregators discovering misconduct by a broker to make whatever inquiries are reasonably necessary to determine the nature and full extent of the broker's conduct. Where there is sufficient information to suggest that a broker has acted poorly, any customer affected by that misconduct should be told and remediated promptly.

The second observation relates to what is sometimes termed the 'rolling bad apples' phenomenon. In the chapter of this Report dealing with financial advice, I make two recommendations about financial advisers. In short, they are that:

- compliance with the Australian Banking Association (ABA)'s reference checking and information-sharing protocol for financial advisers (or, at least, substantially similar requirements) should be mandatory for all AFSL holders whose licence authorises the provision of financial advice; and
- the reporting of 'serious compliance concerns' by AFSL holders to ASIC should be formalised, and licensees should be required to report such concerns to ASIC on a quarterly basis.

In my view, similar requirements should apply to mortgage brokers.

Recommendation 1.5 – Mortgage brokers as financial advisers

After a sufficient period of transition, mortgage brokers should be subject to and regulated by the law that applies to entities providing financial product advice to retail clients.

Recommendation 1.6 – Misconduct by mortgage brokers

ACL holders should:

- be bound by information-sharing and reporting obligations in respect of mortgage brokers similar to those referred to in Recommendations 2.7 and 2.8 for financial advisers; and
- take the same steps in response to detecting misconduct of a mortgage broker as those referred to in Recommendation 2.9 for financial advisers.

2.6 Aggregators

It is important to recognise that many mortgage brokers interact with lenders through aggregators. Aggregators provide services to brokers, such as access to administrative support and information technology systems. They also operate as a single point of contact between large numbers of brokers and particular lenders. In this way, they also provide a service to lenders. Aggregators are currently remunerated by commissions paid by lenders, part of which is typically passed on to brokers.

Under the proposed model, this form of remuneration should not continue.

If brokers value the service provided to them by an aggregator, they should pay the aggregator a fee for that service. If lenders value the service provided to them by an aggregator, they too should pay the aggregator a fee for that service. The market should determine those fees. The Treasury-led working group should monitor the activities of aggregators under the new model.

2.7 Introducers

Before leaving the topic of intermediated home lending, I should say something about introducers.

As I noted in the *Interim Report*, at a practical level, introducers are more clearly the face of the lender than the borrower.¹⁰⁸ Under the law, introducers must comply with certain requirements, including that they do no more than refer the potential borrower to the lender and facilitate the borrower making contact with the lender.¹⁰⁹ Introducers have an obligation to disclose to a potential borrower any benefits, including commissions, that the introducer may receive for the referral.¹¹⁰ The effect of the current regime is that introducers are not permitted to be involved in the credit application or assessment process.

¹⁰⁸ FSRC, *Interim Report*, vol 1, 57.

¹⁰⁹ National Consumer Credit Protection Regulations 2010 (Cth) (the NCCP Regulations) regs 25(2)(a), 25(2A)(a).

¹¹⁰ NCCP Regulations reg 25(2)(b).

Introducers must only act within the confines of their prescribed role. Entities must have systems in place to ensure that introducers do not exceed this role. And entities should not regard the role of the introducer as modifying their own responsible lending obligations.

If introducers and entities behave in this way, introducer programs are not incompatible with responsible lending obligations.

3 Intermediated auto lending and associated issues

Consumers making large purchases, such as motor vehicles, whitegoods, or furniture, may borrow money in order to pay the price. Often the application for credit is made at the point of sale, not at the lender's premises. The person with whom the consumer deals at the point of sale is not subject to the NCCP Act.¹¹¹ Retail dealers, like car dealers, are entitled to, and do, act as agents for lenders without holding an ACL.¹¹² Under the point-of-sale exceptions to the NCCP Act, many car dealers (and some retailers), without holding an ACL, have offered loans to consumers to be provided by a lender.¹¹³ Retail dealers acting in this way are sometimes referred to as 'vendor introducers'.

The case studies examined by the Commission showed three kinds of relevant conduct leading to adverse outcomes for the borrower, or at least, a lender making a loan that was not properly shown to be 'not unsuitable' for the borrower:

- the use of so-called 'flex commissions';
- lenders relying on the retail dealer to provide accurate information about the borrower's financial situation; and
- lenders capitalising the cost of 'add-on insurances' in the amount lent.

¹¹¹ NCCP Regulations reg 23.

¹¹² Background Paper No 4, 23

¹¹³ Exhibit 1.158, Witness statement of Michael Saadat, 5 March 2018, 2 [11], 23 [128]; Background Paper No 4, 23.

3.1 Flex commissions

I discussed the use of flex commissions in the *Interim Report*.¹¹⁴ As I recorded there, under that kind of arrangement, the lender fixed a base rate of interest that would be charged under the loan agreement. If the dealer could persuade the borrower to agree to pay a higher rate, the dealer received a large part of the interest payable over and above the base rate. In more recent times, lenders provided that the agreed rate must not exceed a rate fixed by the lender but, below that cap, the dealer was free to offer a loan on behalf of the lender at a rate greater than the base rate fixed by the lender.

Many borrowers knew nothing of these arrangements. Lenders did not publicise them; dealers did not reveal them. The dealer's interest in securing the highest rate possible is obvious. It was the consumer who bore the cost. To the borrower, the dealer might have appeared to be acting for the borrower by submitting a loan proposal on behalf of the borrower. The borrower was given no indication that in fact the dealer was looking after its own interests rather than acting as a mere conduit between lender and borrower. For all the borrower knew, the interest rate the dealer quoted had been fixed by the lender. But, whenever the dealer quoted a rate larger than the base rate, the dealer was acting in its own interests.

Since 1 November 2018, flex commissions have been banned.¹¹⁵ But, because at least one large lender, Westpac, was continuing to offer flex commission arrangements to car dealers when the Commission looked at these matters in March 2018, there will be many car loan contracts on foot where the interest rate being charged will be above whatever rate the lender fixed at the time as its base rate.

Until 1 November 2018, the conduct was not unlawful. It was conduct that Westpac accepted could create unfairness in individual transactions.¹¹⁶ But despite recognising this to be so, Westpac considered that it could

¹¹⁴ FSRC, *Interim Report*, vol 1, 63–4.

¹¹⁵ ASIC Credit (Flexible Credit Cost Arrangements) Instrument 2017/780 (Cth).

¹¹⁶ FSRC, *Interim Report*, vol 2, 89; Westpac, Module 1 Case Study Submission, 9 [41].

not stop the practice because doing that ‘would simply leave the market to others who did not’.¹¹⁷

Flex commissions stand as one of the starker examples of changes to practices in the financial services industry – even changes seen by important industry participants as desired and desirable – foundering on the rock of first-mover disadvantage. There are times, and this was one, where regulatory intervention was necessary to achieve change.

3.2 Relying on the retail dealer

Lenders relied, and continue to rely, on retail dealers submitting completed loan applications that give accurate information about the applicant’s financial situation and sufficient means for the lender to verify the applicant’s financial situation. Often, the retail dealer will not make the underlying sale unless the loan is approved. The dealer thus has a strong reason to portray the loan applicant’s financial situation in a way that will warrant loan approval. On this matter the case studies showed that dealers did not, and it can safely be assumed, do not now, always record the true position.

Yet the lender must meet its obligations under the NCCP Act, regardless of whether it has sub-contracted some or all of the steps to a retail dealer and regardless of whether its contract with the dealer obliges the dealer to do these things on pain of termination of the dealership.

As the Productivity Commission has noted, when the NCCP Act was introduced in 2009, the Government said that it would review the exemption of retailers within 12 months.¹¹⁸ In 2013, Treasury announced a review of the exemptions for retail dealers (in its terms, vendor introducers), released a discussion paper and sought submissions.¹¹⁹ The discussion paper proposed three options for consideration:¹²⁰

- maintaining the status quo;

¹¹⁷ Westpac, Module 1 Case Study Submission, 10 [45]; FSRC, *Interim Report*, vol 2, 90.

¹¹⁸ Productivity Commission, Report 89, 29 June 2018, 432.

¹¹⁹ Treasury, *The Exemption of Retailers from the National Consumer Credit Protection Act 2009*, January 2013.

¹²⁰ Treasury, *The Exemption of Retailers from the National Consumer Credit Protection Act 2009*, January 2013, 2.

- requiring retail dealers to comply with the NCCP Act; or
- modifying the application of the obligations in the NCCP Act, according to the functions they are performing, so that retail dealers who are more actively involved in product selection and delivery would be subject to a higher level of regulation:
 - retail dealers acting as a broker would be required to hold an ACL or be appointed as a credit representative by an ACL holder;
 - retail dealers who act only on behalf of a single financier or under first or second choice arrangements would be subject to modified and limited regulation under the NCCP Act; and
 - retail dealers who have a role in product selection but have a limited role in arranging finance would be subject to different modified regulation under the NCCP Act.

As the 2013 Treasury discussion paper said, the exemption of retail dealers under the NCCP Act has several consequences:¹²¹

- they are not subject to entry or conduct standards and ASIC has no power to exclude from the market any who engage in conduct that is dishonest or incompetent;
- they have no responsible lending obligations; and
- consumers may be unable to obtain remedies for their conduct.

Treasury did not complete the review. The Productivity Commission has recommended that Treasury do that 'with a view to removing or reforming the exemption'.¹²²

On the material I have seen, I would strongly favour the second option identified by Treasury in its 2013 discussion paper. That is, I strongly favour removing the exemption of retail dealers from the operation of the NCCP Act, with the consequence that retail dealers would be subject to the requirements of that Act.

¹²¹ Treasury, *The Exemption of Retailers from the National Consumer Credit Protection Act 2009*, January 2013, 7.

¹²² Productivity Commission, Report 89, 29 June 2018, 433.

Recommendation 1.7 – Removal of point-of-sale exemption

The exemption of retail dealers from the operation of the NCCP Act should be abolished.

3.3 Capitalising add-on insurance

As will be explained when dealing with other aspects of insurance and how it is sold, I consider that add-on insurance, including add-on insurance offered in connection with the sale of motor vehicles, should generally be sold under a deferred sales model. The detail of that model is discussed further in the course of dealing with other forms of insurance that may be said to be of low value to consumers.

One likely consequence of this change is that the premiums payable for policies subject to the deferred sales model could not be financed by the loan made to purchase the vehicle without specific adjustment of the loan arrangement. However, in my view, the potential inconvenience caused by this outcome is justified in light of the benefits to the consumer of moving to a deferred sales model.

4 Access to banking services

Before moving away from consumers' interactions with banks, I think it necessary to say something about access to banking services.

It is unsurprising that large entities, carrying on their businesses in all parts of Australia, apply the same policies and procedures whenever they can. But, as the Commission's inquiries showed, not all Australians can always resort to those standard policies and procedures. Not all Australians have the same access to telephone or internet banking.¹²³ Not all Australians can 'step into the nearest branch' to sort out some issue that has emerged. Not all Australians have English as a first language or are as adept in using the English language as others. Not all Australians can easily produce

¹²³ See generally Transcript, Shayne Elliott, 28 November 2018, 7285.

standard identification records. Not all Australians need, or benefit from, 'standard offerings' like informal overdrafts.

For some Australians, these characteristics arise from living in a regional or remote location. As I said in the *Interim Report*, at 30 June 2017, about 28% of the Australian population lived in regional or remote areas. This is nearly 7 million people. At the same time, only 4% of all branches of ADIs and 2% of ATMs were located in areas classified as remote or very remote. The banks' branch networks have been shrinking for some years. The banks have fewer face-to-face points of presence.¹²⁴ But, as will be apparent from what I have said, it is not only people who live regionally or remotely who will experience the types of issues that I have described.

Four steps should be taken to improve access to banking services. None was seriously opposed in the submissions provided to the Commission.

The first relates to the way in which the 2019 Banking Code deals with customers requiring particular assistance.

Chapter 14 of the 2019 Banking Code is entitled 'Taking extra care with customers who may be vulnerable'. One clause in that chapter (clause 40) provides that: 'If you tell us about your personal or financial circumstance, we will work with you to identify a suitable way for you to access and undertake your banking'. But the general tenor of this and other provisions of the chapter is that they are directed only to those who are vulnerable and they will apply *only* upon the customer telling the bank of the circumstances that make the customer vulnerable.

It is not only the vulnerable who need consideration. Those identified above (including those who live in remote or isolated areas, who are not adept in using English, who cannot readily produce standard identification documents, and who neither need nor benefit from products such as informal overdrafts) also require consideration.

¹²⁴ FSRC, *Interim Report*, vol 1, 257.

I consider that provision should be made in the 2019 Banking Code to require banks to work with customers who live in remote areas, or who are not adept in using English, to identify a suitable way for those customers to access and undertake their banking. Some of those to whom these provisions would apply will identify as Aboriginal or Torres Strait Islander peoples, but the relevant criteria are remoteness and language, not identification.

Second, as explained during the fourth and fifth rounds of the Commission's hearings, the Australian Transaction Reports and Analysis Centre (AUSTRAC) has published guidance intended to overcome the difficulties that are sometimes faced by Aboriginal and Torres Strait Islander people in assembling documentary proof of identity (AUSTRAC Guidance).¹²⁵ The AUSTRAC Guidance recognises that some Aboriginal and Torres Strait Islander customers may not have identification documents that reporting entities most commonly use to establish and verify the identity of their customers, or that the information contained in the documents may no longer be accurate or up to date. As a result, these people may face barriers in accessing financial services.¹²⁶

During the fourth round of hearings, Ms Lynda Edwards from Financial Counselling Australia and Mr Nathan Boyle from ASIC gave evidence about the implementation of the AUSTRAC Guidance. Ms Edwards said that the processes outlined in the AUSTRAC Guidance are 'not always ... used' by financial services entities.¹²⁷ Mr Boyle said that the AUSTRAC Guidance has been 'taken up by financial services institutions at the ... head office level', but that application of the Guidance 'hasn't filtered down to the customer-facing staff or to the telephone staff'.¹²⁸ As a result, Mr Boyle said that he was 'still not seeing a real reduction in the difficulties that people are having identifying themselves on the ground'.¹²⁹

¹²⁵ See AUSTRAC, *Aboriginal and/or Torres Strait Islander People* (13 December 2018) AUSTRAC <www.austrac.gov.au/aboriginal-andor-torres-strait-islander-people>.

¹²⁶ AUSTRAC, *Part B of an AML/CTF Program (Customer Due Diligence Procedures)* (13 December 2018) AUSTRAC <www.austrac.gov.au/part-b-amlctf-program-customer-due-diligence-procedures>.

¹²⁷ Transcript, Lynda Edwards, 3 July 2018, 3726.

¹²⁸ Transcript, Nathan Boyle, 3 July 2018, 3727.

¹²⁹ Transcript, Nathan Boyle, 3 July 2018, 3727.

In my view, these problems may be addressed at least in part by amending the 2019 Banking Code to provide that, if a customer is having difficulty proving his or her identity, and tells the bank that he or she identifies as an Aboriginal or Torres Strait Islander person, the bank will follow the AUSTRAC Guidance.

Third, the 2019 Banking Code should be amended to record that banks will not allow informal overdrafts on basic accounts without prior express agreement with the customer. The 2019 Banking Code refers to ‘basic, low or no fee accounts’.¹³⁰ I use the expression ‘basic account’ to embrace all three types of accounts.

I explained in the *Interim Report* that a ‘basic account’ is a bank account that provides the account holder with essential banking services at a lower cost than other forms of account.¹³¹ Those who are on a low income, especially those in receipt of certain government benefits or holding government concession cards, may find that a ‘basic account’ suits their needs better than other forms of account.¹³²

As I also explained in the *Interim Report*, an informal overdraft will arise when a bank allows a customer to withdraw more than the amount standing to the credit of the customer’s account.¹³³ The bank may allow overdrawing without any prior agreement with the customer.¹³⁴ If the bank does meet the customer’s request to withdraw an amount larger than the balance standing to the credit of the account, the bank will charge the customer a fee for lending the customer the amount of the informal overdraft.¹³⁵

I have two principal concerns with informal overdrafts, particularly on basic accounts. The first is that, as I said in the *Interim Report*, the fee charged when an informal overdraft is granted may be small but, with repeated

¹³⁰ See, eg, 2019 Banking Code, Ch 16.

¹³¹ FSRC, *Interim Report*, vol 1, 260.

¹³² FSRC, *Interim Report*, vol 1, 260; see also 2019 Banking Code, Ch 16.

¹³³ FSRC, *Interim Report*, vol 1, 260.

¹³⁴ FSRC, *Interim Report*, vol 1, 260.

¹³⁵ FSRC, *Interim Report*, vol 1, 260.

overdrawing, these fees can soon mount up.¹³⁶ The second is that the evidence received during the fourth round of hearings indicated that some customers did not know that they had been offered, and had made use of, an informal overdraft.¹³⁷ Some customers knew nothing more than that their request to withdraw money had been met.

In my view, these characteristics suggest that the ABA should amend the Banking Code to provide that informal overdrafts should not be offered on basic accounts unless the customer has expressly sought, and been granted, that facility. In those circumstances, a customer will have actively turned their mind to whether they wish to have the facility, and they will be aware of the potential consequences of using the facility.

Fourth, the ABA should amend the Banking Code to provide that banks will not charge dishonour fees on basic accounts. In their submissions in response to the *Interim Report*, each of the major banks advised that they had adopted this position.¹³⁸ Other banks, to the extent that they have not followed the lead of the major banks, should do so, and also discontinue charging dishonour fees on basic accounts.

Before leaving this topic, I make two further observations.

The first is that clause 181 of the 2019 Banking Code will oblige banks to comply with the *Code of Operation: Recovery of Debts from Department of Human Services Income Support Payments or Department of Veterans' Affairs Payments*. The Code of Operation provides for what has come to be known as the 90% arrangement, which limits the amount that a bank may take from government benefits in reduction of a debt owed to the bank. Restricting informal overdraft arrangements to customers who actively seek out such an arrangement would very likely go some way to reducing the numbers of customers on benefits who owe significant debts to banks, and would very likely go some way to reducing the amounts owed by individual customers.

¹³⁶ FSRC, *Interim Report*, vol 1, 260.

¹³⁷ Transcript, Nathan Boyle, 3 July 2018, 3721.

¹³⁸ ANZ, Interim Report Submission, 5 [24]–[26]; CBA, Interim Report Submission, 25 [125], 26 [137]; NAB, Interim Report Submission, 37 [144]; Westpac, Interim Report Submission, 50 [242].

The second observation is about the importance of continuing to develop innovative solutions to address barriers to access.

One example of this, which I discussed in the *Interim Report*, is CBA's Indigenous Customer Assistance Line (ICAL).¹³⁹ ICAL provides support for geographically isolated Aboriginal and Torres Strait Islander customers in 90 remote communities by providing free balance inquiries, replacement cards, access to funds, and other, more general, support.¹⁴⁰ ICAL uses a special identification process tailored to the customers who use the service.¹⁴¹ Financial Counselling Australia (FCA) told the Commission that the ICAL service is 'very helpful' for both Aboriginal and Torres Strait Islander people, and for financial capability workers working with that population, because the dedicated staff 'are trained to understand the specific issues facing them and respond appropriately to issues such as remoteness and identification'.¹⁴²

Westpac is now in the process of establishing such a service,¹⁴³ and ANZ has indicated that it is willing to do so.¹⁴⁴

A telephone service, no matter its efficacy, is not capable of solving all of the issues impeding access to banking services, whether by Aboriginal and Torres Strait Islander people or by others living in remote areas. It could only ever form part of a range of initiatives directed towards improving access. But the provision of this service has been identified as helpful by those working with Aboriginal and Torres Strait Islander communities,¹⁴⁵ and I strongly encourage the development of such services.

¹³⁹ FSRC, *Interim Report*, vol 1, 258.

¹⁴⁰ FSRC, *Interim Report*, vol 1, 258.

¹⁴¹ FSRC, *Interim Report*, vol 1, 258.

¹⁴² FCA, Interim Report Submission, 18 [77].

¹⁴³ Westpac, Interim Report Submission, 47–8 [225].

¹⁴⁴ ANZ, Interim Report Submission, 4 [20]; cf ANZ, Module 4 Policy Submission, 18 [85]; Transcript, Shayne Elliott, 28 November 2018, 7290.

¹⁴⁵ Legal Aid NSW, Module 4 Policy Submission, 16; CALC, Module 4 Policy Submission, 21 [77]–[79].

Recommendation 1.8 – Amending the Banking Code

The ABA should amend the Banking Code to provide that:

- banks will work with customers:
 - who live in remote areas; or
 - who are not adept in using English,to identify a suitable way for those customers to access and undertake their banking;
- if a customer is having difficulty proving his or her identity, and tells the bank that he or she identifies as an Aboriginal or Torres Strait Islander person, the bank will follow AUSTRAC's guidance about the identification and verification of persons of Aboriginal or Torres Strait Islander heritage;
- without prior express agreement with the customer, banks will not allow informal overdrafts on basic accounts; and
- banks will not charge dishonour fees on basic accounts.

5 Lending to small and medium enterprises

With some exceptions, I generally do not favour altering the rules that govern lending to small and medium enterprises (SMEs).

5.1 The lending framework

I will begin by explaining why I do not favour extending the provisions of the NCCP Act to small businesses.

As I said in the *Interim Report*, the responsible lending provisions of the NCCP Act do not apply to lending for business purposes.¹⁴⁶ In particular, the provisions of section 128 of the NCCP Act prohibiting an ACL holder from entering a credit contract with a consumer without making an assessment that the credit contract will not be unsuitable for the consumer do not apply. Nor do the hardship, pre-contractual disclosure, price regulation, and enforcement provisions of the National Credit Code. I explained in the *Interim Report* that the policy choices that have been made to limit the application of this regime reflect recognition of the need to ensure that small businesses have access to reasonably affordable and available credit.¹⁴⁷

That said, there are some important provisions that do apply to small business lending. A number of protections within the ASIC Act that apply to consumers also apply to lending to small businesses. These include the prohibition on misleading or deceptive conduct in relation to financial services¹⁴⁸ and on unconscionable conduct in connection with the supply or possible supply of financial services,¹⁴⁹ as well as the implication of particular warranties into contracts for the supply of financial services¹⁵⁰ and the unfair contract terms regime,¹⁵¹ which I discuss in some detail in the chapter of this Report concerning insurance. In addition, there are a number of general law principles that supplement this framework.¹⁵² And the chief protection for small business borrowers has for some time been, and remains, the Banking Code, to which I will return.¹⁵³ Among other things, the Banking Code provides that, if a lender is considering providing a borrower 'with a new loan, or an increase in a loan limit', the lender will 'exercise the care and skill of a diligent and prudent banker'.¹⁵⁴

¹⁴⁶ FSRC, *Interim Report*, vol 1, 162.

¹⁴⁷ FSRC, *Interim Report*, vol 1, 163.

¹⁴⁸ ASIC Act ss 12DA, 12DB, 12DC, 12DF.

¹⁴⁹ ASIC Act ss 12CA, 12CB.

¹⁵⁰ ASIC Act s 12ED, read with the definition of 'small business' in s 12BC(2).

¹⁵¹ ASIC Act Pt 2 Div 2 Sub-div BA.

¹⁵² FSRC, *Interim Report*, vol 1, 164.

¹⁵³ FSRC, *Interim Report*, vol 1, 164.

¹⁵⁴ 2019 Banking Code cl 49.

As I said in the *Interim Report*, the evidence and submissions provided to the Commission did not reveal any great appetite to change this lending framework.¹⁵⁵ The submissions received by the Commission following the *Interim Report* were consistent with this trend.¹⁵⁶ I do not consider this surprising: extending the responsible lending obligations in the NCCP Act would likely increase the cost of credit for small business and reduce the availability of credit. I am not persuaded that the benefits to be gained in individual cases from applying the NCCP Act to small business outweigh the overall costs of taking that step. I therefore do not consider that the NCCP Act should be amended to extend its operation to lending to small businesses.

In the *Interim Report*, I also raised a number of questions about how banks practically discharge their obligations under the Banking Code when lending to small businesses. One question related to the inquiries that a diligent and prudent banker should make when deciding whether to offer or extend a line of credit.¹⁵⁷ Other questions related to how banks discharge their obligations to assess whether small businesses will be able to repay a loan.¹⁵⁸ The Commission received a number of submissions from banks about the steps that they take to discharge these obligations. Having reviewed those submissions, I do not consider that it would be useful to prescribe any particular approach to be applied by all banks in respect of the discharge of these obligations.

Recommendation 1.9 – No extension of the NCCP Act

The NCCP Act should not be amended to extend its operation to lending to small businesses.

¹⁵⁵ FSRC, *Interim Report*, vol 1, 164. These submissions were generally consistent with the submissions made to Mr Khoury: see Philip Khoury, *Independent Review Code of Banking Practice*, 31 January 2017, 49 [8.4.2].

¹⁵⁶ See, eg, ABA, Module 3 Policy Submission, 8; ANZ, Module 3 Policy Submission, 3–4 [16]–[22]; ASBFEO, Interim Report Submission, 4; ASIC, Module 3 Policy Submission, 2–3 [4]–[7]; CBA, Module 3 Policy Submission, 4–6 [17]–[19]; NAB, Module 3 Policy Submission, 5–6 [16]–[17]; Westpac, Module 3 Policy Submission, 1 [2(c)], 2 [5], 4–6 [16]–[20].

¹⁵⁷ FSRC, *Interim Report*, vol 1, 334.

¹⁵⁸ FSRC, *Interim Report*, vol 1, 334.

5.2 The 2019 Banking Code and the definition of ‘small business’

I consider that the definition of ‘small business’ in the 2019 Banking Code is too complicated and too confined in its reach. The definition advanced in the Khoury Review, which would have had the Banking Code govern loans to any business (or group) employing fewer than 100 full time equivalent employees, where the loan applied for was less than \$5 million, is preferable to the three-part test now set out in the 2019 Banking Code. As it stands, satisfying the three-part test requires: annual turnover of less than \$10 million, fewer than 100 full-time employees, and less than \$3 million total debt to all credit providers (including amounts undrawn under existing loans, any loan being applied for and the debt of all of its related entities that are businesses).¹⁵⁹ I see no reason to doubt Mr Khoury’s evidence that adopting the test he proposed would have a relatively small effect, extending coverage of the provisions to another 10,000 or 20,000 businesses.¹⁶⁰ I recommend that the ABA amend the definition of ‘small business’ in the 2019 Banking Code of Practice to adopt the definition proposed in the Khoury Review.

Recommendation 1.10 – Definition of ‘small business’

The ABA should amend the definition of ‘small business’ in the Banking Code so that the Code applies to any business or group employing fewer than 100 full-time equivalent employees, where the loan applied for is less than \$5 million.

¹⁵⁹ 2019 Banking Code cl 1.

¹⁶⁰ Transcript, Philip Khoury, 21 May 2018, 2024–9.

5.3 Guarantors

I do not favour altering or adding to the existing law in relation to guarantees, whether given in support of lending to SMEs or more generally.

As I explained in the *Interim Report*, because third party guarantees are commonly taken in support of loans to SMEs, the general law principles that affect whether a guarantee is enforceable are important.¹⁶¹

The law, as it now stands, will sometimes prevent a creditor from enforcing a guarantee given by a volunteer.¹⁶² In the *Interim Report*, I made reference to the cases of *Commercial Bank of Australia Ltd v Amadio*¹⁶³ and *Garcia v National Australia Bank Ltd*.¹⁶⁴ I explained that, in *Amadio*, the High Court held that it would be unconscionable to allow the bank to enforce a guarantee given by the parents of a borrower because the bank's employee had shut his eyes to the misconduct by which the son had procured his parents to give the guarantee. I also explained that, in *Garcia*, the High Court held that it would be unconscionable to allow the bank to enforce a guarantee of a company's obligations given by the wife of the principal of the company when the bank had not taken steps to explain the content and effect of the guarantee or have a third party do so. Though the wife was both a shareholder and director of the company, her participation was nominal rather than substantial and she was, therefore, treated as a volunteer.

These principles are important, and they form the backdrop against which many individuals and businesses have structured their dealings. I therefore approach any amendment to these principles with caution.

The 2019 Banking Code has introduced some additional protections for guarantors, particularly those contained in Part 7 of the Code. I consider that those developments are desirable. But the evidence received by the Commission has not persuaded me that any steps need to be taken beyond those developments.

¹⁶¹ FSRC, *Interim Report*, vol 1, 178.

¹⁶² FSRC, *Interim Report*, vol 1, 178–9.

¹⁶³ *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447.

¹⁶⁴ *Garcia v National Australia Bank Ltd* (1998) 194 CLR 395.

If the principles of general law do not prevent enforcement, if the bank has assessed the principal debtor's ability to repay according to the standard set in the 2019 Banking Code, and if no other provisions of the 2019 Banking Code stand against enforcement, then a guarantee should be enforceable according to its terms.

The issues referred to so far have all been issues about loan origination. What about loan renewal and enforcement?

5.4 Loan renewal and enforcement

Matters relating to extending the term of a loan or continuing the terms on which a loan was first made have been a potent source of disagreement between small business borrowers and banks, and a frequent cause of dissatisfaction. This is understandable. If the bank will not extend the term of a loan beyond the term originally agreed or if the bank will do that only on terms the borrower considers unfair, the borrower will often feel let down by 'his' or 'her' bank. If the borrower cannot refinance elsewhere, the loan agreement will probably be enforced and the borrower's business will fail.

Clause 86 of the 2019 Banking Code will provide, in general terms, that lenders must give three months' notice of their intention not to renew a loan to a small business borrower who is not in default. I consider that this requirement is appropriate, and that it will go some way to ameliorating the hardship demonstrated in some of the case studies that related to loan renewal and enforcement.

But I do not favour any reform beyond this. In particular, **I do not favour imposing any obligation on a lender to renew a loan or to renew it on particular terms.** There is, in my view, no sound basis for seeking to interfere in what must be the free choice of both parties to decide whether to make an agreement and, if so, on what lawful terms that agreement will be made. The risk that a term loan will not be extended, and the risk that new and different terms may be sought by the lender as the price for making a new loan agreement, must both rest with the borrower. These are risks that are inherent in any and every business venture that borrows.

5.5 Agricultural enterprises

Four states – New South Wales, Victoria, Queensland and South Australia – have legislated for farm debt mediation.¹⁶⁵ There are differences between the schemes but, essentially, each requires banks and other creditors to offer mediation to farmers before taking enforcement action against farm property, including the farm itself and farm machinery. The object is to have a neutral and independent mediator assist the farmer and the lender to reach an agreement about current and future debt arrangements. As was revealed in case studies dealt with in the *Interim Report*, farm debt mediation has too often been treated as a step that is taken only because the lender considers enforcement very probable, even inevitable, and the applicable statute requires a process of mediation before enforcement can proceed. The mediation may then be treated as no more than a step that must be taken before the lender demands and obtains an order requiring repayment of all that is owing.

Properly used, however, mediation may allow the lender and the borrower to agree upon practical measures that will, or may, lead to the borrower working out of the financial difficulties that have caused the lender to treat the loan as distressed. Ordinarily, then, **I consider that lenders should offer farm debt mediation as soon as the loan is classified as distressed. If used in conjunction with rural financial counselling services,¹⁶⁶ early farm debt mediation should allow wider and better choices for the lender and borrower about servicing, and ultimately repaying, the loan.** As indicated below, I consider that the 2019 Banking Code should be amended accordingly.

In addition to this question about the timing of farm debt mediation, however, there is a wider issue about its regulation. As mentioned, only four states have legislated for farm debt mediation (South Australia's compulsory farm debt mediation scheme having entered into force since the publication

¹⁶⁵ *Farm Debt Mediation Act 1994* (NSW); *Farm Debt Mediation Act 2011* (Vic); *Farm Business Debt Mediation Act 2017* (Qld); *Farm Debt Mediation Act 2018* (SA).

¹⁶⁶ See generally Department of Agriculture and Water Resources, *Rural Financial Counselling Service (RFCS)* (6 August 2018) Department of Agriculture and Water Resources <www.agriculture.gov.au/ag-farm-food/drought/assistance/rural-financial-counselling-service>.

of the *Interim Report*). In addition to this, Western Australia operates a voluntary scheme.

One solution to the issue of inconsistent adoption of farm debt mediation by states would be the instigation of a single national legislated scheme. There was little or no disagreement expressed in submissions to the Commission that there would be advantage to this solution.¹⁶⁷ The evident advantage of a single scheme would be that banks and other lenders would be expected to formulate nationally applicable policies and training about how best to use the scheme. And using the scheme to best advantage should result in better and more orderly resolution of the difficulties that are presented for both lender and borrower when a loan is distressed.

What about the application of Banking Code provisions to agricultural enterprises?

Many agricultural enterprises employ fewer than 100 full-time equivalent employees. If the amount of the particular facility is less than \$5 million, Mr Khoury's draft of the Banking Code would have applied the Code's small business provisions to the transaction. As I have already said, I favour the definition of small business and small business facility proposed by Mr Khoury after his detailed review of the Code and its operation.

There are, however, several respects in which I consider that applicable norms of conduct should be amended to deal with agricultural enterprises. They concern valuation of security, farm debt mediation and charging default interest.

First, I consider that Prudential Standard APS 220 should be amended to require that internal appraisals of the value of land (including, but not limited to agricultural land) be independent of loan origination, loan processing and loan decision processes. APRA has already said that it intends to revise its credit risk capital framework to effect this position.¹⁶⁸

¹⁶⁷ See, eg, ANZ, Interim Report Submission, 25 [122]; CBA, Interim Report Submission, 24 [125]; Westpac, Interim Report Submission, 46 [220]; Suncorp, Interim Report Submission, 4; ABA, Interim Report Submission, 29–30 [3.3.7]; NAB, Interim Report Submission, 33–4 [124]–[125]; ASBFEO, Interim Report Submission, 8.

¹⁶⁸ APRA, Module 4 Policy Submission, 5 [19]–[20].

Second, I consider that APRA should amend APS 220 to provide for valuation of agricultural land in a manner that will recognise, to the extent possible:

- the likelihood of external events (including, but not limited to, fire, drought and flood) affecting the land's realisable value; and
- the time that may be taken to realise the land by sale at a reasonable price affecting the land's realisable value.

Third, as further explained below, I would not stop banks providing in their loan agreements for charging of default interest (whether by fixing a rate and providing that a lower rate is 'acceptable' so long as there is no default, or by adopting some other form of provision). But I do consider that there are powerful reasons for the ABA to amend the 2019 Banking Code to provide that, while a declaration remains in force, banks will not charge default interest on loans secured by agricultural land in an area declared to be affected by drought or other natural disaster.

Natural disasters are not the only reason an agricultural loan may become distressed.

Although I would stop short of proposing any change in the law or in the Code, **I would urge banks dealing with any distressed loan to recognise and apply their own hardship policies.**

Evidence to the Commission suggested that banks may not always have done so in connection with distressed agricultural loans.¹⁶⁹

Fourth, when dealing with distressed agricultural loans, I urge banks to:

- ensure that those loans are managed by experienced agricultural bankers;
- offer farm debt mediation as soon as a loan is classified as distressed. The purpose of mediation should be to seek agreement about how to work out of existing and reasonably anticipated financial distress;

¹⁶⁹ Transcript, Ross McNaughton, 29 June 2018, 3581–3.

- manage every distressed loan on the footing that working out will be the best outcome for bank and borrower, and enforcement the worst;
- recognise that appointment of receivers or any other form of external administrator is a remedy of last resort; and
- cease charging default interest when there is no realistic prospect of recovering the amount charged.

I will say something further about the final point. Providing for the payment of default interest is, and should remain, a matter for any lender to proffer (within the limits of the law) as a term of the loan contract it offers to make. But there comes a time, especially in connection with distressed agricultural loans, when charging default interest serves no larger commercial purpose than providing a bargaining chip to be thrown onto the table by the bank even though, when played, it is a chip with no realisable value.

Recommendation 1.11 – Farm debt mediation

A national scheme of farm debt mediation should be enacted.

Recommendation 1.12 – Valuations of land

APRA should amend Prudential Standard APS 220 to:

- require that internal appraisals of the value of land taken or to be taken as security should be independent of loan origination, loan processing and loan decision processes; and
- provide for valuation of agricultural land in a manner that will recognise, to the extent possible:
 - the likelihood of external events affecting its realisable value; and
 - the time that may be taken to realise the land at a reasonable price affecting its realisable value.

Recommendation 1.13 – Charging default interest

The ABA should amend the Banking Code to provide that, while a declaration remains in force, banks will not charge default interest on loans secured by agricultural land in an area declared to be affected by drought or other natural disaster.

Recommendation 1.14 – Distressed agricultural loans

When dealing with distressed agricultural loans, banks should:

- ensure that those loans are managed by experienced agricultural bankers;
- offer farm debt mediation as soon as a loan is classified as distressed;
- manage every distressed loan on the footing that working out will be the best outcome for bank and borrower, and enforcement the worst;
- recognise that appointment of receivers or any other form of external administrator is a remedy of last resort; and
- cease charging default interest when there is no realistic prospect of recovering the amount charged.

6 Enforceability of industry codes

I deal next with the enforceability of industry codes, and I do so by reference principally to the 2019 Banking Code.

6.1 Enforcing the code

As I explained in the introduction to this Report, I consider it 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. In the 2019 Banking Code, the provisions to be applied are the promises that are made to customers (and guarantors) in the Code.

In order to explain why I have reached this view, I need to say something about the purpose of industry codes and about the model that I propose to achieve this outcome. In the following paragraphs, I focus on the 2019

Banking Code. In the chapter of this Report dealing with insurance, I will say something further about some issues that arise in connection with the three insurance codes.

6.2 The purpose of industry codes

Industry codes of practice occupy an unusual place in the prescription of generally applicable norms of behaviour. They are offered as a form of ‘self-regulation’ by which industry participants ‘set standards on how to comply with, and exceed, various aspects of the law’.¹⁷⁰ They are offered, therefore, as setting generally applicable and enforceable norms of conduct. Industry codes pose some challenge to the understanding that the fixing of generally applicable and enforceable norms of conduct is a public function to be exercised, directly or indirectly, by the legislature.

As Treasury pointed out, self-regulation through an industry code carries with it a number of limitations and difficulties:¹⁷¹

- the standards set may not be adequate;
- not all industry participants may subscribe to, and be bound by, the code;
- monitoring and enforcement of compliance with the code may be inadequate; and
- the limited consequences for breach of the code may not be enough to make industry participants correct and prevent systemic failures in its application.

I would add one point. There may now be some doubt about the extent to which obligations contained in industry codes can be relied on and enforced by individuals. The doubt arises, in part, because of the broad range of provisions contained in industry codes. Some are expressed as promises, capable of direct application to the relationship between an individual and a financial services entity. Others are not.

¹⁷⁰ Treasury, Interim Report Submission, 9 [56].

¹⁷¹ Treasury, Interim Report Submission, 9–10 [58].

Another matter to be considered is the necessarily incremental development of this area of the law through judicial decisions. Intermediate courts of appeal have held that terms contained in earlier versions of the Code are incorporated into, and form part of, the contract between bank and customer or guarantor.¹⁷² Of necessity, these decisions related to specific provisions of the Code, and were informed by the specific circumstances of the cases.

In the circumstances, there may be some uncertainty about which provisions of industry codes can be relied on, and enforced, by individuals. Uncertainty of this kind is highly undesirable. All participants in the financial services industry – including consumers – must know what rules govern their dealings. This is especially so given that rights under contracts with financial services entities are capable of being traded, assigned and subrogated. Parties to contracts, not only the immediate but also any successor parties, must know what terms govern their relationship.

Some attention has already been given to how these limitations and difficulties can be met. In its December 2017 report, the ASIC Enforcement Review Taskforce made five recommendations about industry codes in the financial sector. It recommended that:

- ASIC approval should be required for the content of and governance arrangements for relevant codes;¹⁷³
- entities should be required to subscribe to the approved codes relevant to the activities in which they are engaged;¹⁷⁴
- approved codes should be binding on and enforceable against subscribers by contractual arrangements with a code monitoring body;¹⁷⁵
- an individual customer should be able to seek appropriate redress through the subscriber's internal and **external dispute resolution**

¹⁷² *Brighton v Australia and New Zealand Banking Group Ltd* [2011] NSWCA 152; *Doggett v Commonwealth Bank of Australia* (2015) 47 VR 302; *National Australia Bank Ltd v Rose* [2016] VSCA 169.

¹⁷³ ASIC Taskforce Review, Final Report, December 2017, 33.

¹⁷⁴ ASIC Taskforce Review, Final Report, December 2017, 34.

¹⁷⁵ ASIC Taskforce Review, Final Report, December 2017, 35.

arrangements for non-compliance with an applicable approved code;¹⁷⁶ and

- the code monitoring body, comprising a mix of industry, consumer and expert members, should be required to monitor the adequacy of the code and industry compliance with it over time, and periodically report to ASIC on these matters.¹⁷⁷

Each of these recommendations is directed towards meeting difficulties of the kind identified by Treasury, and I see their force. But, as I explain below, I consider it necessary to go one step beyond what was proposed by the ASIC Enforcement Review Taskforce. As Treasury rightly said in its submissions, '[f]or codes to be meaningful rather than tokenistic, there needs to be reasonably effective mechanisms in place to ensure adherence'.¹⁷⁸ In particular, there must be adequate means to identify, correct and prevent systemic failures in applying the code. As I have said, in order to do that, some provisions of the codes should be picked up and applied as law.

Before saying more about that, I note that Treasury invited consideration of whether similar aims could be achieved by providing ASIC with rule-making powers generally similar to those given by the *Competition and Consumer Act 2010* (Cth) (the Competition and Consumer Act).¹⁷⁹ Treasury observed that adopting a model of that kind would require consideration of how wide the power would be and what accountability mechanisms or constraints would accompany it.¹⁸⁰

I do not favour pursuing this course.

As ASIC indicated in Regulatory Guide 183, which related to the approval of codes, harnessing the views and collective will of relevant industry participants is essential to the creation of an industry code.¹⁸¹ I would not

¹⁷⁶ ASIC Taskforce Review, Final Report, December 2017, 35.

¹⁷⁷ ASIC Taskforce Review, Final Report, December 2017, 35.

¹⁷⁸ Treasury, Interim Report Submission, 12 [65].

¹⁷⁹ Treasury, Interim Report Submission, 14 [76].

¹⁸⁰ Treasury, Interim Report Submission, 14 [76].

¹⁸¹ ASIC, Regulatory Guide 183, March 2013, 4 [183.1].

discard those benefits by giving ASIC the entire responsibility for creation of the kinds of norms that are now set out in the 2019 Banking Code and that have been developed and applied within significant parts of the banking sector for many years. As I explain below, 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. But it is now time to give certainty and enforceability to key code provisions that govern the terms of the contract made or to be made between the financial services entity and the customer or a guarantor.

6.3 Identifying the enforceable code provisions

In my view, the law¹⁸² should be amended to provide that breach of an enforceable code provision will constitute a breach of the law. The law should also be amended to provide for remedies that may follow from such a breach. Those remedies should be modelled on those now set out in Part VI of the Competition and Consumer Act.

I anticipate that the process of identifying and rendering enforceable the enforceable code provisions will proceed in four steps:

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

I say more about each of these steps below, but before I do, I think it important to emphasise two points.

¹⁸² The Corporations Act may be the preferable option, given that it already contains ASIC's code approval power: see s 1101A.

First, by creating a system of enforceable code provisions, I do not intend to interfere with ASIC's existing, and more general, power under section 1101A of the Corporations Act to approve industry codes. I consider that industry should continue to be given the option to seek general ASIC approval of its codes, because, as ASIC commented in Regulatory Guide 183, 'where approval by ASIC is sought and obtained, it is a signal to consumers that this is a code they can have confidence in'.¹⁸³ To that end, 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 ACL holders; and
- industry codes of conduct approved by ASIC may include 'enforceable code provisions', being provisions in respect of which a contravention will constitute a breach of the law.

Second, the model that I have proposed is intended to supplement, rather than derogate from, existing internal and external dispute resolution mechanisms provided by the relevant codes. In my view, the model is necessary because something beyond the existing mechanisms is required. Experience shows that systemic issues identified by the Financial Ombudsman Service (FOS), or revealed in the course of determining individual disputes, have not always been resolved in ways that have encouraged or secured future compliance with norms.¹⁸⁴ Entities have sometimes disagreed with the conclusions reached by the external dispute resolution body and, where they have, they may have chosen to persist in some practice that has been criticised. Problems of that kind are likely to be reduced, and perhaps even eliminated, if breaches of enforceable code provisions are made contraventions of the relevant statute, and can thereby be enforced through the courts.

Returning to the steps I have identified above, industry should identify the provisions of its codes that govern, or are intended to govern, the terms of the contract made or to be made between the financial services institution and the customer. Taking the example of the 2019 Banking Code, I anticipate that this specification will include obligations such as the obligation to engage with customers in a fair, reasonable and

¹⁸³ ASIC, Regulatory Guide 183, March 2013, 4 [183.3].

¹⁸⁴ See, eg, FSRC, *Interim Report*, vol 2, 298–302.

ethical manner (clause 10), the obligation to exercise the care and skill of a diligent and prudent banker when extending credit (clause 49) and provisions about guarantees (chapters 25–29). I say more about the nature of the task presented by the three insurance codes in the chapter dealing with insurance.

Industry should then seek ASIC's approval of the proposed enforceable code provisions. In the particular case of the 2019 Banking Code, which has already been approved by ASIC, this will require the ABA to identify for ASIC the subset of code provisions that will be 'enforceable code provisions'.

If industry did not put forward its proposed enforceable code provisions in a timely manner, consideration would have to be given to whether it is desirable to establish and impose a mandatory industry code. The process for implementing a mandatory code should be the same as the process used in respect of industry codes prescribed under the Competition and Consumer Act.¹⁸⁵ To that end, the law should be amended to provide for the establishment and imposition of mandatory financial services industry codes, so that the relevant mechanisms are in existence should they need to be exercised. Those provisions should be in a similar form to the provisions that exist in the Competition and Consumer Act, including section 51AE of that Act.

After receiving a proposal from industry, ASIC should review the proposed enforceable code provisions put forward by industry. ASIC's role must go beyond being the passive recipient of industry proposals. Rather, ASIC should assess whether industry has identified, from the provisions contained in the code, those provisions that should be made enforceable code provisions. In undertaking this task, ASIC should have particular regard to the need to ensure that all terms governing the contract made or to be made have been identified. ASIC should also assess whether the proposed enforceable code provisions are expressed clearly and unambiguously, so that they are capable of being enforced through the courts. ASIC should continue to engage with industry until any defects are remedied.

Finally, if financial services entities breach an enforceable code provision, customers and guarantors should be able to elect whether to enforce that

¹⁸⁵ See generally Treasury, *Industry Codes of Conduct: Policy Framework*, 2017, 14–15.

breach through existing internal or external dispute resolution mechanisms, or through the courts. As I have said above, to effect this outcome, the law should be amended to provide that breach of an enforceable code provision will constitute a breach of the law. The law should also be amended to provide for the remedies for a breach. The remedies should be modelled on those now set out in Part VI of the Competition and Consumer Act.

As noted above, it would be for the customer (or guarantor) to elect which path was to be taken in seeking redress. Resort to internal dispute resolution procedures would not constitute any election about future action. The enforceable code provisions should specify, however, that resort to the Australian Financial Complaints Authority, or another external dispute resolution mechanism, will be treated as an election not to pursue court remedies unless good cause is shown to the contrary. I say ‘unless good cause is shown to the contrary’ because I consider that it should ultimately be left to the court to determine whether steps taken outside that forum should lead to the preclusion of court proceedings in any particular case.

6.4 The proposed model: Codes more broadly

As noted above, in setting out this model for enforceable code provisions, I do not intend to interfere with the broader development of, or operation of, industry codes. Nor do I intend to modify or limit ASIC’s powers to approve the non-enforceable provisions of industry codes. With that said, I consider that the law should be amended to provide 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.

I draw attention to this point because I consider it important that the banking industry, and (as I will come to) the insurance industry, continue to develop their industry codes over time. I expect that the non-enforceable provisions of industry codes will continue to play an important role in setting standards of behaviour within those industries over time.

Similarly, as will be apparent from what I have said, subject to the caveat with respect to insurance that I deal with in the appropriate chapter, I do not consider that any amendment should be made to the basic structure of internal and external dispute resolution.

Recommendation 1.15 – Enforceable code provisions

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 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.

Recommendation 1.16 – 2019 Banking Code

In respect of the Banking Code that ASIC approved in 2018, the ABA and ASIC should take all necessary steps to have the provisions that govern the terms of the contract made or to be made between the bank and the customer or guarantor designated as ‘enforceable code provisions’.

7 Processing and administrative errors

7.1 Identifying processing and administrative errors

The case studies revealed numerous cases where banks charged fees or interest in amounts larger than agreed because of what were called ‘processing’ or ‘administrative’ errors. Often the errors went undetected for some time. Often identification of who had been affected and what

compensation should be paid took many months. Some of the events were examined in detail in the case studies dealt with in the *Interim Report*.¹⁸⁶

No systems for processing the numbers of transactions or variety of arrangements offered by banks will ever operate perfectly. Mistakes in enterprises as large as a bank are inevitable. In the end it is a human endeavour. Three points made in the *Interim Report* should be repeated. As I said then, and repeat, they are simple but fundamental.¹⁸⁷

First, entities should not offer to sell what they cannot deliver. And that is what has been done when an entity has offered interest rate or fee discounts but has not charged the proper rate or the proper fee because relevant accounts were not linked, or automated systems were not properly programmed to charge the right rate or fee.

Failing to charge the contractually stipulated rate or fee is evidently conduct that falls below community standards and expectations. Performing a contract according to its terms must be seen as a standard of behaviour that the community expects to be met.

Failing to charge the contractually stipulated rate or fee is also misconduct. It is a breach of duty or it is a breach of a recognised and widely adopted benchmark for conduct, or, most probably, it is both.

Further, failing to charge the correct rate or fee might also constitute a contravention of section 912A of the Corporations Act or section 47 of the NCCP Act. Those sections oblige a financial services licensee and a credit licensee respectively to do *all* things necessary to ensure that the services covered by their licences are provided efficiently, honestly and fairly. And not charging the right rate or the right fee may be, in at least many cases, not providing the relevant service 'efficiently, honestly and fairly'. Regardless of whether failing to charge the right rate and right fee is a breach of section 912A or section 47, it is, on its face, a breach of contract.

Second, the entity that sells a product should have adequate systems in place *before* the first sale is made. Selling without knowing that what

¹⁸⁶ See, eg, FSRC, *Interim Report*, vol 2, 74–82, 438–42.

¹⁸⁷ FSRC, *Interim Report*, vol 1, 66–7.

is sold can be delivered is, at best, careless of the interests of the customers to whom the product is sold. At worst, it is deceptive.

The third, and equally simple, observation to make is that, if an entity does not deliver what it has sold, the entity must remedy that default and the consequences of the default as soon as is reasonably practicable.

Once this is acknowledged, it is clear that the processing or administrative errors identified by banks called for much quicker responses than were frequently observed. One example is ANZ's prolonged processes for identifying and then compensating customers affected by failures that were first identified in 2003, too many of which were still far from complete when the Commission took evidence on the subject in March 2018.

A fourth point should be made. Often, processing or administrative errors go undetected for as long as they do because communications from the bank to the customer do not alert the customer to the need to check what has been charged, or do not permit the customer to make that check. In all but the most exceptional cases, the bank's communication will take the form it does on the assumed basis that it is accurately recording the consequences of the applicable arrangements with the customer. But if that is what the communication does convey, it may be that the communication is likely to mislead or deceive.

Banks, and other financial services entities, do not always recognise that the law relating to misleading and deceptive conduct does not depend upon intention. The relevant focus is upon the effect of the conduct in issue.

It follows that there may be occasions where so-called processing or administrative errors should be examined through the lens of the law relating to misleading and deceptive conduct. Doing that may cause entities to give better attention, before products are launched into the market, to whether their systems do support the product. Compensating customers who have not been given what was promised is very much a second-best solution.

7.2 Preventing processing and administrative errors

Recognising, as I must, that no systems for processing the numbers of transactions or variety of arrangements offered by banks will ever operate perfectly, does not mean that there is nothing to be done except sweep up the consequences after the event.

Banks *must* do more to prevent these errors. As was noted in the *Interim Report*, even confining attention to home loans, about \$239 million had been repaid to customers in respect of processing and administrative errors before the Commission began its inquiries.¹⁸⁸ And it will be recalled that other forms of processing and administrative errors were explored and are discussed in the *Interim Report*.

Mr Elliott, the CEO of ANZ, told the Commission that processing and administrative errors arose from a combination of factors.¹⁸⁹ Of those, I mention two in particular: number and complexity of products, and absence of ‘end-to-end’ accountability. Both are issues wholly within the control of every financial services entity.

It is for each bank to decide what products it will issue. It is for each bank to determine whether its administration and IT systems are set up in ways that will deliver to customers what the customers have been promised and charge them no more than is agreed. And the more numerous and more complex the bank’s offerings are, the greater the care needed to ensure that the bank can deliver what it has promised and charge only what it is entitled to charge.

The evidence led in the Commission shows that processing or administrative errors have occurred when the ‘left hand does not know what the right hand is doing’. And that has occurred because there has been no clearly identified ‘ownership’ of the overall process beginning with someone within the bank proposing a new product or product feature and culminating in the bank offering that product, or product feature to customers. There has been, in Mr Elliott’s terms, disaggregation of the management of the value chain with no-one ‘accountable from the design of the product through to its implementation and if something goes wrong, remediating it and, importantly, keeping it fit for purpose’.¹⁹⁰

Each of the tasks mentioned by Mr Elliott is fundamental to the performance of a bank’s business. So important is it that a senior executive within the bank be accountable for the bank meeting the promises it makes to customers in respect of the products it sells or issues to them,

¹⁸⁸ FSRC, *Interim Report*, vol 1, 37.

¹⁸⁹ Transcript, Shayne Elliott, 28 November 2018, 7277–8.

¹⁹⁰ Transcript, Shayne Elliott, 28 November 2018, 7278.

that I consider that it is a responsibility that should be subject to the provisions of the **Banking Executive Accountability Regime** (BEAR). There should be one person in the bank responsible for those tasks in respect of *all* the bank's products. The person having responsibility for those tasks should be an 'accountable person' under section 37BA of the *Banking Act 1959* (Cth) (the Banking Act); the ADI should have the accountability obligations specified in section 37C with respect to that person (and the accountable person, the obligations set out in section 37CA); and the key personnel of the ADI should have the obligations described in section 37D with respect to the accountable person.

To these ends, APRA should consult with at least the four largest banks about how best to describe or define, for the purposes of section 37BA(2)(b)(ii) and (4) of the Banking Act, a responsibility embracing the matters described by Mr Elliott in respect of product design, delivery, maintenance and, where necessary, remediation. Following that consultation, APRA should determine that responsibility for the purposes of section 37BA(2)(b) of the Banking Act. The consequence would be that each bank subject to the BEAR would be required to give APRA an accountability statement and an accountability map under section 37F identifying (among other things) the responsibilities of the accountable person and details of the reporting lines and lines of responsibility of the accountable person.¹⁹¹ The further consequence would be that there should no longer be that disaggregation of responsibility that has contributed to so many and such costly processing and administrative errors.

Recommendation 1.17 – BEAR product responsibility

After appropriate consultation, APRA should determine for the purposes of section 37BA(2)(b) of the Banking Act, a responsibility, within each ADI subject to the BEAR, for all steps in the design, delivery and maintenance of all products offered to customers by the ADI and any necessary remediation of customers in respect of any of those products.

¹⁹¹ Banking Act ss 37F, 37FA, 37FB.

Conclusion

This chapter has dealt with ‘traditional’ banking services. It has not dealt with issues arising in connection with financial advice, superannuation or insurance and has not considered the larger questions of culture, governance and remuneration examined in later parts of this Report.

Some changes should be made in connection with traditional banking services.

I am not persuaded that the NCCP Act’s framework for responsible lending to consumers needs change. The responsible lending issues identified during the Commission’s hearings will be resolved by banks applying the law as it stands. As I have explained, however, reform is required to other aspects of home lending: to the duties of mortgage brokers and to the remuneration structures associated with home lending. Other reforms affecting consumers are also necessary, including removing the exemption of retail dealers from the operation of the NCCP Act and several reforms to improve the accessibility of banking for all Australians.

While I do not consider that the NCCP Act should be extended to apply to lending to small businesses, some reforms are needed in this area. A number of them concern agricultural loans, including introducing a national scheme of farm debt mediation, strengthening standards for valuations and not charging default interest in certain circumstances.

The changes I recommend in relation to consumer lending and lending to small businesses are underpinned by two broader changes: one directed to improving the ways in which banking products work – by introducing a responsibility for product design, delivery and maintenance into the BEAR; and the second directed to making the promises made in the Banking Code more meaningful – by introducing statutory consequences for breaching key provisions of the Code.

An addendum: Bankwest

Chapter 5 of the *Interim Report* – Bankwest and CBA – set out my conclusions about complaints that have been made regarding CBA’s conduct in respect of customers who had borrowed from Bankwest before CBA acquired Bankwest in 2008.

I seek neither to add to, nor subtract from, what I said about those matters in the *Interim Report*.

Since the *Interim Report* was published, the Solicitor Assisting the Commission, Counsel Assisting and I have received many communications from those who see themselves as ‘victims’ of Bankwest disputing what is said in the *Interim Report*, and asking me to re-open consideration of some or all of the issues considered in the *Interim Report* and, more recently, saying how necessary it is that there be a further inquiry into their complaints.

I now will make only two points.

First, as I said in the *Interim Report*:¹⁹²

[I]t should not be surprising that the sense of individual grievance [of borrowers who suffered loss], joined with the grievances of others, should spark allegations that the lender did not act according to the lender’s judgments about the risks of continuing the loan to a particular borrower, but acted according to some overall plan that was at least improper if not unlawful. And this is what has happened with respect to CBA’s conduct in relation to the Bankwest business loan book. Borrowers, seeing that others were dealt with and affected in ways that they regard as relevantly similar, have formed the unshakeable view that CBA’s conduct towards them was wrong. They will not accept that CBA may have acted case by case, according to judgments made about each loan. Instead they seek to assign reasons for CBA’s conduct that they say show how and why the conduct was wrong.

Second, as those who now agitate for a new inquiry have said in their correspondence with the Commission, their allegations have been the central focus of many previous inquiries and, I would add, two cases in the Supreme Court of New South Wales that have gone to judgment.¹⁹³ Yet they say there should be yet another inquiry. I do not agree. Enough is enough.

¹⁹² FSRC, *Interim Report*, vol 1, 208.

¹⁹³ FSRC, *Interim Report*, vol 1, 190–3.

3. Financial advice

Introduction

Over the last decade, many Australians have sought financial advice. Over the same period, the financial advice industry has grown significantly. As at 1 April 2018, there were 25,386 financial advisers in Australia, an increase of around 41% compared with the number of financial advisers in August 2009.¹ The Productivity Commission has noted that in 2015/2016 the financial advice sector was estimated to be worth \$4.6 billion in revenue.²

Three different issues have emerged in connection with the provision of financial advice. The first is ‘fees for no service’: ongoing advice fees charged when no advice was given to the client. The second is that clients have often been given poor advice that has left them worse off than they would have been if proper advice had been given. The third is the fragmented and ineffective disciplinary system for financial advisers.

1 History

Each issue has its roots in the history of the financial advice industry. It is not possible to understand the current issues without first understanding their history – the context in which the issues arose, the decisions that contributed to them, and the fate of past attempts to resolve them.

Expressed in a single sentence, that history tells the story of an incomplete transformation – from an industry dedicated to the sale of **financial products** to a profession concerned with the provision of financial advice. I say ‘incomplete’ because I do not believe that the practice of giving financial advice is yet a profession. The general weight of the evidence

¹ Background Paper No 6 (Part A), 7.

² Background Paper No 6 (Part A), 8.

given to the Commission by those involved in the industry was to the same effect. Some said it is on the cusp;³ others were, perhaps, more cautious.⁴

Despite recognition, within the industry, that the provision of financial advice is not yet a profession, those who seek financial advice do not always appreciate this. Mrs Jacqueline McDowall, who gave evidence in the Commission's second round of hearings, had confidence in the advice that she received because she believed her financial adviser was a professional. She said:⁵

[W]e felt with his – with his professional advice, he knew what he was talking about, and we felt that, yes, we're all – we're all going there together, he's looking after us.

As in many other cases, however, that confidence was misplaced. Mrs McDowall received poor advice. By the end of her experience, Mrs McDowall said:⁶

I will never, ever trust anybody again, even if they say they're a professional this or a professional that. It's all just to gain money for their side.

Others paid fees – sometimes large amounts, over many years – for services they were never provided. The consequences for advisers who gave poor advice, or who charged fees for no service, were often inadequate.

This state of affairs shows, and is the result of, the incomplete transformation I described above.

For some time now, a financial adviser has been something between a salesperson and a professional adviser. The industry has moved from scandal to scandal, causing financial harm to clients, and damaging public confidence in the value of financial advice. This cannot continue.

³ Transcript, Michael Wright, 20 April 2018, 1444–5.

⁴ Transcript, Peter Kell, 16 April 2018, 1031.

⁵ Transcript, Jacqueline McDowall, 19 April 2018, 1363.

⁶ Transcript, Jacqueline McDowall, 19 April 2018, 1371.

But, before considering what can and should be done about it, it is necessary to look back, to see how it came about.

1.1 How did the financial advice industry emerge?

Traditionally, the business of banking comprised lending, deposit-taking and the provision of transaction services.⁷ Until the 1970s, the reach of the funds management sector – that is, entities that pool and invest money on behalf of customers – was limited. At that time, the sector was composed largely of superannuation and life insurance companies.⁸

From the 1970s, Australia began to deregulate its financial markets. Restrictions on bank interest rates and liability structures were removed; foreign banking was made easier to access; the Australian dollar was floated.⁹ The financial sector expanded. At the same time, growth in the size and liquidity of securities markets allowed more diverse financial products to develop.¹⁰

From 1983, successive changes to the tax treatment of superannuation increased the complexity of superannuation but also established it as a vehicle for compulsory saving. These developments included the incorporation of superannuation into employment awards in 1986 and legislation in 1991 imposing tax penalties where employer contributions were not made.¹¹ With greater amounts of savings invested in

⁷ Malcolm Edey and Brian Gray, 'The Evolving Structure of the Australian Financial System' (Paper presented at The Future of the Financial System Conference, H C Coombs Centre for Financial Studies, Kirribilli, 8–9 July 1996) 8–9.

⁸ Malcolm Edey and Brian Gray, 'The Evolving Structure of the Australian Financial System' (Paper presented at The Future of the Financial System Conference, H C Coombs Centre for Financial Studies, Kirribilli, 8–9 July 1996) 7.

⁹ RBA, *Submission to the Financial System Inquiry*, March 2014, 16 <http://fsi.gov.au/files/2014/04/Reserve_Bank_of_Australia.pdf>.

¹⁰ Malcolm Edey and Brian Gray, 'The Evolving Structure of the Australian Financial System' (Paper presented at The Future of the Financial System Conference, H C Coombs Centre for Financial Studies, Kirribilli, 8–9 July 1996) 17–20.

¹¹ Malcolm Edey and Brian Gray, 'The Evolving Structure of the Australian Financial System' (Paper presented at The Future of the financial System Conference, H C Coombs Centre for Financial Studies, Kirribilli, 8–9 July 1996) 35.

superannuation funds, Australians had a far higher exposure to capital markets, and increasingly began to seek financial advice.

Before the early 1980s, Australians who required financial advice often went to their bankers, brokers, accountants and insurance advisers.¹² As the market for superannuation and investment products grew, the life insurance companies and other financial institutions that manufactured financial products looked to financial advisers to sell them.¹³ At that time, most financial advisers came from a background of life insurance, in which a sales-driven, commission-based culture prevailed and comprehensive advice was not commonly sought or given.¹⁴ These were the roots of today's financial advice industry, and the culture has endured.

The 1990s brought even more of the Australian public into the market for financial products and services, and therefore advice.¹⁵ A series of privatisations (such as CBA, Telstra and Qantas) and demutualisations (such as AMP and NRMA Insurance)¹⁶ increased share ownership. Further deregulation of the financial sector contributed to a surge in credit provision and the design of new and more complex financial products. These developments in combination with the prevailing low interest rates raised household indebtedness and increased the value of market-linked financial assets that households held.¹⁷

It was in the 1990s that banks began their expansion into wealth management.

¹² Janet Cowan, William Blair and Sharon Taylor, 'Personal Financial Planning Education in Australian Universities' (2006) 15 *Financial Services Review* 43, 46.

¹³ Robert Brown, 'Reinventing Financial Planning' (2008) 3(1) *Australian Journal of Financial Planning* 17, 20.

¹⁴ Robert Brown, 'Reinventing Financial Planning' (2008) 3(1) *Australian Journal of Financial Planning* 17, 20.

¹⁵ Background Paper No 7, 5.

¹⁶ See also ASX, *The Australian Share Ownership Study* (2014) 26–7 <www.asx.com.au/documents/resources/australian-share-ownership-study-2014.pdf>.

¹⁷ Marianne Gizycki and Philip Lowe, 'The Australian Financial System in the 1990s' (Paper presented at The Australian Economy in the 1990s Conference, H C Coombs Centre for Financial Studies, Kirribilli, 24–5 July 2000) 187.

1.2 Development of the regulatory framework

The regulatory framework that governs financial advice and product sales today was designed in response to, and in the midst of, these changes. A number of design decisions should be noted for their part in shaping the financial advice industry as it is today.

The 1997 Financial System Inquiry chaired by Mr Stan Wallis (the Wallis Inquiry) reviewed the then fragmented regulation of the financial system and recommended that there be a 'consistent and comprehensive disclosure regime' administered by a single regulator.¹⁸ The adoption of this model marked the start of the uniform treatment of traditional intermediary services and of financial sales and advice relating to funds management. In 1998, the Australian Securities and Investments Commission (ASIC) was established, combining the responsibilities of the then Australian Securities Commission and the Insurance and Superannuation Commission.¹⁹

In April 1997, Treasury released its Corporate Law Economic Reform Program Paper No 6 (CLERP 6). Although extensive amendments have been made to the legislation passed to implement CLERP 6, a number of its underlying principles have endured. One of those principles was to fold sales and advice relating to insurance and superannuation into the regulation of securities.²⁰ That regulatory framework was premised on independent intermediation and the use of mandatory disclosure as a means of investor protection.²¹ It did not take into account that insurance and superannuation decisions were usually made with consumption (a payment in case of injury; an income stream at retirement) rather than investment in mind, or that those products were usually sold by sales agents and not independent brokers such as those who traded in securities.²²

Another key principle in CLERP 6 was to regulate intermediaries (including advisers) at firm level rather than at the individual level, in part to allow

¹⁸ Wallis Inquiry, Final Report, 17.

¹⁹ Background Paper No 7, 6.

²⁰ See Treasury, *Corporate Law Economic Reform Program – Proposals for Reform: Paper No 6*, April 1997, 1, Proposal 1.

²¹ Background Paper No 7, 8.

²² Background Paper No 7, 8.

ASIC to target its resources efficiently.²³ Thus, under the *Corporations Act 2001* (Cth) (the Corporations Act), individual advisers do not hold licences. The licensed entity is commonly the relevant **financial services entity** and individual advisers act as authorised representatives of the licensed entity. The firm has a statutory obligation to ensure that its authorised representatives comply with financial services laws.

Importantly, CLERP 6 did not provide that financial advisers were to be independent from product issuers. It is not clear whether the authors considered the possibility that financial advisers may be employed or authorised by issuers of products about which they advise, a situation that is now widespread. Nor did CLERP 6 engage with the fiduciary duties or other general law obligations that may attach to financial advisers but conflict with their employment conditions. The financial advice industry is still caught in this structural link between product issuers and the adviser's legal obligation to act in the best interests of the client.²⁴

Finally, CLERP 6 established that household access to wholesale markets and complex products would not be restricted.²⁵ Rather, it relied on mandatory pre-disclosure as the means to inform consumers about risks on the basis that consumers would then make informed and rational choices about the best investment strategies for them. That meant leveraged and complex investments could be marketed and sold in the retail market.²⁶

1.3 Vertical integration

The Wallis Inquiry reflected the prevailing conditions of deregulation and globalisation, which produced a sense that financial markets would displace banks from their core functions and cause financial service providers to specialise and disaggregate.²⁷ It expected that this rise in competition would eliminate mispricing of financial products and services, create efficiencies in the system and ultimately produce lower costs for consumers.²⁸ The RBA

²³ Background Paper No 7, 9–10.

²⁴ Background Paper No 7, 10.

²⁵ Background Paper No 7, 10–11.

²⁶ Background Paper No 7, 10–11.

²⁷ RBA, *Submission to the Financial System Inquiry*, March 2014, 14.

²⁸ See Wallis Inquiry, Final Report, Ch 4.

has said that the Wallis Inquiry underestimated banks' capacity to expand and acquire businesses along their supply chains.²⁹

From the time of the Wallis Inquiry, banks' accumulation of wealth management businesses accelerated. During the late 1990s and early 2000s, each of the major banks acquired or merged with a fund manager.

- In 2000, CBA acquired Colonial Mutual Life Assurance Ltd,³⁰ which conducted life and other insurance businesses, and a funds management business.
- In 2000, NAB acquired the financial services businesses of Lend Lease, including MLC Holdings Ltd.³¹
- In 2002, ANZ entered joint venture arrangements with ING Group in respect of wealth management and life insurance businesses in Australia and New Zealand,³² and later acquired the full business.
- In 1999, Westpac founded Magnitude Group Pty Ltd. In 2002, Westpac acquired all of BT Financial Group's asset accumulation businesses.³³ And in 2008, as part of its merger with St George Bank Ltd, Westpac acquired St George's financial advice business, which included employed advisers as well as Securitor Financial Group Ltd.

The **vertical integration** of product manufacture with product sale and financial advice is a 'one stop shop' vision in which retail customers' investment needs can be provided alongside traditional banking facilities such as loan and deposit services. Vertical integration has seen the acquisition by entities of a number, or all, of the steps in supply of financial products to consumers, starting with designing and creating the product,

²⁹ RBA, *Submission to the Financial System Inquiry*, March 2014, 14.

³⁰ CBA, 'Intention to Merge with Colonial' (ASX Announcement, 10 March 2000).

³¹ Lend Lease, 'LLC Ann: Sale of MLC Businesses to NAB Uncon Settlement 30/6' (ASX Announcement, 27 June 2000).

³² ANZ, 'ANZ & ING Complete Funds Management and Life Insurance JV' (ASX Announcement, 30 April 2002).

³³ Westpac, 'Westpac Completes BT Financial Group Transaction' (ASX Announcement, 31 October 2002).

providing asset management services and investment platforms, and engaging in distribution to customers by way of financial advice or sales.³⁴

From the perspective of banks, vertical integration always promised the benefit of cross-selling opportunities (the opportunities for cross-selling financial products to existing and new customers).³⁵ Vertical integration also promises the virtue of efficiency, which is then passed on to consumers in the form of lower costs and greater access to financial advice.³⁶ Customers may also enjoy the simplicity of dealing with just one institution.³⁷ However the internal efficiency of the 'one stop shop' does not necessarily produce efficiency in outcomes for customers. The 'one stop shop' model creates a bias towards promoting the owner's products above others, even where they may not be ideal for the consumer.³⁸

By the time of the Final Report of the Financial System Inquiry in 2014 (the Murray Inquiry), the 'one stop shop' model was well established in the market. The Murray Inquiry report observed that the high concentration of and steadily increasing vertical integration in some sectors had the potential to limit the benefits of competition in the future.³⁹ While the report did not express a view as to the merits of vertical integration, the Murray Inquiry recommended ways in which to make ownership and alignment

³⁴ See generally Productivity Commission, Report 89, 29 June 2018, ch 9.

³⁵ See, eg, Theodore Golat, 'Banks' Wealth Management Activities in Australia', *Reserve Bank Bulletin* (2016) September Quarter, 53, 54–6.

³⁶ See Transcript, Michael Wilkins, 28 November 2018, 7242. Mr Wilkins said that vertical integration provides a number of advantages, particularly in respect of 'affordability of advice', in that 'the administration of advice networks can have its fixed costs spread over a broader cost base'. See also Productivity Commission, Report 89, 29 June 2018, 249–50.

³⁷ See Transcript, Brian Hartzler, 21 November 2018, 6832. Mr Hartzler considered that Westpac owning advice licensees, and being able to provide financial advice, was part of Westpac providing systems that 'make it convenient for people to manage their banking and their investments all in one place', which would 'help make [Westpac] a more attractive bank for people to be with'.

³⁸ Productivity Commission, Report 89, 29 June 2018, 85, quoting Choice, *Competition in the Australian Financial System: Submission to the Productivity Commission*, September 2017, 30; ASIC, Report 562, 1 January 2018, 16.

³⁹ Murray Inquiry, Final Report, 255–6.

more transparent.⁴⁰ It did, however, note that the Global Financial Crisis (GFC) had exposed ‘significant numbers of Australian consumers holding financial products that did not suit their needs and circumstances’ and that there were ‘significant problems relat[ing] to shortcomings in disclosure and financial advice’.⁴¹

1.4 Early scandals

Scandals dating back to the GFC began to shed light on the conflicts and culture in the financial advice industry. Regulatory responses, however, focused on the remediation of specific instances of poor advice, rather than seeking to identify root causes within institutions and the industry. Those responses set the tone for future approaches to misconduct by financial advisers, that is, to compensate customers according to arrangements negotiated with ASIC while requiring few changes to the business itself.

1.4.1 Storm Financial

Shortly before the second half of 2008, Storm Financial was a profitable company with \$77 million in annual revenue and \$120 million in consolidated gross assets.⁴²

The business model of Storm Financial was to provide advice in standard or template form, with minimal tailoring to the investor.⁴³ Almost 90% of Storm’s clients were encouraged to take out loans against the equity in their own homes, to obtain a margin loan and use the funds from these loans to invest in the share market via index funds.⁴⁴ In late 2008 and early 2009, many clients of Storm Financial were in negative equity positions, sustaining significant losses.⁴⁵

⁴⁰ Murray Inquiry, Final Report, 271–2.

⁴¹ Murray Inquiry, Final Report, 27.

⁴² *ASIC v Cassimatis (No 8)* (2016) 336 ALR 209, 1023 [1].
See also *ASIC v Cassimatis (No 9)* [2018] FCA 385, [6].

⁴³ *ASIC v Cassimatis (No 8)* (2016) 336 ALR 209, 1023 [9].

⁴⁴ See *ASIC v Cassimatis (No 8)* (2016) 336 ALR 209, 1023 [9];
ASIC, Media Release 18-081MR, 22 March 2018.

⁴⁵ ASIC, Media Release 18-081MR, 22 March 2018.

Many investors lost their investment, their homes and their life savings and still had significant debts outstanding. ASIC estimated the total loss suffered by investors who borrowed to invest through Storm was about \$830 million.⁴⁶

In December 2008, ASIC commenced an investigation into Storm Financial.⁴⁷ In early 2009, Storm Financial was placed into voluntary administration and liquidators were subsequently appointed.

ASIC commenced a number of legal proceedings in relation to the Storm Financial scandal including proceedings alleging that the directors of Storm Financial had breached their duties as directors and that Storm Financial had provided inappropriate advice.⁴⁸ In March 2018, the Federal Court imposed a penalty of \$70,000 (from a maximum penalty of \$200,000) on each of the directors of Storm Financial and ordered that each be disqualified from managing corporations for seven years.⁴⁹

ASIC also entered into settlement agreements with various institutions to provide compensation for losses suffered:

- In 2012, ASIC entered into a settlement agreement with CBA to make available up to \$136 million as compensation to CBA customers who had borrowed from the bank to invest through Storm Financial.⁵⁰ CBA had already provided approximately \$132 million to Storm Financial investors under its resolution scheme.⁵¹
- In 2013, ASIC intervened in a class action brought against Macquarie Bank in respect of Storm Financial regarding the fairness of settlement arrangements. The Full Federal Court held that the distribution of the

⁴⁶ ASIC, Media Release 12-227MR, 14 September 2012.

⁴⁷ ASIC, *ASIC Investigation Background* (28 October 2016) ASIC <<https://storm.asic.gov.au/proceedings/summary-of-asic-actions/asic-investigation-background/>>.

⁴⁸ ASIC, *Summary of ASIC Actions: Civil Penalty Proceedings against the Cassimatises* (28 October 2016) ASIC <<http://storm.asic.gov.au/proceedings/summary-of-asic-actions/>>.

⁴⁹ ASIC, Media Release 18-081MR, 22 March 2018. See also *ASIC v Cassimatis (No 9)* [2018] FCA 385, [98], [106].

⁵⁰ ASIC, Media Release 12-227MR, 14 September 2012.

⁵¹ ASIC, Media Release 12-227MR, 14 September 2012.

settlement sum was not fair and reasonable to all group members and a revised settlement arrangement was made. Macquarie agreed to pay \$82.5 million by way of compensation and costs.⁵²

- In 2014, ASIC made a settlement agreement with the Bank of Queensland. BOQ agreed to pay approximately \$17 million as compensation for losses suffered on investments made through Storm Financial.⁵³

1.4.2 Commonwealth Financial Planning (CFPL)

In 2010, a whistleblower raised with ASIC allegations of misconduct by financial advisers employed by CFPL, a subsidiary of CBA.⁵⁴ The allegations included that certain CBA financial advisers were advising clients to invest in profit-generating but high risk products that were not appropriate for them, switching products without the relevant client's permission and forging clients' signatures on documents.

As a result, when the GFC occurred, thousands of clients of CFPL, many of whom were nearing retirement or had already retired, lost millions of dollars.

CBA paid more than \$20 million in compensation to clients who had received inappropriate financial advice from two CFPL financial advisers (Mr Don Nguyen and Mr Anthony Awkar).⁵⁵

It later became apparent, however, that the misconduct extended beyond these two advisers and CBA subsequently implemented a second compensation program.⁵⁶

⁵² ASIC, Media Release 13-214MR, 12 August 2013.

⁵³ ASIC, Media Release 14-244MR, 22 September 2014.

⁵⁴ Simon Hoyle, 'For CBA He Was the Wrong Guy in the Wrong Place at the Wrong Time', Professional Planner (online), 4 July 2014 <www.professionalplanner.com.au/featured-posts/2014/07/04/striking-a-blow-29119/>; Jeff Morris, 'I Gift Wrapped Commonwealth Bank for ASIC and It Did Nothing', The Sydney Morning Herald (online), 27 April 2018 <www.smh.com.au/business/banking-and-finance/i-gift-wrapped-commonwealth-bank-for-asic-and-it-did-nothing-20180427-p4zbyk.html>.

⁵⁵ Exhibit 2.277, Undated, Updated CFP Board Pack, 182–5; see also ASIC, Report 431, 23 April 2015, 27, 52.

⁵⁶ ASIC, Report 431, 23 April 2015, 6.

In October 2011, ASIC accepted an **enforceable undertaking** (EU) from CFPL that required CFPL to review the advice given to clients by an additional 16 advisers, and pay to clients any compensation arising from that review. Three additional CFPL advisers and six advisers from another CBA advice arm, Financial Wisdom Limited, were subsequently identified as also having provided inappropriate advice and CBA paid compensation to those clients who had been affected by it.⁵⁷

In 2013, Australian media reported misconduct by financial planners at CFPL, a systematic cover up by management, and inadequate offers of compensation to complaining customers.⁵⁸

In July 2014, CBA commenced the Open Advice Review Program. The program was open to those who had been customers of CFPL and Financial Wisdom between 1 September 2003 and 1 July 2012. The program has offered a total of \$37.6 million in compensation to customers.⁵⁹

1.5 The FoFA reforms

As noted above, several financial product and financial services providers had collapsed during or after the GFC. The losses had been large and many consumers had been affected. Reforms, known as the **Future of Financial Advice** (FoFA) reforms, were proposed. The reforms were properly seen as radical alterations to the regulation of the financial advice industry that had emerged and developed in the decade or so that preceded their enactment.

The 2012 FoFA reforms⁶⁰ had three principal elements:

⁵⁷ ASIC, Report 431, 23 April 2015, 6–7.

⁵⁸ Adele Ferguson and Chris Vedelago, 'Targets, Bonuses, Trips – Inside the CBA Boiler Room,' *The Sydney Morning Herald* (online), 22 June 2013 <www.smh.com.au/business/banking-and-finance/targets-bonuses-trips-inside-the-cba-boiler-room-20130621-2oo9w.html#ixzz3ls7bmVx0>; quoted in Adam Steen, Dianne McGrath and Alfred Wong, 'Market Failure, Regulation and Education of Financial Advisors' (2016) 10(1) *Australasian Accounting, Business and Finance Journal* 4, 9.

⁵⁹ CBA, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Submission*, 29 January 2018, 10 [33].

⁶⁰ Effected by the *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth); *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth).

- the imposition of a best interests obligation on financial advisers giving personal advice to retail clients;
- a ban on **conflicted remuneration**; and
- measures intended to promote greater transparency in the charging of fees for advice by requiring consumer agreement to ongoing fees, and enhanced disclosure of fees and the services associated with ongoing fees.

Further changes were made in 2014 and 2015.⁶¹

The content and extent of changes to be made in 2012, and later in 2014 and 2015, were contested. Before the introduction of the legislation that was enacted in 2012, the Government established a ‘Peak Consultation Group’ drawn from bodies as diverse as the Association of Financial Advisers (AFA), the Australian Bankers’ Association (ABA), CHOICE, Industry Super Australia and the Property Council of Australia. For about 12 months before the legislation was enacted, this group met each month to discuss the proposals. It is, therefore, not surprising that the resulting provisions show signs of compromise and accommodation of widely divergent interests.

In the *Interim Report*, I focused on two of those compromises. The first was that conflicts of interest between adviser and client should be permitted to remain but be ‘managed’. The second was that some forms of conflicted remuneration were, and still are, allowed to continue. Both of those compromises lie at the heart of the issue that I will deal with in the third section of this chapter – the provision of poor advice – and I will return to them there.

It is convenient, however, to say something about another consequence of the FoFA reforms.

In many ways, the FoFA reforms represented an important step towards making financial advice a profession. Putting to one side the ‘safe harbour’ provision in section 961B(2), to which I will return later in this chapter, the FoFA reform introduced statutory requirements for financial advisers

⁶¹ Corporations Amendment (Revising Future of Financial Advice) Regulation 2014 (Cth); Corporations Amendment (Financial Advice) Regulation 2015 (Cth); *Corporations Amendment (Financial Advice Measures) Act 2016* (Cth).

to act in the best interests of their clients,⁶² and to prioritise the interests of their clients over the interests of product issuers and **Australian financial services licence (AFSL)** holders.⁶³

Perhaps more significantly, the FoFA reforms required the financial advice industry to make a fundamental change to the way advisers were remunerated. Before the introduction of those reforms, a significant source of revenue for financial advisers was commissions on the products they recommended. As in the case of **mortgage brokers**, financial advisers commonly received a combination of upfront and **trail commissions**: upfront commissions when the product was sold, and trail commissions in subsequent years.

While the compromises made in the FoFA reforms allowed advisers to continue to receive many of those commissions – most notably, trail commissions on products purchased before 1 July 2013, and upfront and trail commissions on many life insurance products – the ban on conflicted remuneration played an important role in shifting the financial advice industry from a commission-based model to a fee-for-service model.

Unlike many other service industries that operate on a fee-for-service model, much of the financial advice industry did not choose to structure its fee arrangements on the basis that a client would pay a fixed fee or an hourly fee for the time spent by an adviser in preparing advice for the client. Rather, in what appears to have been an attempt to replicate the revenue stream that flowed from a combination of upfront and trail commissions, many advisers charged an upfront fee for preparation of a statement of advice, and encouraged clients to enter into an ‘ongoing fee arrangement’, under which the adviser would charge an ongoing fee in exchange for particular services.

Of course, 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. This shift – from a model that imposed no ongoing obligations on a financial adviser to a model that did impose such obligations – lies at the heart of the ‘fees for no service’ matter, which I will take up in the next section of this chapter.

⁶² Corporations Act s 961B(1).

⁶³ Corporations Act s 961J(1).

1.6 More recent developments

Before I turn to that matter, it remains to say something briefly about more recent developments.

In February 2017, the Government announced changes designed to lift the professional, education and ethical standards of financial advisers.⁶⁴ The changes include compulsory education requirements, supervision for new advisers, a code of ethics for the industry, an industry exam and ongoing annual professional development obligations. Details regarding these changes (as at April 2018) were set out in Part B of the Commission's sixth published Background Paper.⁶⁵

A new Commonwealth standard setting body, the Financial Adviser Standards and Ethics Authority (FASEA), was established in 2017 to develop these requirements and govern the professional standing of the financial advice sector.⁶⁶ FASEA will develop the new code of ethics, and professional organisations will be able to apply to ASIC for approval as code monitoring bodies. All advisers will be required to subscribe to the code of ethics of a monitoring body by 1 January 2020.⁶⁷

Other requirements commenced on 1 January 2019.⁶⁸ From that date, new advisers are required to hold a relevant degree before they are eligible to sit the exam and commence a year of supervised work and training.⁶⁹ Existing advisers have two years to pass the exam (by 1 January 2021) and five years to reach a standard equivalent to a degree (by 1 January 2024).⁷⁰

⁶⁴ The Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Higher Standards for Financial Advisers to Commence' (Media Release, 9 February 2017).

⁶⁵ Background Paper No 6 (Part B), 8–12.

⁶⁶ See generally Treasury, *Financial Adviser Standards and Ethics Authority Limited (FASEA)* <<https://treasury.gov.au/programs-and-initiatives-banking-and-finance/financial-adviser-standards-and-ethics-authority-limited-fasea/>>.

⁶⁷ Treasury, Module 2 Policy Submission, 15.

⁶⁸ See generally ASIC, *Professional Standards for Financial Advisers – Reforms* (17 June 2018) <<http://asic.gov.au/regulatory-resources/financial-services/professional-standards-for-financial-advisers-reforms/>>.

⁶⁹ See, generally, Corporations Act Ch 7 Pt 7.6 Div 8A.

⁷⁰ See, generally, Corporations Act Ch 10 Pt 10.23A.

Some entities moved to implement these new standards sooner. For example, on 7 May 2018, ANZ announced it would begin implementing a range of initiatives to ‘help improve the quality of financial planning, and customer remediation when things go wrong’.⁷¹ One of those initiatives was that ANZ will ‘[o]nly employ new planners with a relevant undergraduate degree and industry certification, and require existing planners to be enrolled in further necessary training by January 2019’.⁷²

1.7 Further Observations

The proposed changes to lift the professional, education and ethical standards of financial advisers represent a further important step towards making financial advice a profession. Once these changes have taken effect, it may be possible to ask again whether the financial advice industry has truly changed from an industry dedicated to the sale of financial products to a profession concerned with the provision of financial advice.

But, in my view, without more being done, the answer will be ‘no’.

In the next three sections of this chapter, I deal with three matters that will need to be addressed before the provision of financial advice can truly be regarded as a profession.

First is the charging of ‘fees for no service’. As I said in the *Interim Report*, charging for what you do not do is dishonest. Although this should have been obvious to everyone, the practice of charging ‘fees for no service’ has been endemic in the financial advice industry. **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.**

⁷¹ ANZ, ‘ANZ Unveils Plan to Improve Financial Planning’ (Media Release, 7 May 2018).

⁷² ANZ, ‘ANZ Unveils Plan to Improve Financial Planning’ (Media Release, 7 May 2018).

Second is poor advice – which, too often, is the result of **the conflicts of interest that continue to characterise the financial advice industry**. Other professions are not so pervaded by conflicts of interest and do not have such a high tolerance for the continued existence of conflicts of interest. 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.**

Third is the disciplinary system for financial advisers. **One hallmark of a profession is the existence of a credible and coherent system of professional discipline where the ultimate sanction is expulsion from the profession.** While ASIC now has the power to ban financial advisers from providing financial services, **the existing disciplinary arrangements for financial advisers are fragmented, and hampered by inadequate sharing of information.**

Making financial advice a profession is important not merely for its own sake. It is a necessary step to protect those who seek financial advice. As I said above, clients place their trust in advisers on the basis that they will behave like professionals.

Two different solutions present themselves. The first is to have advisers act as salespeople, and be clearly identified as such. The second is to have advisers act as professionals. Past reforms have favoured this second course, and it is now too late to undo those reforms. Even if it were not too late, it is the course that I favour. Leaving the sale of complex financial products entirely to intermediaries who have no obligation to act in the interests of customers is likely only to lead to further poor outcomes for consumers of financial products. It will also leave Australians without access to financial advice. While finishing the transformation of financial advice to a profession will take time and effort, it is not impossible.

I therefore turn to consider the three matters that I believe will need to be addressed before the provision of financial advice can truly be regarded as a profession.

2 Fees for no service

Introduction

When a client consulted a financial adviser, the agreement made between them often said that the adviser would provide the client with certain services in exchange for an ongoing fee. The services to be provided under those arrangements were often so loosely defined that they had little or no substantive content beyond a promise to speak to the client (sometimes to *offer* to speak to the client) once each year.⁷³

Some superannuation funds charged members fees for providing the member with ‘access’ to advice (described in one case as ‘ongoing general support services’⁷⁴) from a nominated adviser. The member may have played no part in negotiating for provision of the service.⁷⁵

It is now clear that over the last decade many who sought and obtained advice from a financial adviser, and many members of superannuation funds, were charged ongoing fees for services that were not provided. The fees were charged ‘invisibly’, in that they were deducted from consumers’ investment accounts, often enough their superannuation accounts.

The total amounts taken were very large. By August 2018, AFSL holders, including entities wholly owned by AMP and by the major banks, had paid clients about \$260 million in compensation for the money that had been taken, together with interest on the amount of earnings lost.⁷⁶ At that time, the total amount paid and to be paid as compensation was estimated to be about \$850 million – but the then Deputy Chair of ASIC said that he

⁷³ FSRC, *Interim Report*, vol 1, 128.

⁷⁴ The MasterKey Business Super plan of which MLC Nominees Pty Limited was trustee and NULIS Nominees (Australia) Ltd became trustee. See Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [13].

⁷⁵ For example, the ‘employer service fee’ charged to members of the MasterKey Business Super (MKBS) plan was deducted from member accounts of MKBS where the *employer* and the adviser had agreed that the fee would be charged. See Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [13].

⁷⁶ Transcript, Peter Kell, 17 August 2018, 5254–5.

‘wouldn’t at all be surprised if it ends up being in excess of a billion dollars’.⁷⁷ Evidence given during the seventh round of hearings supported that prediction. By the time of those hearings:

- the amount that AMP expected to pay was \$359.7 million,⁷⁸ of a total amount of approximately \$1 billion received by AMP in ongoing service fees in the 10 year period between 2008 to 2017;⁷⁹
- CBA had paid a total of approximately \$116 million in remediation for its ‘fees for no service’ conduct;⁸⁰ and
- Westpac estimated that, for its salaried advisers, across both 2017 and 2018, \$117 million would be paid.⁸¹ Westpac had not then made a provision in its accounts for remediation of amounts received by its authorised representatives.⁸²

The fees were deducted automatically from clients’ accounts. Many licensees did not keep records that would allow them to determine whether the promised services were delivered. Some licensees kept records that showed that the adviser formerly ‘linked’ with the client was no longer linked with that client. The client may have terminated the relationship with the adviser; the adviser may have left the advice licensee; the client may no longer have been an eligible member of the relevant superannuation fund to seek advice from the nominated adviser; the client may have died. There could be, and there were, many reasons why the records of the licensee showed that the client could not (and therefore would not) receive the promised services.

But in all these kinds of case, advice licensees charged clients’ investment accounts with ongoing fees. The fees were charged in many cases without the licensee asking, or knowing, whether services had been provided, and

⁷⁷ Transcript, Peter Kell, 17 August 2018, 5254–5.

⁷⁸ Transcript, Michael Wilkins, 27 November 2018, 7192; Exhibit 7.112, Witness statement of Michael Wilkins, 21 November 2018, 22.

⁷⁹ Transcript, Michael Wilkins, 27 November 2018, 7199.

⁸⁰ Transcript, Matthew Comyn, 20 November 2018, 6677.

⁸¹ Transcript, Brian Hartzer, 21 November 2018, 6836.

⁸² Transcript, Brian Hartzer, 21 November 2018, 6838.

even in many cases where the licensee's records showed that the promised services could not possibly be delivered. And, in cases where there was no 'linked adviser', the licensee kept the fees for itself.

Several questions arise from clients having been charged ongoing fees for services that were not provided:

- How and why did these events occur?
- What has been the response to these events?
- Has that response been adequate?
- What changes are necessary to ensure these events do not occur again?

I will consider each of those questions in turn.

2.1 How and why did these events occur?

In the *Interim Report*, I identified several considerations that pointed towards the conclusion that the root cause of the fees for no service conduct was greed: greed by licensees, and greed by advisers.

The evidence that emerged in later rounds of the Commission's hearings only served to reinforce that conclusion.

However, expressed at that level of generality, the identification of the root cause provides little guidance about whether the responses that have been made are adequate, or about what changes should be made to ensure that these events do not occur again.

It is therefore appropriate that I say something further about the causes of the fees for no service conduct.

Before doing so, it is important to notice that, as the proceedings of the Commission continued, and the nature and extent of the fees for no service conduct became more evident, it seemed to me that some sought to deflect attention away from whether the conduct was dishonest. There began to emerge a narrative, reflected even in the evidence of Mr Wayne Byres, Chair of the Australian Prudential Regulation Authority (APRA), that fees for no service was all just a series of careless mistakes capable of being swept aside as 'processing errors'.

This explanation was advanced by Mr Andrew Thorburn, CEO of NAB. He sought to portray the charging of fees for no service as a product of poor systems and carelessness. It was, in his words, ‘just professional negligence’.⁸³ And Mr Byres said, in his statement, that ‘in many cases the fees for no service issue was in large part a product of poor IT infrastructure ... [and] legacy system issues’.⁸⁴

I cannot and do not accept this.

As I put to Mr Thorburn, his proposition was that ‘this money fell into the pocket of NAB accidentally’.⁸⁵ Mr Thorburn’s frank, and inevitable response was ‘I can’t disagree with that ... it wasn’t intended to be ours but it became ours’.⁸⁶ The amounts of money that just ‘fell into the pocket’ of so many large and sophisticated financial entities, the number of times it happened, and the many years over which it happened, show that it cannot be swept aside as no more than bumbling incompetence or the product of poor computer systems. I say more about these matters when considering whether the responses to fees for no service have been adequate.

In identifying the causes of the conduct, the observations made by ASIC in its October 2016 report provide a useful starting point. In that report, ASIC observed that during the time fees were being charged for no service:

- the financial advice industry had a culture of reliance on automatic periodic payments such as sales commissions and adviser service fees;
- some advice licensees prioritised advice revenue and fee generation over ensuring that they delivered the required services;
- some licensees and advisers did not keep adequate records to enable monitoring and analysis; and

⁸³ Transcript, Andrew Thorburn, 26 November 2018, 7073.

⁸⁴ Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, 91 [363]; Transcript, Wayne Byres, 30 November 2018, 7475.

⁸⁵ Transcript, Andrew Thorburn, 26 November 2018, 7070.

⁸⁶ Transcript, Andrew Thorburn, 26 November 2018, 7070.

- some licensees did not develop and enforce effective monitoring and checking procedures to prevent systemic failures.⁸⁷

No doubt these observations were then, and remain, accurate. But, as I said in the *Interim Report*, they are observations that do not go far beyond the proposition that fees were charged for no service. Points made in the *Interim Report* should be repeated.

The first is obvious. Charging for what you do not do is wrong. No doubt, as Mr Anthony Regan – then AMP’s Group Executive, Advice and New Zealand – pointed out, fees were charged for no service during a period that saw great legal and regulatory change.⁸⁸ But contrary to Mr Regan’s evidence, neither the pace nor the extent of regulatory change made any contribution to the occurrence of these events. As Mr Regan himself accepted, charging fees for no service is obviously wrong.⁸⁹

Since Mr Regan’s evidence, others have also recognised that this conduct is wrong. In his evidence in the seventh round of hearings, Mr Matthew Comyn, CEO of CBA, accepted that charging fees for no service reflected not only an unacceptable culture and lack of professional conduct among CBA’s advisers, but an unacceptable culture on the part of managers.⁹⁰ Mr Thorburn said that retaining fees charged for a service when NAB did not provide that service was ‘absolutely wrong’.⁹¹ Mr Thorburn accepted that where a financial adviser charges and retains fees to a client for services they know they have not provided, that is dishonest conduct.⁹² (As explained above, Mr Thorburn sought to assert that no-one *knew* this was happening. The money just kept ‘falling into NAB’s pocket’.)

Second, and equally obviously, making an ongoing fee arrangement gives the adviser a financial advantage. The adviser stands to earn, and to continue to earn, annual amounts from the client. The less the adviser does before the fee is paid, the greater the financial advantage.

⁸⁷ ASIC, Report 499, 27 October 2016, 8.

⁸⁸ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, 54 [291].

⁸⁹ Transcript, Anthony Regan, 16 April 2018, 1072–3.

⁹⁰ Transcript, Matthew Comyn, 20 November 2018, 6679.

⁹¹ Transcript, Andrew Thorburn, 26 November 2018, 7067–8.

⁹² Transcript, Andrew Thorburn, 26 November 2018, 7073.

And, as ASIC noted in its 2016 report, licensees did not have systems in place to ensure that *any* services were provided in return for the fees being charged. Licensees did, however, have systems in place that recorded incoming revenue.⁹³

Third, licensees did nothing to prevent advisers having more customers on their books than they could monitor or advise annually. Often, the advisers had ‘acquired’ (or ‘inherited’) those clients from some other adviser.⁹⁴ And licensees such as AMP and its associated entities, that have provided, and continue to provide, ‘**buyer of last resort**’ arrangements for advisers who wish to leave the business, not only facilitate, but actively encourage, the treatment of client books as a tradeable asset to be valued as a multiple of annual income earned. The annual income in this case consisted of commissions and fees paid by clients.⁹⁵

Fourth, the services to be provided under ongoing fee arrangements often were, and still are, neither well-defined nor onerous. Evidence showed how the services to be provided under ongoing service arrangements may not only be very loosely defined but also defined in a way that has little or no substantive content beyond a promise to speak with the client once each year. Describing the services (as Mr Michael Wright, the national head of BT Financial Advice did) as ‘strategic advice and reassurance’⁹⁶ may encourage both adviser and client to view the provision of ongoing services as a matter of form rather than substance and as a matter that is not of any immediate or pressing moment or value. What exactly was, or is, to be provided in an ‘annual review’? What is meant when it is said that the client may ‘have access’ to the adviser? Was (or is) the only promise made to ‘offer’ an annual review? And some advisers have in the past charged fees for services that ASIC said had ‘limited’ (I would say no) value such as maintaining records that the law required the advisers to maintain and retain.⁹⁷

⁹³ ASIC, Report 499, 27 October 2016, 39–40 [191(a)].

⁹⁴ ASIC, Report 499, 27 October 2016, 40 [191(b)].

⁹⁵ Transcript, Anthony Regan, 16 April 2018, 1061–2.

⁹⁶ Transcript, Michael Wright, 20 April 2018, 1450.

⁹⁷ ASIC, Report 499, 27 October 2016, 40.

As ASIC pointed out in its submissions, the promised services, even if provided, may not give the client a benefit commensurate with their cost. If, as each of Ms Marianne Perkovic (on behalf of CBA), Mr Regan (on behalf of AMP) and Mr Darren Williams (on behalf of ANZ) said may be the case, the future advice fee is fixed as a percentage of the ‘funds under advice’ (rather than as a fixed dollar sum), the question of value for money is all the more evident. Ms Perkovic said that the maximum fee charged by CFPL, under its Legacy package, was 0.94% of funds under advice;⁹⁸ Mr Regan produced an example of an agreement between an adviser at Hillcross and a client where the ongoing service fee was fixed at 0.6% of funds under advice;⁹⁹ Mr Williams said that some ongoing service fees were calculated as a percentage of the fees under advice but that other such fees were fixed as a flat dollar amount.¹⁰⁰

When asked to describe what was generally provided under ongoing advice arrangements, Mr Wright said, that ‘before FoFA, the conversation was much more around performance. Post-FoFA, and particularly now in our business, the conversation is much more around *strategic advice and reassurance*’.¹⁰¹ Mr Wright spoke of how the ‘conversation’ was now used to reflect on statutory changes, and ensure that strategic advice was going to meet the client’s goals and aspirations by, if needs be, ‘rebalanc[ing] or reposition[ing]’ to meet those goals.¹⁰²

Subject to one important qualification, the descriptions that Ms Perkovic, Mr Regan and Mr Williams gave of ongoing services were not substantially different from the description given by Mr Wright. The qualification that must be noted is that Ms Perkovic described the ‘core component’ of ongoing

⁹⁸ Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 5 [29].

⁹⁹ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 [AMP.6000.0020.0234 at .0236].

¹⁰⁰ Exhibit 2.92, Witness statement of Darren Williams, 13 April 2018, 10–11 [49].

¹⁰¹ Transcript, Michael Wright, 20 April 2018, 1450 (emphasis added).

¹⁰² Transcript, Michael Wright, 20 April 2018, 1450.

services as an annual review¹⁰³ but, according to Ms Perkovic, at least in the case of Bankwest Financial Advice (BWFA), the mere offer of an annual review was considered sufficient for the fee to be charged.¹⁰⁴

If done properly, an annual review might require the application of a deal of time, skill and judgment. Whether it did would depend not only upon the skill and diligence of the adviser but also upon what investments the client had, whether the client's circumstances had changed and whether investment conditions had changed either generally or in relation to one or more of the products in which the client had invested. Absent extraordinary external events or radical change in the client's personal position, it would be very easy to provide the service with little time and little effort. And, as pointed out above, the less work that is done, the greater the financial advantage to the adviser.

The fifth consideration to notice is that the fees charged under ongoing fee arrangements were, and still are, often charged 'invisibly': by being deducted from the client's investment accounts. If there is no recognition of a pressing need for the services and the charge is deducted automatically against funds under investment, neither adviser nor client may think about whether the services promised have been or should be provided. One line in a periodic investment statement recording the payment will draw the matter to attention *only* if the client is attentive enough to look beyond the total given at the foot of the statement. And there are many who will not do that. Whether a fee disclosure statement draws the matter to the client's attention may depend upon what emphasis the adviser gives when presenting the statement, to how beneficial the adviser's past advice has been, and how well the client's investments have proved or are proving to be.

Sixth, before the FoFA reforms required advisers to obtain client agreement every two years for the charging of ongoing fees, and to provide information each year about the services provided in exchange for the ongoing fee, the client may have made the agreement for ongoing fees at the time advice was first provided and neither at that time nor thereafter adverted to, or

¹⁰³ Provided in the past, by one CBA licensee, BWFA, by telephone. See Exhibit 2.73, Witness statement of Marianne Perkovic, 3 April 2018, 4 [24], 9 [62].

¹⁰⁴ Transcript, Marianne Perkovic, 18 April 2018, 1289–92.

been reminded of, the adviser's obligation. This problem was made worse by the transitional arrangements for the FoFA reforms. Although those reforms commenced on 1 July 2012, the Corporations Act provided that compliance with the new provisions (including the provisions requiring the giving of renewal notices and fee disclosure statements) was not compulsory until 1 July 2013.

Because of the way the provisions of the Corporations Act requiring the giving of fee disclosure statements and renewal notices were structured, the first occasion on which an adviser could have been required to give a fee disclosure statement was 1 July 2014, and the first occasion on which an adviser could have been required to give a renewal notice was 1 July 2015. This meant that, even after the FoFA reforms took effect, it was some years before advisers were required to bring to their clients' attention the services provided (or not provided) in exchange for their ongoing fees.

Seventh, income from trail commissions was, and has remained, an important part of the revenue earned from the provision of financial advice. This is consistent with ASIC's observation of an industry culture that relies on automatic periodic payments from customers.¹⁰⁵ The highest source of revenue for financial advisers providing advice on behalf of three out of AMP's four advice licensees for every year between 2008 and 2018 (for which AMP had records)¹⁰⁶ was ongoing or trail commissions.¹⁰⁷ And for the fourth of those advice licensees, where fees for service were the largest source of revenue for advisers, the advisers were employees of the licensee.

Yet Mr Wright gave evidence that despite clients not going to an adviser for ongoing advice,¹⁰⁸ most clients of authorised representatives of the financial advice businesses conducted by Westpac's advice licensees (Magnitude and Securitor) would be on an ongoing fee arrangement.¹⁰⁹

¹⁰⁵ ASIC, Report 499, 27 October 2016, 8.

¹⁰⁶ AMP did not have records about revenue sources for two entities (Charter and iPac) for 2008 to 2011 because those entities were not then part of AMP. See Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, 21 [78].

¹⁰⁷ Exhibit 2.171, Witness statement of Anthony Regan, 11 April 2018, 19–21 [77]–[78].

¹⁰⁸ Transcript, Michael Wright, 20 April 2018, 1451.

¹⁰⁹ Transcript, Michael Wright, 20 April 2018, 1449–50.

(He said that fewer clients of Westpac's *employed* financial advisers would have ongoing arrangements. Even so, it is to be noted that the case study relating to Mrs McDowall showed that an adviser employed by Westpac signed Mr and Mrs McDowall up for an ongoing fee of \$3,000 per annum.¹¹⁰ The point not having been explored in evidence, one can only wonder what the purpose of that ongoing fee might have been thought to be.)

2.2 What has been the response to these events?

The causes having been identified, the next question is how the entities and regulators have responded to these events.

Those responses must be understood in light of the way in which the issues emerged. That history was set out in the *Interim Report*¹¹¹ but should be repeated here.

In 2014, ASIC started its 'Wealth Management Project', a major project focusing upon the financial advice businesses conducted by ANZ, CBA, NAB, Macquarie, Westpac and AMP.¹¹² In April 2015, ASIC announced that it was 'investigating multiple instances of licensees charging clients for financial advice, including annual advice reviews, where the advice was not provided'.¹¹³ ASIC said that it would 'consider all regulatory options, including enforcement action' where it found evidence of breaches of the law and that it would 'look to ensure that advice licensees follow a proper process of customer remediation and reimbursement of fees where such breaches have occurred'.¹¹⁴ As events turned out, however, until immediately before the time the Commission began taking evidence about fees for no service, ASIC had undertaken some investigations and had pursued remediation, but had taken no enforcement action.¹¹⁵ Rather, as Mr Peter Kell, Deputy Chair of ASIC, said, '[m]ost of ASIC's work

¹¹⁰ Exhibit 2.98, Witness statement of Jacqueline McDowall, 4 April 2018, Exhibit JM-2 [WIT.0900.0001.0037 at .0059].

¹¹¹ FSRC, *Interim Report*, vol 1, 124–5.

¹¹² Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, 2 [9].

¹¹³ ASIC, Media Release 15-081MR, 16 April 2015.

¹¹⁴ ASIC, Media Release 15-081MR, 16 April 2015.

¹¹⁵ Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, Exhibit PK-4 [ASIC.0902.0001.3189].

in the [fees for no service] project [had] focused on remediation'.¹¹⁶ And it was not until a few days before those hearings began that ASIC announced:

- first, that it had agreed with ANZ that ANZ would give an EU in relation to the charging of fees for no service; and
- then, a few days later, that it had agreed with CBA that two of CBA's financial advice licensees (CFPL and BWFA, a CBA licensee that ceased to provide advice in 2016) would give an EU in relation to the charging of fees for no service.

In October 2016, ASIC reported that AMP, ANZ, CBA and NAB had all identified systemic issues in relation to the charging of ongoing fees; Westpac had identified a systemic issue 'in relation to one adviser only'; Macquarie had not identified any systemic failures in respect of fees for no service.¹¹⁷

ASIC said that '[m]ost of the systemic failures identified' had occurred before the FoFA reforms, which became mandatory on 1 July 2013.¹¹⁸ But the report also revealed that, as at 31 August 2016, compensation arising from fees for no service was estimated to be more than \$178 million in respect of about 200,000 customers,¹¹⁹ and that by 31 August 2016, about \$23.7 million had been paid, or agreed to be paid to over 27,000 customers. Between 31 August 2016 and 31 January 2018, the total compensation paid or agreed to be paid and the number of customers affected increased markedly, to the figures given by Mr Kell in his April 2018 statement: more than \$216 million and more than 305,000 customers.¹²⁰ And, contrary to the tenor of ASIC's 2016 report, the evidence to the Commission showed that there had been some significant systemic failures after the FoFA reforms.

As I said in the *Interim Report*, advice licensees may well regard their undertaking remediation programs for clients who had been charged fees

¹¹⁶ Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, 11 [42].

¹¹⁷ ASIC, Report 499, 27 October 2016, 5 [7].

¹¹⁸ ASIC, Report 499, 27 October 2016, 6 [16].

¹¹⁹ ASIC, Report 499, 27 October 2016, 7.

¹²⁰ Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, PK-3 [ASIC.0902.0001.3370].

for no service as their public acknowledgment of wrongdoing.¹²¹ But, until about March 2018, ASIC's chief focus had been upon remediation. And the only formal and public steps that ASIC had taken with respect to the issue, beyond issuing its reports and press releases, was ASIC's acceptance of the ANZ and CBA EUs, just before the Commission began its hearings about fees for no service.¹²² Those undertakings went no further than to record ASIC's 'concerns' and the acknowledgment by the relevant entities that those concerns were 'reasonably held'. As I also said in the *Interim Report*, this was well short of a full and frank acknowledgment by the entities that what they had done was wrong; there was also no public denunciation of the conduct as wrong.¹²³

ASIC's October 2016 report about fees for no service focused upon advice licensees associated with AMP, ANZ, CBA, NAB or Westpac. The report showed, among other things, that some of the advice licensees had not then completed their review and remediation activities.¹²⁴ As the work of the Commission proceeded, it became clear not only that some entities had still not completed their review and remediation activities, but also that the work would have to continue for some time. It is important to record why that is so.

First, some entities appear not to have given the tasks high priority. The work of identifying who should be compensated and how much compensation should be paid is detailed and time consuming. In their evidence to the Commission, some entities recognised that they had given too little attention to these matters and had not done enough work, quickly enough.¹²⁵

Second, some entities began to look for particular kinds of cases where fees were charged for no service only because evidence was led in the Commission about some other entity having charged fees in those

¹²¹ FSRC, *Interim Report*, vol 1, 125.

¹²² Enforceable Undertaking, ASIC and ANZ, 29 March 2018, 5 pt 3; ASIC, Media Release 18-092MR, 6 April 2018; Enforceable Undertaking, Commonwealth Bank Subsidiaries, 9 April 2018, 9 [3.5.5]; ASIC, Media Release 18-102MR, 13 April 2018.

¹²³ FSRC, *Interim Report*, vol 1, 126.

¹²⁴ ASIC, Report 499, 27 October 2016, 21.

¹²⁵ See Transcript, Darren Whereat, 20 April 2018, 1519–20, 1546; Transcript, Sarah Britt, 23 April 2018, 1607, 1609–10, 1619.

circumstances. So, when evidence was led, in April 2018, about Count Financial Limited having charged ongoing fees to dead clients,¹²⁶ other entities asked, apparently for the first time, whether they had also done this.¹²⁷ So, for example:

- In May 2018, NAB made a breach notification to ASIC and APRA concerning fees it had charged to members following notification of their death.¹²⁸ NAB identified this breach after undertaking reviews to confirm whether it had charged ongoing advice fees to members where they were deceased, having become 'aware of similar issues affecting another financial services entity'.¹²⁹
- In June 2018, AMP made a breach notification to ASIC and APRA that, in short, it had retained or not properly refunded premiums charged to members after their death.¹³⁰ That breach notification identified 3,124 members with a total of \$922,902 in premium refunds owing.¹³¹ At 5 September 2018, AMP had identified that 4,645 customers were affected by this issue, with \$1.3 million in premium refunds owing.¹³² In the sixth round of hearings, AMP's Group Executive for Wealth Solutions and Chief Customer Officer, Mr Paul Sainsbury explained that AMP commenced an investigation into whether it had charged deceased members fees after notification of their death following 'Commonwealth Bank's circumstances around premiums [for] deceased members'.¹³³

Third, some entities proposed what ASIC described as 'review and remediation processes that were legalistic and not focused on customers'

¹²⁶ Transcript, Marianne Perkovic, 19 April 2018, 1340–1.

¹²⁷ Transcript, Linda Elkins, 15 August 2018, 4962–3.

¹²⁸ Exhibit 7.80, Witness statement of Andrew Thorburn, 19 November 2018, 55–6 [192], [194(d)].

¹²⁹ Exhibit 7.80, Witness statement of Andrew Thorburn, 19 November 2018, 55 [194(a)].

¹³⁰ Transcript, Paul Sainsbury, 17 September 2018, 5884; Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 Tab 3 [AMP.6000.0281.0046].

¹³¹ Transcript, Paul Sainsbury, 17 September 2018, 5884; Exhibit 6.234, Witness statement of Paul Sainsbury, Exhibit PJS-2 Tab 3 [AMP.6000.0281.0046 at .0046].

¹³² Transcript, Paul Sainsbury, 17 September 2018, 5892.

¹³³ Transcript, Paul Sainsbury, 17 September 2018, 5891.

interests¹³⁴. Issues of that kind were considered more fully in the case study about NULIS Nominees (Australia) Ltd. As that case study showed, negotiations about these processes could be, and in that case were, protracted.

Fourth, progress appears to have been hampered by deficiencies in record keeping: deficiencies by both the licensee in having access to the authorised representatives' records, and by the authorised representative in recording whether or not the service was provided.¹³⁵

Until the Commission began to examine these matters, however, compensation appears to have been ASIC's sole focus. As the Commission's work proceeded, ASIC's focus widened. First, ASIC moved to secure the EUs given by ANZ and CBA. In September 2018, ASIC instituted civil penalty proceedings against MLC Nominees Pty Ltd and NULIS in the Federal Court of Australia alleging contraventions of various provisions of the Corporations Act, the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act) and the *Superannuation Industry (Supervision) Act 1993* (Cth) in connection with the charging of certain advice fees.¹³⁶ And, still more recently, ASIC has said that it is considering other forms of response.

2.3 Were the responses adequate?

Between them, AMP, ANZ, CBA, NAB and Westpac will pay customers of their advice licensees or their superannuation funds compensation totalling \$850 million, or more, for taking money as payment for services that were not provided. Each of those entities will pay its own amount of compensation, and none of them is responsible for what the others did. It is neither right nor useful to seek to impose collective responsibility. But, in judging the adequacy of the responses made by the entities

¹³⁴ ASIC, Report 499, 27 October 2016, 42 [203].

¹³⁵ See, eg, Transcript, Brian Hartzer, 21 November 2018, 6838; Transcript, Andrew Thorburn, 26 November 2018, 7096–7; Transcript, Michael Wilkins, 21 November 2018, 7196–7.

¹³⁶ *ASIC v MLC Nominees Pty Ltd & Anor* FCA, NSD1654/2018; ASIC, Media Release 18-259MR, 6 September 2018. See also the case study about NAB and NULIS in vol 2 of this Report.

and by the regulators, it is necessary to recognise that the conduct ran through the whole industry.

Until this Commission was established, ASIC and the relevant entities approached the fees for no service conduct as if it called, at most, for the entity to repay what it had taken, together with some compensation for the client not having had the use of the money. That is, the conduct was treated as if it was no more than a series of inadvertent slips brought about by some want of care in record keeping.

It is necessary to keep steadily in mind that entities took money (a lot of money) from their customers for nothing. The conduct was so widespread that seeing it as no more than careless must be challenged.

It is necessary to go behind the global characterisation of the conduct as charging 'fees for no service'. The description is accurate but it is incomplete. In many cases, the advice licensee knew that the client would not receive any services in exchange for the ongoing fee. And there were cases where ongoing fees were charged when there could have been no possibility of providing the services for which the fees were charged.

The first kind of case, where the advice licensee knew that the client would not receive the relevant services includes, but would not be limited to, cases where the advice licensee's records showed no adviser (or advice group) assigned to the client. It may also include cases where the advice licensee knew that the 'linked' adviser had so many clients that he or she could not possibly have provided ongoing advice to all, but it is more convenient to leave this kind of case aside at this point.

If the advice licensee's records showed no 'linked adviser' the fee deducted from the client was taken by the advice licensee for its own use. Hence, the essential facts of the case can be described as:

- money was taken from clients;
- the money was taken as the fee for advice given or to be given to the client by an adviser;
- but no advice was given; and
- the advice licensee took the money for itself; it did not pay it to an adviser or return it to the client. (Or, putting the same point another

way, the licensee retained for itself the difference between fees charged and fees remitted.)

The second kind of case includes, but again may not be limited to, cases where the advice licensee charged the client an ongoing fee for advice given or to be given after it had been told of the client's death. Again, the essential facts are simple:

- money was taken from clients;
- the money was taken as the fee for advice given or to be given to the client by an adviser;
- but the advice licensee knew that the promised advice had not been given and could not be given; and
- the advice licensee took the money anyway and either paid it to the adviser or took it for itself.

2.3.1 Possible offences

In both kinds of cases described, there is a real question whether, contrary to section 1041G of the Corporations Act, the licensee, in the course of carrying on a financial services business in this jurisdiction, engaged in dishonest conduct in relation to a financial product or financial service. Section 1311(1) of the Corporations Act makes that contravention an offence.

Since November 2010, for an individual, the maximum penalty for that offence has been imprisonment for 10 years, or a fine the greater of 4,500 penalty units or three times the total value of the benefits obtained by the person and reasonably attributable to the commission of the offence, or both. Since November 2010, for a body corporate, the maximum penalty for that offence has been a fine the greatest of 45,000 penalty units, or three times the total value of the benefits obtained by a person and reasonably attributable to the commission of the offence, or, if the court cannot determine the total value of those benefits, 10% of the body corporate's turnover during the year ending at the end of the month in which the body corporate committed or began committing the offence.¹³⁷

¹³⁷ Corporations Act s 1311, Sched 3, item 310.

There is also a real question whether, contrary to section 12DI(3) of the ASIC Act, the licensee, in trade or commerce, accepted a payment for financial services and, at the time of acceptance, there were reasonable grounds for believing that the person would not be able to supply the financial services within a reasonable time. Section 12GB(1) of the ASIC Act makes that contravention an offence.

Since 2001, for an individual, the penalty for that offence has been a fine not exceeding 2,000 penalty units. Since 2001, for a body corporate, the maximum penalty for that offence has been a fine not exceeding 10,000 penalty units.

Of these two provisions, I consider that section 1041G – with its emphasis on dishonest conduct – more accurately reflects both the nature and the gravity of the conduct described in the two cases set out above. I also consider that the maximum penalties applicable to a contravention of section 1041G more accurately reflect the gravity of that conduct. Accordingly, it is on that provision that I have focused.

I will say more about the construction and application of section 1041G later in this chapter. For present purposes, the important point is that ASIC appears not to have considered the application of the criminal law in connection with fees for no service until a witness giving evidence to the Commission was asked whether she had thought that taking money to which there was no entitlement raised a question of the criminal law.¹³⁸

The charging of fees for no service has extended over many years. Breach notifications given to ASIC by entities refer to events occurring at various times: in September 2007,¹³⁹ ‘throughout 2013–2014’,¹⁴⁰ ‘Financial Year (FY) 2014’.¹⁴¹

¹³⁸ Transcript, Nicole Smith, 8 August 2018, 4365.

¹³⁹ Exhibit 2.13, Witness statement of Anthony Regan, 11 April 2018, Exhibit AGR-1 Tab 33 [AMP.9000.0001.1460].

¹⁴⁰ Exhibit 2.77, Witness statement of Marianne Perkovic, 3 April 2018, Exhibit MP-13 [CBA.0001.0039.0453].

¹⁴¹ Exhibit 2.78, Witness statement of Marianne Perkovic, 9 April 2018, Exhibit MP-2 [CBA.0517.0020.0018].

Documents ASIC produced to the Commission showed that, in the second half of August 2018, ASIC began to examine whether a brief of evidence should be prepared and submitted to the Commonwealth Director of Public Prosecutions in connection with one entity's possible contravention of section 1041G. Information made available to the Commission did not show any direct examination of possible criminal proceedings against other entities in connection with a possible contravention of section 1041G.

2.3.2 Communication to ASIC

Having considered the documents and other information provided by ASIC, as well as the submissions made in response to the *Interim Report*, I decided that I should, and in November 2018 did, communicate to ASIC information obtained in the course of the Commission's inquiries that relates, or may relate, to the possible contravention by other entities of section 1041G.¹⁴² In particular, I informed ASIC that I was of the opinion that the information and evidence provided to the Commission showed that the conduct of at least two other entities may have contravened section 1041G. I further informed ASIC that I was of the opinion that the information and evidence provided to the Commission showed that:

- entities other than the two to which I specifically referred in my communication, and the entity that was the subject of the work ASIC began in August 2018, may have engaged in conduct of the kinds described above as the first kind of case and the second kind of case; and
- if they did, the conduct may have contravened section 1041G.

I invited ASIC to consider whether criminal or other legal proceedings should be instituted in respect of that conduct.

Examination of these issues by ASIC is still continuing, and it would not be right for me to anticipate the outcome of those deliberations. Nor would it be right for me now to name the entities I identified in my communication to ASIC. But it is important that I explain my opinion that section 1041G may apply to conduct of the kinds described and explain why I think it important to consider its application.

¹⁴² *Royal Commissions Act 1902* (Cth) s 6P.

2.3.3 Section 1041G

As I have said, I think it important to begin by recognising both the essential character and the scale of the conduct in issue. It was, as I have said, entities taking money for nothing. And at least \$850 million will be paid in compensation.

Section 1041G prohibits engaging in dishonest conduct in relation to a financial product or financial service. On its face, taking money for nothing is dishonest conduct. If the conduct in issue was a contravention of section 1041G, it is that section that best captures and conveys the criminality.

Section 1041G was added to the Corporations Act, with effect from 11 March 2002, by the *Financial Services Reform Act 2001* (Cth). It has, therefore, been in force for the times relevant to these matters. Section 1311 of the Corporations Act makes contravention of section 1041G an offence. The penalties specified for failure to comply with section 1041G have been amended from time to time. That detail need not be noticed. There is a proposal to amend the definition of ‘dishonesty’ in section 1041G(2).¹⁴³ That amendment, if made, will have only prospective effect and may also be set aside from consideration.

As the provision stood at the relevant times, it provided that:

- (1) A person must not, in the course of carrying on a financial services business in this jurisdiction, engage in dishonest conduct in relation to a financial product or financial service.
- (2) In this section:

Dishonest means:

- (a) dishonest according to the standards of ordinary people; and
- (b) known by the person to be dishonest according to the standards of ordinary people.

The provisions of Part 2.5 of the Commonwealth Criminal Code (about corporate criminal responsibility) do not apply to an offence based on

¹⁴³ See ASIC Taskforce Review, Report, 68–9; ASIC Taskforce Review, Government Response, 10.

section 1041G (or other provisions of Chapter 7).¹⁴⁴ Instead, section 769B provides (in effect) that people (including bodies corporate) are generally responsible for the conduct of their directors, agents or employees.

Thus, subject to some exceptions that are not relevant, conduct engaged in on behalf of a body corporate by a director, employee or agent, within the scope of the person's actual or apparent authority, is taken, for the purposes of a proceeding for an offence based on section 1041G, to have been engaged in also by the body corporate.¹⁴⁵ If it is necessary to establish the state of mind of the body corporate, it is sufficient to show that a director, employee or agent of the body, being a director, employee or agent by whom the conduct was engaged in within the scope of that person's actual or apparent authority, had that state of mind.¹⁴⁶

To return, then, to the facts set out above. There is no doubt that money was taken from clients. Nor is there any basis for doubting that, when taken, the taker did not intend to return it to the client. If there was no adviser linked to the client, the money taken was applied by the taker to its own use. (I say the money was applied by the taker to its own use on the basis that the total of the amounts deducted exceeded the total amount paid out to advisers. The excess was constituted by the fees charged but not remitted.) If the client had died and the taker had been told and had recorded that the client had died, there could be no ongoing service given and the taker's records showed that there could be none given.

I consider that it is open to a jury to conclude, beyond reasonable doubt, that, in either of the cases described, the taker, in the course of its carrying on a financial services business in this jurisdiction engaged in conduct in relation to a financial service that was dishonest according to the standards of ordinary people and that the conduct was known by the taker to be dishonest according to the standards of ordinary people. It is necessary to explain both conclusions.

¹⁴⁴ Corporations Act s 769A.

¹⁴⁵ Corporations Act s 769B(1)(a), read with s 769B(10)(a)(i).

¹⁴⁶ Corporations Act s 769B(3).

In the first kind of case, one or more employees of the taker, acting within the scope of their actual authority, will have directed the application of the fee received to the taker's own account. It is the application of what was taken (to the entity's own use) that is the dishonest act. It is dishonest because it is taking something for nothing. And if no more is said or known, I think the only conclusion open to a jury, once it found that the taking was objectively dishonest, would be that the person or persons who directed that the funds be taken to the entity's own use *knew* that its taking was dishonest according to the standards of ordinary people.¹⁴⁷ If it is decided (beyond reasonable doubt) that the taking was objectively dishonest, a doubt could be entertained about *knowledge* of dishonesty *only* by speculating about the existence of some unarticulated and unsupported claim of right. And there is no issue about that 'unless the absence of knowledge or, which is the *same* thing, belief as to legal right is *specifically* raised *and* there is some evidence to that effect'.¹⁴⁸

In the second kind of case (death of the client) the taker may either retain the amount taken or may have passed it on to an adviser. If the taker retained the money (and some did) the case would be of the first kind considered. If the taker passed some or all of it on to an adviser, the taking itself would be the dishonest act, there being no possibility of supplying the contracted services. But subject to that difference, this second kind of case would be analysed in the same way as the first. The taking is objectively dishonest. Absent some evidence of a belief as to the legal right to take the money, it follows from the objective dishonesty of the taking that the taker knew it to be dishonest.

¹⁴⁷ As Toohey and Gaudron JJ said in *Peters v The Queen* (1998) 192 CLR 493, 509 [31]: 'As a matter of ordinary experience, it will generally be inferred from an agreement to use dishonest means to deprive another of his or her property or to imperil his or her rights or interests *that the parties to that agreement knew that they had no right* to that property or to prejudice those rights or interests. And as with the defence of honest claim of legal right, *it will be taken there is no issue in that regard unless the absence of knowledge* or, which is the same thing, belief as to legal right *is specifically raised and there is some evidence to that effect*' (emphasis added; footnote omitted).

¹⁴⁸ *Peters v The Queen* (1998) 192 CLR 493, 509 [31] (Toohey and Gaudron JJ). As five members of the High Court pointed out in *Macleod v The Queen* (2003) 214 CLR 230, 241–2 [35]–[37] (Gleeson CJ, Gummow and Hayne JJ), 256 [99] (McHugh J), 264–5 [130] (Callinan J), the ratio of the decision in *Peters* is to be found in the reasons of Toohey and Gaudron JJ.

The two-part test of dishonesty that now appears in section 1041G(2) derives from the English decision in *R v Ghosh*.¹⁴⁹ That it originates from *Ghosh* is made plain by the May 1997 Report of the Model Criminal Code Officers Committee proposing a draft definition of ‘dishonesty’ not materially different from what was later enacted in section 1041G as a legislative embodiment of the *Ghosh* test.¹⁵⁰

Consistent with what Toohey and Gaudron JJ said in *Peters*, Lord Lane CJ said in *Ghosh* that the first question for a jury will be the objective one of whether the conduct was dishonest according to the standards of ordinary people. If it was:¹⁵¹

then the jury must consider whether the defendant himself must have realised that what he was doing was by those standards dishonest. *In most cases, where the actions are obviously dishonest by ordinary standards, there will be no doubt about it. It will be obvious that the defendant himself knew that he was acting dishonestly.* It is dishonest for a defendant to act in a way which he knows ordinary people consider to be dishonest, *even if he asserts or genuinely believes that he is morally justified in acting as he did.*

It would be for prosecuting authorities to determine how charges would be framed. One way may be to fix upon one or more events of ‘taking’ by the entity. But however the charges are framed, it may be expected that the prosecution would seek to lead evidence that the particular takings charged were made as part of an established system and were not matters of accident. If the taking of fees was objectively dishonest, the question becomes as I have indicated: on what basis *on the evidence* would it be argued that a jury should entertain a reasonable doubt that the defendant knew that it was acting dishonestly by taking payment for a service that it did not provide?

¹⁴⁹ [1982] QB 1053.

¹⁵⁰ Model Criminal Code Officers Committee, Report, *Chapter 3, Conspiracy to Defraud*, May 1997, 32–3.

¹⁵¹ *R v Ghosh* [1982] QB 1053, 1064 (emphasis added).

2.4 Avoiding future fees for no service

So far, I have considered the causes of the fees for no service conduct, and the responses to that conduct. It remains for me to consider what can, and should, be done to prevent similar conduct from occurring in the future.

2.4.1 Improvements to systems and processes

Some of the necessary steps are already underway.

In its 2016 report, ASIC recorded the changes that some licensees – AMP, ANZ, CBA and NAB – had made to their systems to prevent a recurrence of charging fees for no service. Those changes varied from changing system controls,¹⁵² to altering record keeping and oversight.¹⁵³

A number of entities provided further detail about those changes in their evidence to the Commission. To take CFPL as an example, since identifying fees for no service issues, CFPL has:¹⁵⁴

- introduced a system that provides a central electronic record of all customers paying ongoing service fees and when ongoing service is provided;
- introduced a centralised document management system to record customer interactions and retain evidence of delivery of service;
- established an Ongoing Services Admin and Support team to administer ongoing service processes and controls;
- included reviews of ongoing services as part of the file audit process; and
- implemented additional processes and controls for customers paying ongoing fees when an adviser leaves CFPL, including checks designed to identify customers who are paying ongoing fees but are not assigned to an adviser.

¹⁵² ASIC, Report 499, 27 October 2016, 35–8.

¹⁵³ ASIC, Report 499, 27 October 2016, 36–8.

¹⁵⁴ Exhibit 7.2, Witness statement of Matthew Comyn, 14 November 2018, 49 [166].

Further, as I noted in the *Interim Report*, one of the requirements of the ANZ and CBA EUs was to have senior management attest that the relevant licensee's compliance systems and processes were (at the time of the undertaking) reasonably adequate to track the licensee's contractual obligations to its ongoing service clients. ANZ's attestation was to be 'audited';¹⁵⁵ the attestation relating to CFPL (BWFA having ceased to carry on advice business) was to be 'supported by an expert report'.¹⁵⁶

As noted above, and in the *Interim Report*, inadequate systems and processes of licensees may have contributed to some of the fees for no service conduct. It is to be hoped that the steps taken by entities to improve their systems and processes will go some way to preventing similar conduct from occurring in future.

However, as explained above, it is important not to view the fees for no service conduct as being merely the result of inadequate systems or processes. It had other and equally important causes, not least the enticing call of profit, the uncertain content of what was promised and the capacity to deduct the fees invisibly. Those matters are not solved by changing the systems and processes of AFSL holders.

2.4.2 Further changes

As I said in the *Interim Report*, the uncertainty of the content of what is promised is not an issue to be solved by regulation. It is, and must be, a matter for client and adviser to decide what if any services will be provided after the provision of initial advice. It is, and must be, a matter for client and adviser to decide how those services are defined.

Even accepting that it is a matter for client and adviser to decide what services are to be provided, and how those services are to be defined, it is consistent with the policies that underpinned the FoFA reforms to consider:

- first, the information that an adviser must give a client about the services to be provided under such an arrangement;

¹⁵⁵ Enforceable Undertaking, ASIC and ANZ, 29 March 2018, 5–6 pt 3. See also ASIC, Media Release 18-092MR, 6 April 2018.

¹⁵⁶ Enforceable Undertaking, ASIC and CBA, 9 April 2018, 8–9 [3.3]–[3.5]. See also ASIC, Media Release 18-102MR, 13 April 2018.

- second, the period for which a contract for future services can be made; and
- third, the mechanism by which advisers and licensees should be permitted to charge ongoing fees to clients.

I deal with each in turn.

Information about the services to be provided

Under existing law, where a client has entered into an ongoing fee arrangement with a financial adviser, the adviser must give the client a fee disclosure statement each year.¹⁵⁷ Among other things, the fee disclosure statement must set out:¹⁵⁸

- the amount of each ongoing fee paid under the arrangement by the client in the previous year;
- information about the services that the client was entitled to receive under the arrangement during the previous year; and
- information about the services that the client received under the arrangement during the previous year.

The fee disclosure statement is plainly a backward-looking document, looking *back* at what services the client *was entitled* to receive, and what services *were provided*. Neither the definition of ongoing fee arrangement in section 962A(2) nor any other provision of the Corporations Act appears to require an adviser to identify prospectively with any degree of specificity what services the client *will be entitled* to receive, and what services *will be provided*.

Obviously, principles of contractual certainty under the law of contract will require that those services be specified with some degree of certainty. But that degree of certainty could be reached by saying that the services to be provided under the ongoing fee arrangement are such services as the adviser chooses to provide. That is not satisfactory.

¹⁵⁷ Corporations Act ss 962H, 962S.

¹⁵⁸ Corporations Act s 962H(2).

In my view, a financial adviser who enters into an ongoing fee arrangement with a retail client should be required to provide to the client – every time the ongoing fee arrangement is made or renewed – a statement of the services that the client will be entitled to receive under the arrangement during the coming year.

The duration of the arrangement

Under existing law, a client who entered into an ongoing fee arrangement after 1 July 2013 must positively renew the arrangement every two years – otherwise, the arrangement will terminate.¹⁵⁹ This is achieved in practice by requiring the giving of a renewal notice every two years,¹⁶⁰ and providing that the ongoing fee arrangement will automatically terminate unless the client positively opts to renew it within 30 days of receiving the renewal notice.¹⁶¹

An important function of a renewal notice is to prompt a client who has entered into an ongoing fee arrangement to consider whether he or she values what he or she is receiving under that arrangement. A client who is asked to give positive consent to the renewal of an ongoing fee is likely to focus his or her mind on what he or she has received in exchange for that fee.

As noted above, ASIC's view is that the services promised under ongoing fee arrangements, even when provided, may not give the client a benefit commensurate with their cost. I have no basis on which to doubt that view. Where the ongoing fee is fixed as a percentage of the 'funds under advice' (rather than as a fixed dollar sum), the question of value for money is all the more evident.

The information that the client needs in order to assess whether the services provided under an ongoing fee arrangement represent value for money is currently set out in the fee disclosure statement as a record of what *was* done. That statement must be provided annually. There is no reason that a client should not continue to receive annually a fee disclosure statement of that kind.

¹⁵⁹ Corporations Act Pt 7.7A Div 3 ss 962A–962Q; see especially ss 962K, 962L.

¹⁶⁰ Corporations Act s 962K.

¹⁶¹ Corporations Act s 962N.

But the central changes I would make are to require that ongoing fee arrangements must be renewed annually and that the client be told what *will* be done.

Subject to an exception for certain arrangements entered into between 1 July 2012 and 1 July 2013, no requirement to give a renewal notice currently applies to ongoing fee arrangements made before 1 July 2013.

As noted above, before the FoFA reforms required advisers to obtain client agreement every two years for the charging of ongoing fees, the client may have made the ongoing fee arrangement at the time advice was first provided and neither at that point nor thereafter adverted to, or been reminded of, the adviser's obligations. I have no doubt that this was a key contributing factor in many instances where fees were charged for no service.

While this position has been addressed to some extent by the requirement to provide fee disclosure statements,¹⁶² there are still some ongoing fee arrangements in relation to which financial advisers are not required to provide renewal notices. That is no longer acceptable. I can see no principled reason for it to be maintained.

Regardless of whether a client entered into an ongoing fee arrangement before or after 1 July 2013, that arrangement must be subject to annual renewal.

Authorisation for deductions

Ongoing fees have often been paid, and are still often paid, by deduction from clients' investment accounts, including superannuation accounts. The 'invisible' nature of the payments contributed to the charging of fees for no service.

Deducting advice fees from superannuation accounts presents its own particular issues and I deal with those in the chapter on superannuation. But, subject to that important qualification, I see no reason in principle why licensees should not be permitted to continue to deduct fees from investment accounts (other than superannuation accounts), provided the entity making the deduction has the express authority of the client.

¹⁶² Corporations Act s 962S.

I noted in the *Interim Report* that platform operators have routinely deducted, and continue to deduct, ongoing service fees from clients' accounts and have remitted, and continue to remit, the fees to advice licensees without having any authority beyond the licensee's claim to be entitled to payment. (If the client's account has insufficient cash to make the payment, assets are liquidated to realise sufficient cash.) As I said there, to pay away money held on behalf of another, on the request of the party who claims payment, is a distinctly unusual arrangement. It is not one that I consider should be permitted to continue.

If a licensee wants a product issuer to deduct an ongoing fee from a client's investment account, then the client must give the issuer express authority for this to occur. That authority should operate only for the period of the ongoing fee arrangement to which it relates, and should be required to be renewed annually, with the ongoing fee arrangement.

Conclusion

In what I have said above, I have tried, as far as possible, to recommend changes to the *substance* of ongoing fee arrangements, rather than the *form* in which those arrangements are given effect. The heart of the matter is this: if a financial adviser and a client want to enter into an arrangement under which the client agrees to pay fees on an ongoing basis, the arrangement:

- must be renewed annually by the client;
- must tell the client clearly what fees he or she will pay, and what services he or she will receive in exchange for those fees; and
- must not permit or require the deduction of fees from any account held by the client except with the client's express written authority, which must also be renewed annually.

Those requirements should apply to *all* ongoing fee arrangements, whenever made.

If ongoing fee arrangements have those characteristics, those arrangements will be unlikely to give rise to fees for no service conduct of the kind that was the subject of evidence before the Commission.

Recommendation 2.1 – Annual renewal and payment

The law should be amended to provide that ongoing fee arrangements (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; 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.

3 Inappropriate advice

Introduction

The second matter that emerged in connection with the provision of financial advice is that clients have often been given poor advice that has left them worse off than they would have been if proper advice had been given.

I repeat what I said in the *Interim Report*.¹⁶³

Hindsight will always show that some advice an adviser gives a client turns out to have been disadvantageous. Advice that is given about financial products or investment will not always turn out for the best.

Not all advisers (financial or other) are equally skilled or diligent. In some cases, reasonable advisers may form radically different views about what should be done.

¹⁶³ FSRC, *Interim Report*, vol 1, 138–9.

Nothing can be done to change these outcomes. But recognising that there will be unforeseen and unwanted outcomes and recognising that some advisers will not be as skilled or diligent as others cannot be permitted to obscure some large and deep-seated issues.

The cases of ‘inappropriate’ advice considered in the course of the Commission’s work called attention to four recurring points:

- advisers proposing actions that benefited the adviser;
- advisers proposing actions that benefited the licensee either with whom the adviser was aligned or by whom the adviser was employed;
- advisers lacking skill and judgment; and
- licensees being unwilling to find out whether poor advice had been given and, if it had, to take timely steps to put it right.

The first two points, about advisers proposing actions that benefited either the adviser or the licensee with whom the adviser was aligned, direct attention to the conflict between the adviser’s duty to the client and the adviser’s interest.

3.1 Conflicts of duty and interest

As I said in the *Interim Report*,¹⁶⁴ consideration of conflicts of interest, or more accurately, conflicts between duty and interest, begins from two simple points:

- So long as advisers stand to benefit financially from clients acting on the advice that is given, the adviser’s interests conflict with the client’s interests.
- So long as licensees stand to benefit financially from clients acting on the advice that is given, the licensee’s interests conflict with the client’s interests.

¹⁶⁴ FSRC, *Interim Report*, vol 1, 139.

The client's interests always require consideration of whether to take any step, and only then, consideration of what steps to take. Doing nothing is an available choice. Sometimes it is the best choice.

If steps are to be taken, it is in the client's interests to take whatever steps are best for them (best both in the sense of achieving the best outcome for the client, but best also in the sense of achieving that outcome most efficiently at the best available price).

By contrast, the adviser's and licensee's interests are to have the client buy a product or make an investment that will give the adviser, the licensee, or both, a financial benefit. Not only is it in their interests to have the client do something rather than do nothing, it is in their interests to have the client take a step from which the adviser, the licensee, or both will benefit financially.

3.1.1 The legislative premise

The premise for the FoFA reforms was that conflicts of the kind described do exist, must be recognised and should be regulated. The FoFA reforms did not seek to eliminate the conflicts. Instead, the reforms have sought to ameliorate the consequences of the conflicts. The legislation sought to do this by imposing on advisers the best interests obligation¹⁶⁵ with the associated requirements that the adviser provide appropriate advice¹⁶⁶ and give priority to the client's interests.¹⁶⁷

Those provisions were supplemented in two ways. First, by the prohibitions on conflicted remuneration¹⁶⁸. Second, by adding to the general obligation of all financial licensees (to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly¹⁶⁹) the further requirement to have in place adequate arrangements

¹⁶⁵ Corporations Act s 961B(1).

¹⁶⁶ Corporations Act s 961G.

¹⁶⁷ Corporations Act s 961J.

¹⁶⁸ Corporations Act ss 963E–963L.

¹⁶⁹ Corporations Act s 912A(1)(a).

for the management of conflicts of interest that may arise in relation to activities undertaken by the licensee or a representative.¹⁷⁰

The legislative provisions emphasise process rather than outcome. Although the fundamental obligation is cast as a ‘best interests duty’ there is no explicit reference in the legislation to making comparisons of a kind that would merit the use of the superlative ‘best’ in the collocation ‘best interests’. Instead, the Corporations Act provides that the best interests obligation will be met if an adviser follows the steps described in section 961B(2).¹⁷¹

Section 961B(2) is a ‘safe harbour’ provision. Six steps must be taken, and there is a seventh and general catch-all provision requiring the adviser to take any other step that ‘would reasonably be regarded as being in the best interests of the client’. The six required steps are to:

- identify the subject matter of the advice;
- identify the client’s relevant circumstances (objectives, financial situation and needs);
- make reasonable inquiries to remedy the deficiency if the information about the client’s relevant circumstances appears incomplete or inaccurate;
- assess whether the adviser has the required expertise;
- conduct a reasonable investigation into the financial products that might achieve the client’s objectives and meet the client’s needs; and
- base all judgments on the client’s relevant circumstances.

It is convenient to focus on one of those steps: to conduct ‘a reasonable investigation’ into the products that might achieve the relevant objectives of the client and meet the client’s needs.¹⁷² In practice this requires the adviser

¹⁷⁰ Corporations Act s 912A(1)(aa).

¹⁷¹ Section 961B(3) of the Corporations Act deals separately with satisfaction of the best interests duty when advice is given by Australian ADIs.

¹⁷² Corporations Act s 961B(2)(e).

to make little or no independent inquiry into, or assessment of, products. Instead, in most cases, advisers and licensees act on the basis that the obligation to conduct a reasonable investigation is met by choosing a product from the licensee's 'approved products list'.

3.1.2 Applying the current law about the client's interests

ASIC's January 2018 report – *Financial Advice: Vertically Integrated Institutions and Conflicts of Interest* – showed that the approved products lists maintained by advice licensees controlled by the five largest banking and financial institutions included products manufactured by third parties and that third party products made up nearly 80% of the lists.¹⁷³ But the report also showed that, overall, more than two-thirds (by value) of the investments made by clients were made in in-house products.¹⁷⁴ (At the level of individual licensees the proportion varied from 31% to 88% invested in in-house products.¹⁷⁵ By product type, the proportions invested in in-house products varied: 91% for platforms; 69% for superannuation and pensions; 65% for insurance; and 53% for investments. But taken as a whole, the report shows that advisers favour in-house products.)

The result is not surprising. Advisers may be expected to know more about the products manufactured by the licensee with which the advisers are associated than they know about a rival licensee's products. Advisers will often be readily persuaded that the products 'their' licensee offers are as good as, if not better than, those of a rival. And when those views align with the adviser's personal financial interests, advising the client to use an in-house product will much more often than not follow as night follows day.¹⁷⁶

It is the very fact that the result is not surprising that shows that the premise of the current law is flawed. It is not surprising that, despite the breadth of approved product lists, more than two-thirds (by value) of the investments made by clients of vertically integrated institutions were made in in-house

¹⁷³ ASIC, Report 562, 1 January 2018, 28.

¹⁷⁴ ASIC, Report 562, 1 January 2018, 28 [113].

¹⁷⁵ ASIC, Report 562, 1 January 2018, 29.

¹⁷⁶ Sunita Sah, *FSRC Research Paper: Conflicts of Interest and Disclosure*, 7 November 2018, 3–11.

products.¹⁷⁷ And that is not surprising because experience shows, and has shown for decades, that, more often than not, interest trumps duty. But, as noted above, the premise for the FoFA reforms was that, although conflicts between the duties owed by an adviser or a licensee and the interests of that adviser or that licensee exist and must be recognised, those conflicts can be ‘managed’ and regulated. As I have said, the FoFA reforms were not designed to eliminate the conflicts, but to try to ameliorate their consequences.

As the January 2018 ASIC report shows, however, the law, as it stands, has not resulted in conflicts being managed successfully. It has not seen the client’s interests being preferred over the interests of the adviser and the entity with which the adviser is aligned. The law, as it now stands, has not prevented the outcomes described in that report.

The report concluded that, in 75% of the advice files reviewed by ASIC, ‘the adviser had not demonstrated compliance with the best interests duty in section 961B of the Corporations Act’¹⁷⁸ and ‘the adviser appeared to have prioritised their own interests – or those of a related party of the adviser – over the customer’s interests, in breach of section 961J’ of the Corporations Act.¹⁷⁹

Not only that, the report said that a ‘common theme we saw across the non-compliant advice was the unnecessary replacement of financial products, where advisers recommended that a client switch to a new product where their existing product appeared to be suitable to meet the customers’ needs and objectives’.¹⁸⁰

In *none* of the 75% of files judged by ASIC to be ‘non-compliant’ did the adviser demonstrate that following the advice given to the client would leave the client in a *better* position.¹⁸¹

¹⁷⁷ ASIC, Report 562, 1 January 2018, 28 [113].

¹⁷⁸ ASIC, Report 562, 1 January 2018, 36 [137].

¹⁷⁹ ASIC, Report 562, 1 January 2018, 42 [174].

¹⁸⁰ ASIC, Report 562, 1 January 2018, 36 [139].

¹⁸¹ ASIC, Report 562, 1 January 2018, 37 [147].

In 10% of all the files ASIC reviewed, ASIC ‘had significant concerns about the potential impact of the advice on the customer’s financial situation’.¹⁸² The impacts included changed insurance arrangements resulting in exclusions or loadings being applied to the new policy, new insurance arrangements requiring payment of significantly higher premiums ‘on a like-for-like basis’, and the move to a new superannuation platform increasing the continuing superannuation product fees without any additional benefit.¹⁸³

The Commission’s case studies pointed in the same direction. First, there were cases, such as those involving Mr and Mrs McDowall¹⁸⁴ and Ms Donna McKenna¹⁸⁵, where the adviser proposed that the client invest in in-house products that would give an immediate and direct financial benefit to the adviser but which, if followed, would not be in the clients’ best interests. Second, and just as importantly, many of the cases in which entities accepted that clients should be compensated for poor advice were cases where the advice had been to invest in products (in-house or other) that gave the adviser a financial benefit.¹⁸⁶

3.2 Can conflicts be managed better?

Accepting, for the moment, the premise of the FoFA reforms – that conflicts of duty and interest exist, must be recognised and should be ‘managed’ – the question that presents itself is: is there more that could be done to ‘manage’ those conflicts better?

3.2.1 Improved education and standards for financial advisers

I referred earlier to changes to the education requirements for financial advisers, announced in February 2017.¹⁸⁷ As I have mentioned, the changes

¹⁸² ASIC, Report 562, 1 January 2018, 37 [145].

¹⁸³ ASIC, Report 562, 1 January 2018, 37 [145].

¹⁸⁴ FSRC, *Interim Report*, vol 2, 169–74, 179–80.

¹⁸⁵ FSRC, *Interim Report*, vol 2, 242–9.

¹⁸⁶ See, eg, FSRC, *Interim Report*, vol 2, 218–20.

¹⁸⁷ The Hon Kelly O’Dwyer MP, Minister for Revenue and Financial Services, ‘Higher Standards for Financial Advisers to Commence’ (Media Release, 9 February 2017).

include compulsory education requirements, supervision for new advisers, a code of ethics for the industry, an industry exam and ongoing annual professional development obligations. Details regarding these changes (as at April 2018) were set out in Part B of the Commission's sixth published Background Paper.¹⁸⁸

I said in the *Interim Report*,¹⁸⁹ and remain of the view, that prevention of poor advice begins with education and training. Those who know *why* steps are prescribed are more likely to follow them than those who know only that the relevant manual says, 'do it'.

I believe that, as they come into effect, the new education requirements will improve the quality of advice that is given, and improve the way that financial advisers manage the conflicts of interest with which they are faced.

However, while I am confident that improved education and standards are part of the solution, I do not believe that they will be sufficient, without more being done to ensure that conflicts in the financial advice industry are managed adequately.

3.2.2 Design and distribution obligations and product intervention powers

In its submissions in response to the Commission's second round of hearings, Treasury suggested that a number of reforms already underway may assist in addressing conflicts of interest in the financial advice industry. These included the Government's proposed design and distribution obligations and product intervention power.

As I noted in the *Interim Report*,¹⁹⁰ the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 (Cth), if enacted, would introduce design and distribution obligations intended to promote the provision of suitable financial products to consumers of those products. The reforms recognise that current disclosure

¹⁸⁸ Background Paper No 6 (Part B), 8–12.

¹⁸⁹ FSRC, *Interim Report*, vol 1, 143.

¹⁹⁰ FSRC, *Interim Report*, vol 1, 105.

requirements are not, on their own, sufficient to inform consumers fully.¹⁹¹ The obligations revolve around making an appropriate target-market determination for products and dealing with the product accordingly.

Further, ASIC would be granted a new product intervention power. Under the proposed power, ASIC could make an order that a person must not engage in specified conduct in relation to a product where ASIC perceives a risk of significant consumer detriment.¹⁹² ASIC would also be able to ban aspects of remuneration practices where there is a direct link between remuneration and distribution of the product.

I do not doubt that these changes may assist in addressing conflicts of interest in the financial advice industry. Again, however, I do not consider that these changes will be sufficient, without more being done to ensure that conflicts in the financial advice industry are managed adequately.

3.2.3 Better disclosure?

One of the principles that informed many of the recommendations of the Wallis Inquiry was that consumers would make better choices if they were given relevant information. This idea of ‘disclosure’ underpins the now teetering edifice of product disclosure statements (PDSs) and **Financial Services Guides** (FSGs).

The primary means by which a financial adviser’s conflicts of interest are currently disclosed is through an FSG. The provisions explaining when an FSG must be provided are lengthy but, for present purposes, it is enough to say that an FSG must usually be provided when a financial adviser is to give personal advice to a retail client.¹⁹³

The FSG will be prepared and provided by the ‘providing entity’, which will either be:

¹⁹¹ Treasury, Module 2 Policy Submission, 4–5.

¹⁹² Treasury, Module 2 Policy Submission, 4–5. See Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 (Cth) Sched 2 ss 301C, 1023C.

¹⁹³ Background Paper No 7, 55.

- the authorised representative – in cases where the financial service is provided by an authorised representative of an AFSL holder;¹⁹⁴ or
- the AFSL holder – in cases where the AFSL holder is providing the service directly or through a representative who is not an authorised representative.¹⁹⁵

If an FSG is required, it must be provided to the client as soon as is practicable after it becomes apparent that the financial service will be provided to the client, and in any event before that service is provided.¹⁹⁶

Among other things, an FSG must include information about:¹⁹⁷

- who the providing entity acts for when providing the financial service;
- the remuneration (including commission) or other benefits that the providing entity (and certain related parties) are to receive in respect of the provision of the financial service; and
- any associations or relationships between the providing entity, or any related body corporate, and the issuers of any financial products, being associations or relationships that might reasonably be expected to be capable of influencing the providing entity in providing the financial services.

At present, there is no requirement to disclose any information about any approved products list used by the providing entity.

The United Kingdom has gone some way towards requiring disclosure of that kind of information. In the UK, financial advisers who provide personal recommendations to retail clients are divided into two types: those who provide ‘independent advice’ and those who provide ‘restricted advice’.

A financial adviser who provides ‘independent advice’ must assess a sufficient range of relevant products available on the market that must:¹⁹⁸

¹⁹⁴ Corporations Act s 941B.

¹⁹⁵ Corporations Act s 941A.

¹⁹⁶ Corporations Act s 941D(1).

¹⁹⁷ Corporations Act s 942B.

¹⁹⁸ Financial Conduct Authority, Conduct of Business Sourcebook, 6.2B.11.

- be sufficiently diverse with regard to their type, and the product issuers, to ensure that the client's investment objectives can be suitably met; and
- not be limited to relevant products issued by:
 - the financial adviser's firm, or entities having close links with the firm; or
 - other entities with which the financial adviser's firm has such close legal or economic relationships, including contractual relationships, as to present a risk of impairing the independent basis of the advice provided.

A financial adviser who provides 'restricted advice' is not required to assess a range of products of that kind. However, they must disclose to the client, in good time before providing the advice:¹⁹⁹

- the fact that the advice will be 'restricted advice';
- the fact that the advice will be based on a more restricted analysis of different types of relevant products; and
- whether the range will be limited to relevant products issued by entities having close links to the financial adviser's firm or any other legal or economic relationships, such as contractual relationships, so as to present a risk of impairing the independent basis of the advice provided.

A single firm may have advisers who offer independent advice and advisers who offer restricted advice.²⁰⁰ However, a firm must not allow a single financial adviser to provide both independent advice and restricted advice.²⁰¹

By itself, simple disclosure of conflicts of interest, is insufficient as a means of managing them. The whole regime of disclosure presupposes that what is given to a consumer in writing will be read, and if read, will be understood.

¹⁹⁹ Financial Conduct Authority, Conduct of Business Sourcebook, 6.2B.33.

²⁰⁰ Financial Conduct Authority, Conduct of Business Sourcebook, 6.2B.29.

²⁰¹ Financial Conduct Authority, Conduct of Business Sourcebook, 6.2B.29.

Often, that presupposition is wrong. And given the length and complexity of FSGs and PDSs that is unsurprising. Further, as Professor Sah explains in her research paper, disclosure of conflicting interests may fail as ‘a discounting cue for biased advice, it may even make matters worse’.²⁰²

This is not to say, however, that matters that might affect a person’s decision about whether to obtain financial advice from a particular adviser should not be disclosed. If, whether because he or she is required to have regard to an approved products list or for some other reason, an adviser will only consider relevant products issued by:

- the adviser’s firm, or entities having close links with the firm; or
- other entities with which the adviser’s firm has such close legal or economic relationships, including contractual relationships, as to present a risk of impairing the independent basis of the advice provided,

this should be disclosed to the client. I do not think it is necessary to go as far as requiring the disclosure of the approved products list itself. In most circumstances, that list is unlikely to assist a retail client to understand the conflicts of interest that might attend the advice to be provided.

In Australia, quite different requirements govern the use of the word ‘independent’ (and the words ‘impartial’ and ‘unbiased’) by financial advisers from those that are applied in the UK. Relevantly, a financial adviser will contravene section 923A(1) of the Corporations Act if he or she uses any of those words in relation to the financial services he or she provides unless *all* of the following are satisfied:

- the financial adviser does not receive:
 - commissions (other than commissions rebated in full to the client);
 - any form of remuneration calculated on the basis of the volume of business placed by the adviser with a product issuer; or

²⁰² Sunita Sah, *FSRC Research Paper: Conflicts of Interest and Disclosure*, 7 November 2018, 15 [3(b)].

- any other gift or benefit from a product issuer that may reasonably be expected to influence the adviser;
- neither the financial adviser’s employer, nor any person on behalf of whom the adviser provides financial services, receives any of those benefits;
- the financial adviser operates free from direct or indirect restrictions relating to the financial products in respect of which he or she provides financial services; and
- the financial adviser operates without any conflicts of interest that might:
 - arise from his or her associations or relationships with issuers of financial products; and
 - be reasonably expected to influence the adviser in carrying on a financial services business or providing financial services.

At present, there is no requirement for a financial adviser who does not satisfy those requirements to explain to a retail client that he or she is *not* independent. A client may be able to infer that fact from some of the matters disclosed in an FSG. In my view, however, this is not sufficient. A financial adviser who does not meet the requirements set out above and who provides personal advice to a retail client should be required to bring that fact to the client’s attention, and to explain, prominently, clearly and concisely, why that is so. I consider that disclosure of that kind is likely to be more readily understood by, and therefore more useful to, a client than the existing requirement merely to disclose, in general terms, certain information about the providing entity.

Recommendation 2.2 – Disclosure of lack of independence

The law should be amended to require that a financial adviser who would contravene section 923A of the Corporations Act 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.

3.2.4 Amending the best interests duty?

A further possibility would be to amend section 961B of the Corporations Act, which creates the obligation for financial advisers to act in the best interests of the client in relation to the advice. There are several ways in which this could be done.

One option would be to amend the provision to be more prescriptive about how an adviser must pursue the client's best interests. This could be achieved, for example, by requiring advisers to make explicit in the statement of advice the comparisons they have made between products, or to make explicit their reasons for any recommendation to switch products. But I do not favour this approach. It would represent a significant expansion of the safe harbour model and, given that the present safe harbour model does not prevent interest from trumping duty, altering the model is unlikely to work.

Another option would be to remove the safe harbour provision entirely. In my view, such a change would not be without merit. As I have said, the safe harbour provision currently has the effect that, in practice, an adviser is required to make little or no independent inquiry into, or assessment of, products. By prescribing particular steps that must be taken, and allowing advisers to adopt a 'tick a box' approach to compliance, the safe harbour provision has the potential to undermine the broader obligation for advisers to act in the best interests of their clients.

Having said that, I am not convinced that it is necessary or appropriate to remove the safe harbour provision at this stage. There are already many changes affecting financial advisers that will come into effect over the next few years; there will be more if the recommendations in this report are adopted. Whether it is necessary to remove, or otherwise amend, the safe harbour provision will depend in part on how effective those other changes have been in improving the quality of advice given by financial advisers.

In my view, once those changes have come into effect, there will be significant value in conducting a review to determine whether those changes have been effective in improving the quality of advice. The review should consider not only changes in the law, but also changes in the practices of regulators and financial services entities (whether made in response to changes in the law, or otherwise). If those changes have not – or have

not sufficiently – improved the quality of advice given by financial advisers, consideration must be given to what further changes will be necessary.

Among other things, that review should consider whether it is necessary to retain the safe harbour provision. Unless there is a clear justification for retaining that provision at that time, it should be repealed.

Recommendation 2.3 – Review of measures to improve the quality of advice

In three years' time, there should be a review by Government in consultation with ASIC of the effectiveness of measures that have been implemented by the Government, regulators and financial services entities to improve the quality of financial advice. 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. Unless there is a clear justification for retaining that provision, it should be repealed.

Each measure I have described should improve the way that financial advisers manage the conflicts of interest that pervade their industry.

But, in my view, none of those measures, either alone or in combination, will be sufficient to ensure that conflicts of interest in the financial advice industry are managed adequately.

As I noted in the *Interim Report*,²⁰³ the results recorded in ASIC's report on vertical integration were obtained by examining the files of 10 advice licensees associated with the five largest entities: AMP, ANZ, CBA, NAB, and Westpac. As such, they are results based on the work of advisers associated with the largest entities that may, because of their size, be assumed to be the best-resourced, and the most capable of managing conflicts of interest. They are results that, on their face, deny the fundamental premise for the legislative scheme of the FoFA reforms:

²⁰³ FSRC, *Interim Report*, vol 1, 91.

that conflicts of interest can be ‘managed’ by saying to advisers, ‘prefer the client’s interests to your own’. Experience (too often, hard and bitter experience) shows that conflicts cannot be ‘managed’ by saying, ‘Be good. Do the right thing’. People rapidly persuade themselves that what suits them is what is right. And people can and will do that even when doing so harms the person for whom they are acting.

Nor, as I have explained above, can conflicts be ‘managed’ by requiring disclosure of their existence. Since FoFA, disclosure has been treated as a central (even complete and sufficient) remedy for conflicts of interest. The evidence shows that the current arrangements have not worked. Too often, interest trumps duty.

It is necessary, therefore, to see what else can and should be done. And to do that, it is necessary to challenge the fundamental premise of the FoFA reforms that conflicts can be ‘managed’. Not all conflicts can be ‘managed’. As far as reasonably possible, conflicts should be eliminated.

3.3 Reducing or eliminating the conflict

As I said in the *Interim Report*,²⁰⁴ and have repeated above, consideration of conflicts between duty and interest begins from two simple observations:

- So long as advisers stand to benefit financially from clients acting on the advice that is given, the adviser’s interests conflict with the client’s interests.
- So long as licensees stand to benefit financially from clients acting on the advice that is given, the licensee’s interests conflict with the client’s interests.

Consideration of how to reduce or eliminate conflicts of interest in the financial advice industry must therefore begin with consideration of the benefits that flow to advisers and licensees.

3.3.1 Conflicted remuneration

As I have mentioned, the FoFA reforms included a ban on conflicted

²⁰⁴ FSRC, *Interim Report*, vol 1, 139.

remuneration. That is, they provided that a **financial services licensee** must not accept conflicted remuneration and that it must take reasonable steps to ensure that representatives of the licensee do not accept conflicted remuneration.²⁰⁵

Section 963A of the Corporations Act defines conflicted remuneration as ‘any benefit, whether monetary or non-monetary, given to a financial services licensee or a representative of the licensee, who provides financial product advice to persons as retail clients that, because of the nature of the benefit or the circumstances in which it is given:

- could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients; or
- could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.’

That is, the very hinge about which the conflicted remuneration provisions turn, is that the payment is one that ‘could reasonably be expected to influence the choice of financial product recommended to retail clients’.

An authorised representative²⁰⁶ or other representative²⁰⁷ must not accept conflicted remuneration. An employer of a financial services licensee or a representative of a licensee must not give employees conflicted remuneration²⁰⁸ and a product issuer or seller must not do so.²⁰⁹

Volume-based benefits are presumed to be conflicted remuneration.²¹⁰ A platform operator cannot accept volume-based shelf-space fees.²¹¹ Financial services licensees²¹² and authorised representatives²¹³ are forbidden to charge asset-based fees on borrowed amounts.

²⁰⁵ Corporations Act s 963F.

²⁰⁶ Corporations Act s 963G.

²⁰⁷ Corporations Act s 963H.

²⁰⁸ Corporations Act s 963J.

²⁰⁹ Corporations Act s 963K.

²¹⁰ Corporations Act s 963L.

²¹¹ Corporations Act ss 964, 964A.

²¹² Corporations Act s 964D.

²¹³ Corporations Act s 964E.

From 1 January 2018, conflicted remuneration includes volume-based benefits given to a licensee or representative in relation to information given on, or dealing in, a life risk insurance product.²¹⁴ A monetary benefit relating to a life risk product will not be conflicted remuneration if it is a level commission within the applicable cap²¹⁵ and provides a 'clawback' arrangement if the policy is cancelled, not continued, or the policy cost is reduced in the first two years of the policy.²¹⁶

Section 965 seeks to prevent avoidance of the conflicted remuneration provisions by forbidding entering into, beginning to carry out or carrying out a scheme if it would be concluded that the sole purpose of the scheme was to avoid the application of any part of the relevant Corporations Act division.

On their face the conflicted remuneration prohibitions may appear to be comprehensive. But there are exceptions to their application²¹⁷ relating to general insurance,²¹⁸ life risk insurance products²¹⁹ and basic banking products,²²⁰ and there is also power to prescribe benefits, or circumstances in which a benefit is given, that take the benefit outside the definition of conflicted remuneration.²²¹

Any attempt to reduce or eliminate conflicts of interest in the financial advice industry must begin, therefore, with examination of those exceptions, and whether they continue to be justified. That examination must take place against the point of principle made by ASIC in its submissions. This is that

²¹⁴ Corporations Regulations 2001 (Cth) reg 7.7A.11B.

²¹⁵ For the calendar year 2018, 80% upfront commission and 20% trail commission, reducing to 70% upfront and 20% trail in 2019 and 60% upfront and 20% trail from 1 January 2020. See ASIC, ASIC Corporations (Life Insurance Commissions) Instrument 2017/510, 31 May 2017 (Cth) Pts 2, 3; Corporations Act s 963B; Corporations Regulations 2001 (Cth) regs 7.7A.11C(1)(d), 7.7A.11D(1)(b).

²¹⁶ See ASIC, ASIC Corporations (Life Insurance Commissions) Instrument 2017/510, 31 May 2017 (Cth) s 6.

²¹⁷ ASIC, Regulatory Guide 246, 7 December 2017, 72.

²¹⁸ Corporations Act s 963B(1)(a).

²¹⁹ Corporations Act s 963B(1)(b).

²²⁰ Corporations Act s 963D.

²²¹ Corporations Act s 963B(1)(e).

‘any exception to the ban on conflicted remuneration, by definition, has the ability to create misaligned incentives, which can lead to inappropriate advice’.²²² As I said in the *Interim Report*,²²³ that is not a point that depends on evidence. It is the unchallenged (and unchallengeable) basic premise for the conflicted remuneration provisions.

I will begin with the exception that received the most attention in the Commission’s hearings – the exception for **grandfathered commissions**.

The exception for grandfathered commissions

As I noted in the *Interim Report*,²²⁴ after the commencement of the FoFA reforms, payment and receipt of some forms of conflicted remuneration for financial advice was permitted to continue by ‘grandfathering’ provisions made by Subdivision 5 of Division 4 of Part 7.7A of the Corporations Regulations 2001 (Cth).²²⁵ It is neither necessary nor profitable to trace the detail or history of those grandfathering provisions. At the risk of some minor inaccuracy it is enough to note that certain arrangements made before the FoFA reforms came into force in July 2013 that would otherwise have fallen within the ban on conflicted remuneration were, and remain, excluded from the definition of conflicted remuneration. For present purposes, two points are important.

First, despite it being recognised that the grandfathered forms of remuneration are conflicted remuneration (because they could reasonably be expected to influence the choice of financial product recommended by a licensee or representative to retail clients, or could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative), charging and receiving these exempted forms of remuneration has been permitted to continue.

²²² ASIC, Module 2 Policy Submission, 31 [139].

²²³ FSRC, *Interim Report*, vol 1, 97.

²²⁴ FSRC, *Interim Report*, vol 1, 93.

²²⁵ Corporations Regulations 2001 (Cth) regs 7.7A.15B–7.7A.16F.

Second, in 2014 when ASIC looked at the value of ‘grandfathered’ benefits, it found that, ‘[o]n average, licensees indicated that grandfathered benefits were worth around one-third of their total income (though substantially more or less than the average in some cases).’²²⁶

In the *Interim Report*,²²⁷ I posed the following question: If the premise for the conflicted remuneration provisions is accepted (and no-one suggested that it should not be) how can the grandfathering provisions be justified today?

In my view, the answer to that question is now clear: they cannot.

Each of the major banks has already announced steps to reduce or eliminate payments of grandfathered commissions in their financial advice businesses.²²⁸

Westpac was the first to make changes in this area. In June 2018, Westpac announced that financial advisers employed by BT Financial Advice would no longer receive grandfathered commissions. Westpac estimated that up to 140,000 client accounts were subject to commissions that would be removed,²²⁹ and estimated a resulting \$40.8 million annual reduction in revenue.²³⁰ But it also noted the countervailing advantage that the products relieved of grandfathered commission will be more attractive to clients and therefore will be more competitive market offerings.²³¹ Ultimately, Westpac said, it was preferable to make the changes because they were consistent with the intent of the legislation, the interests of customers, and the professionalisation of the financial advice industry.²³²

²²⁶ ASIC, Report 407, 17 September 2014, 30 [96].

²²⁷ FSRC, *Interim Report*, vol 1, 94.

²²⁸ ANZ, Interim Report Submission, 35–6 [175]; CBA, Interim Report Submission, 40 [215]; NAB, Interim Report Submission, 13 [32]; Westpac, Interim Report Submission, 29 [134].

²²⁹ Exhibit 2.278, Witness statement of Michael Wright, 15 August 2018, 5 [27].

²³⁰ The estimate was made as at 15 August 2018: see Exhibit 2.278, Witness statement of Michael Wright, 15 August 2018, 6 [33(a)].

²³¹ Exhibit 2.278, Witness statement of Michael Wright, 15 August 2018, 7 [39].

²³² Exhibit 2.278, Witness statement of Michael Wright, 15 August 2018, 3 [19].

In early July 2018, media reported that Macquarie had issued a statement that it would turn off commissions paid to its private wealth and private bank advisers, affecting approximately 17,000 client accounts.²³³

In August 2018, ANZ informed the Commission that, from April 2019, ANZ Financial Planning would no longer retain grandfathered commissions in relation to the OnePath investment and superannuation platforms, and that clients would receive the amount of the commission by way of a rebate.²³⁴

On 3 September 2018, NAB announced that customers of its Financial Planning and Direct Advice businesses would be rebated grandfathered commissions paid by NAB Wealth product providers from 1 January 2019.²³⁵

On 9 October 2018, CBA announced that it would rebate all grandfathered commissions to CFPL clients from January 2019 in respect of investment and superannuation products. CBA estimated that this would benefit around 50,000 client accounts by a total of approximately \$20 million annually.²³⁶

The submissions made in response to the *Interim Report* also supported ending grandfathered commission payments to financial advisers,²³⁷ and from superannuation accounts.²³⁸ In their submissions, each of the major

²³³ See, eg, Alice Uribe, 'Macquarie Scraps Grandfathered Commissions', *Australian Financial Review*, 3 July 2018 <www.afr.com/business/banking-and-finance/financial-services/macquarie-scraps-grandfathered-commissions-20180703-h126n8>.

²³⁴ Letter from ANZ to Mr Simon Daley dated 20 August 2018.

²³⁵ NAB, 'NAB Moves on Grandfathered Commissions' (Media Release, 3 September 2018).

²³⁶ CBA, Interim Report Submission, 14 [66]–[67].

²³⁷ See Mortgage Choice, Interim Report Submission, 19; ABA, Interim Report Submission, 13; FSC, Interim Report Submission, 10; AMP, Interim Report Submission, [73]; ASFA, Interim Report Submission, 4, 16–17.

²³⁸ See CBA (Colonial First State Investments and Avanteos), Module 5 Policy Submission, 18–19 [99]–[100]; NAB, Module 5 Policy Submission, 16 [67]; Westpac, Module 5 Policy Submission, 13 [44]; ANZ, Module 5 Policy Submission, 7 [40]; ASIC, Module 5 Policy Submission, 20 [98]; ISA, Module 5 Policy Submission, 9 [31]; FSU, Module 5 Policy Submission, 20 [140]; TWU Super, Module 5 Policy Submission, 3–4 [15]–[16]; ASFA, Module 5 Policy Submission, 16–17; AIST, Module 5 Policy Submission, 13.

banks, along with other industry participants, supported legislation to repeal the grandfathering provisions under the Corporations Act.²³⁹

At the time the grandfathering arrangements were first introduced, participants in the industry could say that sudden change in remuneration arrangements may bring untoward consequences for countervailing benefits that would not outweigh the harms of disruption. In the seventh round of hearings, Mr Comyn cast doubt on whether that argument was ever valid. He described the decision by banks to lobby for the grandfathering exemption as a ‘poor decision’.²⁴⁰ Even if the arguments relied on to justify the grandfathering exception were valid when that exception was introduced, it is now clear that they have outlived their validity.

Recommendation 2.4 – Grandfathered commissions

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

The exception for life risk insurance

Another exception that received attention during the Commission’s hearings was the exception for commissions on life risk insurance products.

Until 1 January 2018, commissions paid in respect of life risk insurance products (other than **group life policies** and life policies for members of default superannuation funds) were exempt from the ban on conflicted remuneration. This meant that product issuers – that is, life insurance companies – could continue to pay financial advisers high rates of upfront and trail commission to encourage the advisers to recommend their products.

In the Commission’s sixth round of hearings, the witness statements received from the life insurers showed that each paid commissions to financial advisers (or financial advice entities) whose clients purchased

²³⁹ ANZ, Interim Report Submission, 35–6 [175]; CBA, Interim Report Submission, 14 [66]; NAB, Interim Report Submission, 13 [31]; Westpac, Interim Report Submission, 29 [133]; ABA, Interim Report Submission, 13; FSC, Interim Report Submission, 10; FPA, Interim Report Submission, 10.

²⁴⁰ Transcript, Matthew Comyn, 19 November 2018, 6550.

their products. Between 1 July 2013 and the sixth round of the Commission's hearings:²⁴¹

- Zurich paid more than \$113 million in commissions in respect of its life insurance products;
- AMP paid more than \$380 million;
- CMLA paid more than \$460 million;
- Suncorp paid more than \$590 million;
- AIA paid more than \$690 million;
- Westpac paid more than \$697 million, and a further \$158 million in grandfathered commissions in relation to life insurance arrangements within superannuation accounts;
- TAL paid more than \$840 million;
- OnePath paid more than \$1.02 billion; and
- MLC paid more than \$1.16 billion.

That amounts to a total of more than \$6.1 billion paid in commissions to financial advisers in connection with the sale of life insurance products issued by these insurers in about five years.

As noted above, since 1 January 2018, conflicted remuneration has included volume-based benefits given to a licensee or representative

²⁴¹ Exhibit 6.18, Witness statement of Tim Bailey, 21 August 2018, 26 [20]; Exhibit 6.26, Witness statement of Gregory Johnson, 10 September 2018, 47–8 [143]; Exhibit 6.20, Witness statement of Helen Troup, 31 August 2018, 19 [106]; Exhibit 6.494, 19 December 2018, Letter from CMLA Re Correction to Statement of Helen Troup; Exhibit 6.25, Witness statement of Christopher McHugh, 27 August 2018, 40 [94]; Exhibit 6.11, Witness statement of Michael Thornton, 21 August 2018, 59 Annexure F Table C; Exhibit 6.410, Witness statement of Michael Wright, 20 September 2018, 2–3 Schedule D; Exhibit 6.7, Witness statement of Timothy Thorne, 22 August 2018, 46 [171]; Exhibit 6.24, Witness statement of Gavin Pearce, 21 August 2018, 60–1 [184]; Exhibit 6.13, Witness statement of Sean McCormack, 21 August 2018, Exhibit SAM-1 Tab 20 [MLC.101.007.0060].

in relation to information given on, or dealing in, a life risk insurance product.²⁴² But a monetary benefit relating to a life risk product will not be conflicted remuneration if it is a level commission within the applicable cap²⁴³ and provides a ‘clawback’ arrangement if the policy is cancelled, not continued, or the policy cost is reduced in the first two years of the policy.²⁴⁴

ASIC will conduct a post-implementation review in 2021 to assess the effect of the reforms.²⁴⁵

In the *Interim Report*,²⁴⁶ I questioned the separate treatment of benefits given in relation to life risk products (other than a group life policy for members of a superannuation entity, or a life policy for a member of a default superannuation fund).²⁴⁷

In contrast to the position in relation to grandfathered commissions, few submissions in response to the *Interim Report* supported making any further changes to the exception for life risk insurance products. Many submissions pointed to the fact that the arrangements that took effect on 1 January 2018 reflect a compromise between the risk of underinsurance and the risk of adverse client outcomes arising from conflicts of interest.²⁴⁸ Many submissions proposed that the best course would be to allow the cap on commissions to continue to reduce over the next few years, and to allow ASIC to undertake its planned post-implementation review in 2021.²⁴⁹

²⁴² Corporations Regulations 2001 (Cth) reg 7.7A.11B.

²⁴³ For the calendar year 2018, 80% upfront commission and 20% trail commission, reducing to 70% upfront and 20% trail in 2019 and 60% upfront and 20% trail from 1 January 2020. See ASIC, ASIC Corporations (Life Insurance Commissions) Instrument 2017/510, 31 May 2017 (Cth) Pts 2, 3; Corporations Act s 963B; Corporations Regulations 2001 (Cth) regs 7.7A.11C(1)(d), 7.7A.11D(1)(b).

²⁴⁴ See ASIC, ASIC Corporations (Life Insurance Commissions) Instrument 2017/510, 31 May 2017 (Cth) s 6.

²⁴⁵ ASIC, Media Release 17-168MR, 5 June 2017.

²⁴⁶ FSRC, *Interim Report*, vol 1, 157.

²⁴⁷ Corporations Act s 963B(1)(b).

²⁴⁸ See, eg, NAB, Interim Report Submission, 14 [35].

²⁴⁹ See, eg, CBA, Interim Report Submission, 14–15 [68].

I doubt that a complete ban on conflicted remuneration in respect of life insurance products would lead to significant underinsurance. At the time of writing, the overwhelming majority of life insurance policies in Australia are held through superannuation funds. As at August 2017, more than 70% of Australian life insurance policies were held in this way.²⁵⁰ While it may not follow that every Australian who holds a life insurance policy through a superannuation fund has the same level of cover that he or she would be advised was appropriate on consulting a financial adviser, I am not convinced that a move away from commissions for life insurance products would see large numbers of Australians without an appropriate level of life insurance.

Having said that, I accept that the best way to be sure of the effect of lowering or removing commissions for life insurance products is to assess what happens as the levels of those commissions are reduced over the next few years. I also acknowledge that the financial advice industry will need time to absorb a number of changes over the next few years, and that there may be some benefit in deferring the implementation of further changes to arrangements for life insurance commissions.

I encourage ASIC to take all necessary steps to ensure that it conducts its post-implementation review in 2021 as expeditiously as possible. If that review indicates that the cap on commissions has not contributed (or, at least, not significantly contributed) to underinsurance, then I would urge ASIC to continue reducing the cap – ultimately, to zero. Unless the reduction in life insurance commissions can be shown to contribute significantly to underinsurance, I can see no justification for allowing this form of conflicted remuneration to continue to be paid. While the decision will ultimately be one for ASIC, any decision that commissions should continue to be paid and received in relation to life insurance products should be based on clear evidence that the harm that would flow from abolishing commissions would outweigh the harm that already flows from allowing this form of conflicted remuneration to continue.

²⁵⁰ See Peter Kell, 'Insurance in Super: The Regulators – What Do They Think?' (Speech delivered at the Association of Superannuation Funds of Australia Spotlight on Insurance, Sydney, Australia, 27 February 2018).

Recommendation 2.5 – Life risk insurance commissions

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 exceptions for general insurance, consumer credit insurance and non-monetary benefits

In the course of the review referred to in Recommendation 2.3, a question that ought to arise is whether the exceptions to the ban on conflicted remuneration for general insurance products, consumer credit insurance products and non-monetary benefits remain justified.

Monetary and non-monetary benefits given solely in relation to general insurance products are currently wholly exempt from the ban on conflicted remuneration, and have been since the conflicted remuneration provisions of the Corporations Act commenced on 1 July 2012.²⁵¹ Monetary benefits given in relation to consumer credit insurance products are also exempt,²⁵² as are non-monetary benefits given in the circumstances set out in section 963C of the Corporations Act.

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. In my view, if the exemptions are still in place at that time,²⁵³ it will be appropriate for ASIC to consider whether each of them remains justified.

²⁵¹ Corporations Act ss 963B(1)(a), 963C(1)(a). Advice given in relation to general insurance products and consumer credit insurance products was also carved out of other aspects of the FoFA reforms, including the best interests duty: see Corporations Act s 961B(3).

²⁵² Corporations Act s 963B(1)(ba).

²⁵³ On 18 December 2018, the ACCC released the first interim report of its Northern Australia Insurance Inquiry. One of the recommendations in that report was to remove the exemption for general insurance products from the conflicted remuneration provisions: see ACCC, *Northern Australia Insurance Inquiry: First Interim Report*, November 2018, 196.

Recommendation 2.6 – General insurance and consumer credit insurance commissions

The review referred to in Recommendation 2.3 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; and
- the exemptions for non-monetary benefits set out in section 963C of the Corporations Act.

3.3.2 Structural separation?

Although the most obvious conflicts of interest affecting the provision of financial advice are the conflicts between an adviser's duty and his or her *financial* interests, they are not the only conflicts. Other conflicts can also arise from the associations or relationships between a financial adviser and the issuer of financial products. As I said earlier, advisers may be expected to know more about the products manufactured by the licensee with which the advisers are associated than they know about a rival licensee's products. Advisers will often be readily persuaded that the products 'their' licensee offers are as good as, if not better than, those of a rival. These types of conflicts direct attention to the structure of the industry.

In the *Interim Report*,²⁵⁴ I asked: How far can, and how far should, there be a separation between providing financial advice and manufacture or sale of financial products? There are several forms that any such separation could take.

- One approach would be to require all advisers to be 'independent' advisers, in the sense that they must satisfy the requirements of section 923A(2) of the Corporations Act, which govern the use of the words 'independent', 'impartial' and 'unbiased'.

²⁵⁴ FSRC, *Interim Report*, vol 1, 156.

- Another approach would be to require separation between any AFSL holder authorised to issue financial products and any AFSL holder authorised to provide financial product advice.
- An alternative approach would be to prohibit any adviser who is not an ‘independent’ adviser within the meaning of section 923A of the Corporations Act from recommending any product manufactured by an entity associated with the AFSL holder with which the adviser is associated.

Adopting any of these approaches would be likely to reduce the conflicts of interest that affect the financial advice industry.²⁵⁵ So much may be accepted. But, adopting any of these approaches would also involve significant disruption to that industry, and the financial services industry more broadly.

This point was emphasised in the submissions received by the Commission following the second round of hearings, and in response to the *Interim Report*. Almost none of those submissions supported the enforced separation of product and advice.²⁵⁶ Many pointed to benefits of vertical integration (such as economies of scale, and the convenience for customers of a relationship with a single financial institution)²⁵⁷ that would be lost if

²⁵⁵ ASIC, Treasury, ANZ, CBA, NAB and Westpac all accepted that a vertically integrated business model gives rise to conflicts of interest: ASIC, Module 2 Policy Submission, 4 [15], 29–30 [128]–[137]; Treasury, Module 2 Policy Submission, 6 [38]; ANZ, Module 2 Policy Submission, 3 [11]–[12]; CBA, Module 2 Policy Submission, 2 [6]; NAB, Module 2 Policy Submission, 6 [21]; Westpac, Module 2 Policy Submission, 28 [111].

²⁵⁶ None of ASIC, AMP, ANZ, CBA, NAB, Westpac, the AFA or the FSU supported the enforced separation of product and advice: ASIC, Module 2 Policy Submission, 30 [137]; AMP, Module 2 Policy Submission, 26 [132]; ANZ, Module 2 Policy Submission, 3–4 [11], [15]–[18]; CBA, Module 2 Policy Submission, 1–3 [2]–[7] (in respect of platform operators and financial advisers); NAB, Module 2 Policy Submission, 5 [18], 24 [101]; Westpac, Module 2 Policy Submission, 28 [111]; AFA, Module 2 Policy Submission, 8, 26; FSU, Module 2 Policy Submission, 23 [171], 24 [183]; Westpac, Interim Report Submission, 27–8 [126]–[128]; CBA, Interim Report Submission, 49–50 [268]–[278]; ANZ, Interim Report Submission, 48 [222]–[223]; ABA, Interim Report Submission, 18–19; FSC, Interim Report Submission, 8.

²⁵⁷ ASIC, Report 562, 1 January 2018, 16 [56]–[57].

structural separation were enforced.²⁵⁸ This was perhaps unsurprising from those whose businesses might be affected by the changes. But it is noteworthy that ASIC was among those who did not support structural separation of product and advice.²⁵⁹

Ultimately, whether there should be a separation between the manufacture or sale of financial products and the provision of financial advice will depend on whether the benefits of such a separation would outweigh the costs.

The assessment of those benefits and costs must take place against the backdrop of:

- the changes to the regulation of the financial advice industry that are already in train, and will take effect in the coming years – including the improvements to adviser education standards and the introduction of the design and distribution obligations and ASIC's product intervention power;
- the additional changes to the regulation of the financial industry that will take effect in the coming years if the recommendations in this Report are adopted – including the cessation of grandfathered commissions, and a more coherent and effective disciplinary system; and
- the changes to the industry, as many vertically integrated firms sell parts of their businesses.

I have dealt with the first two of those points elsewhere in this chapter, and I need not repeat those matters here. The third point warrants further attention.

I said earlier in this chapter that from the time of the Wallis Inquiry, banks' accumulation of wealth management businesses accelerated. During the late 1990s and early 2000s, each of the major banks acquired or merged with a fund manager. In more recent times, banks have sold off a number of those acquisitions.

²⁵⁸ See, eg, AMP, Module 2 Policy Submission, 8–10 [34]–[39]; CBA, Module 2 Policy Submission, 1–3 [2]–[7]; NAB, Module 2 Policy Submission, 5 [18]–[20].

²⁵⁹ ASIC, Module 2 Policy Submission, 30 [137].

In May 2017, Westpac sold BT Investment Management, a product manufacturer.²⁶⁰

- In September 2017, CBA announced that it was selling its life insurance business to AIA,²⁶¹ and, in July 2018, announced that it would seek to sell the remainder of that business.²⁶² In late June 2018, CBA announced that it would demerge its other wealth management and mortgage broking businesses, including Colonial First State, Colonial First State Global Asset Management, Count Financial, Financial Wisdom and Aussie Home Loans, into a separately listed entity.²⁶³
- In October 2017, ANZ sold its aligned licensees to IOOF.²⁶⁴
- In May 2018, NAB announced that it proposed to sell its MLC advice, platform and superannuation, and asset management businesses.²⁶⁵
- In October 2018, AMP announced the sale of its life business,²⁶⁶ and throughout the course of 2018, AMP exited almost 200 'higher risk' practices.²⁶⁷ There has also been a change to AMP's business strategy in its advice business throughout 2018. Mr Michael Wilkins' evidence in the seventh round of the Commission's hearings was that AMP's strategy for the period 2018 to 2022 is to transition AMP from primarily a face-to-face aligned advice channel structure, to more integrated and digitally enabled channels.²⁶⁸ Each of these changes was prompted, at least in

²⁶⁰ Transcript, Brian Hartzler, 21 November 2018, 6834.

²⁶¹ CBA, 'Divestment of Australian and New Zealand Life Insurance Businesses' (ASX Announcement, 21 September 2017).

²⁶² CBA, 'Completion of New Zealand Life Insurance Divestment' (ASX Announcement, 2 July 2018).

²⁶³ CBA, 'Intention to Demerge Wealth Management and Mortgage Broking Business' (ASX Announcement, 25 June 2018).

²⁶⁴ ANZ, *Submission in Response to the Commission's Letters of 15 December 2017*, 7 [5.6]; IOOF, 'IOOF to Acquire ANZ's OnePath Pensions and Investments Business and Aligned Dealer Groups' (Media Release, 17 October 2017).

²⁶⁵ NAB, '2018 Half Yearly Results 2018' (Half Year Results, 3 May 2018) 15, 53.

²⁶⁶ AMP announced the sale of its life business on 25 October 2018. See Transcript, Michael Wilkins, 27 November 2018, 7216.

²⁶⁷ Transcript, Michael Wilkins, 28 November 2018, 7246.

²⁶⁸ Transcript, Michael Wilkins, 27 November 2018, 7208.

part, by the increased regulatory scrutiny around AMP's advice business and was, and is, intended to be a way of managing that risk.²⁶⁹

Of course, none of these entities has abandoned the vertically integrated business model entirely.

- ANZ continues to employ financial planners through ANZ Financial Planning.
- NAB continues to employ financial advisers through NAB Financial Planning, and intends to keep one advice licensee, JBWere.
- CBA intends to continue to employ financial advisers through CFPL.²⁷⁰ In the seventh round of the Commission's hearings, Mr Comyn said that CBA wants to continue to provide financial advice for customers, and is exploring the best long-term model for financial advice.²⁷¹ Mr Comyn acknowledged difficulties with and conflicts inherent in vertically integrated business models.²⁷²
- Mr Wilkins made plain in his evidence that AMP remains committed to a vertically integrated business model, and that that model remains fundamental to AMP's business.²⁷³
- At the time of writing, Westpac has not announced its intention to sell its wealth business. In the seventh round of hearings, Mr Brian Hartzer acknowledged that there is a potential for conflict in Westpac owning both the advice licensee and product manufacturer.²⁷⁴

The changes that have been made appear to have resulted, at least in part, from the increased costs associated with employing professional advisers, as compared to a team of salespeople. Mr Hartzer said, in effect, that the cost of compliance to ensure that advisers are properly qualified, and

²⁶⁹ See Transcript, Michael Wilkins, 27 November 2018, 7208, 7216; Transcript, Michael Wilkins, 28 November 2018, 7246.

²⁷⁰ Transcript, Matthew Comyn, 20 November 2018, 6681–2.

²⁷¹ Transcript, Matthew Comyn, 20 November 2018, 6682.

²⁷² Transcript, Matthew Comyn, 20 November 2018, 6682–3.

²⁷³ See Transcript, Michael Wilkins, 28 November 2018, 7238–46.

²⁷⁴ Transcript, Brian Hartzer, 21 November 2018, 6834.

that provision of advice and services is properly documented, is high.²⁷⁵ The tenor of Mr Hartzer's evidence was that the value in Westpac owning advice licensees had changed over time – and changed to a point where the business model was not as profitable as it was once.²⁷⁶ At least to some extent the change can be attributed to a shift in the role authorised representatives have played in Westpac's wealth business; from distribution channels to professionals providing advice and owing duties to clients.²⁷⁷

As further changes to the regulation of the financial advice industry take effect over the coming years, those costs are likely to increase – or, at the least, are unlikely to reduce. It follows that the trend away from vertically integrated institutions may well continue, even if structural separation is not mandated.

A further complicating factor in the analysis is the present uncertainty about the impact of technological developments on the financial advice industry. Many in the industry have recognised that technology is likely to play an important role in the future of financial advice,²⁷⁸ but there is not yet a clear picture of what that role might be. Any recommendation directed to altering the current structure of the industry would need to grapple with the fact that the industry itself will very probably look very different in five years' time.

The industry is already undergoing significant change. Many of those changes – both those already in train, and those recommended in this Report – should improve the way that conflicts of interest are managed by financial advisers, and help to eliminate some of those conflicts. Further changes will follow as the industry adjusts to these and other changes – including, perhaps, a continued shift away from vertically integrated institutions, which would help to reduce or further eliminate conflicts of interest.

²⁷⁵ Transcript, Brian Hartzer, 21 November 2018, 6831.

²⁷⁶ See, generally, Transcript, Brian Hartzer, 21 November 2018, 6832–4.

²⁷⁷ See, generally, Transcript, Brian Hartzer, 21 November 2018, 6832–4.

²⁷⁸ See Background Paper No 6 (Part A), 7. See also AMP, Interim Report Submission, 6 [27]; Westpac, Interim Report Submission, 1 [4]; Institute of Managed Account Professionals, Interim Report Submission, 12; ANZ, Interim Report Submission, 47 [220(c)].

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’.²⁷⁹ I observe, however, that the Productivity Commission recommended, and I agree, that commencing in 2019, the Australian Competition and Consumer Commission (the ACCC) ‘should undertake 5 yearly market studies on the effect of vertical and horizontal integration in the financial system’.²⁸⁰

I am not persuaded that it is necessary to mandate structural separation between product and advice.

4 Professional discipline

Introduction

The third matter that emerged in connection with the provision of financial advice related to the disciplinary system for financial advisers. That system now consists of a number of bodies, each directed at regulating different, though related, norms of behaviour, and each geared to different outcomes.

Those bodies are:

- AFSL holders;
- ASIC;
- industry associations; and
- once they are appointed, the code-monitoring bodies responsible for monitoring compliance with the Code of Ethics developed by FASEA.

²⁷⁹ Productivity Commission, Report 89, 29 June 2018, 272.

²⁸⁰ Productivity Commission, Report 89, 29 June 2018, 274.

The question that I posed in the *Interim Report* was whether this segmentation imposes a satisfactory standard of behaviour on what is, as numerous witnesses noted, an aspiring profession.

It does not.

All too often, the fragmented disciplinary arrangements for financial advisers have meant that advisers who engage in poor or unlawful conduct have not faced appropriate consequences for their actions. Experience shows that those who feel they are unlikely to face consequences for their poor conduct are much more likely to engage in that conduct.

One of the case studies in the second round of the Commission's hearings illustrated some of the issues that arise from the current fragmented disciplinary arrangements for financial advisers. Mr Sam Henderson was one of two financial advisers who provided advice under the AFSL of Henderson Maxwell Pty Ltd.²⁸¹ Mr Henderson was also the CEO of that company.²⁸² Acting in his capacity as a representative of Henderson Maxwell Pty Ltd, Mr Henderson provided financial advice to Ms Donna McKenna. It was poor advice. If implemented, the advice would have caused Ms McKenna to forfeit her entitlement to approximately \$500,000.²⁸³

Ms McKenna made a complaint to the AFSL holder: Henderson Maxwell Pty Ltd.²⁸⁴ The company imposed no consequences on its CEO, Mr Henderson, in respect of his poor advice.

Ms McKenna made a complaint to ASIC, but ASIC took no action against Mr Henderson at that time.²⁸⁵

Ms McKenna made a complaint to the Financial Planning Association of Australia (FPA), an industry association of which Mr Henderson was a

²⁸¹ Transcript, Sam Henderson, 24 April 2018, 1747.

²⁸² Transcript, Sam Henderson, 24 April 2018, 1747.

²⁸³ Transcript, Donna McKenna, 24 April 2018, 1739; Transcript, Sam Henderson, 24 April 2018, 1762.

²⁸⁴ Transcript, Donna McKenna, 24 April 2018, 1740.

²⁸⁵ Exhibit 2.197, Witness statement of Donna McKenna, 16 April 2018, 7–8 [49]–[52].

member.²⁸⁶ The FPA investigated that complaint and, at the time of the second round of the Commission's hearings, was considering resolving the complaint with Mr Henderson on a confidential basis.²⁸⁷ In the course of the FPA's disciplinary process, Mr Henderson did not renew his membership of that organisation as a 'protest to not being heard'.²⁸⁸ Doing so did not affect his ability to continue to provide financial advice. In October 2018, the FPA announced that it had fined Mr Henderson \$50,000.²⁸⁹ Given that Mr Henderson had sold his interests in the advice licensee, Henderson Maxwell, and had left the industry, it is not clear whether or how the penalty would be recovered.

Other case studies in the second round of the Commission's hearings illustrated a different set of issues that arise from the fragmented disciplinary system referred to above. The Commission heard evidence about a number of advisers whose employment or authorised representative status was terminated by the licensee for misconduct, or who resigned after allegations of misconduct were made against them. Most had been members of the FPA. But the relevant AFSL holders did not report their concerns about those advisers to that association.²⁹⁰

Some were also members of the AFA, another industry association. But the relevant AFSL holders did not report their concerns about those advisers to the AFA either.²⁹¹

Some of the advisers became authorised representatives of a different licensee, Dover Financial Advisers Pty Ltd.²⁹² Their previous licensees

²⁸⁶ Transcript, Donna McKenna, 24 April 2018, 1741.

²⁸⁷ Exhibit 2.214, 24 April 2018, Email and Attachment Concerning Agreed Disposal of CRC Disciplinary Proceedings, 10.

²⁸⁸ Transcript, Sam Henderson, 24 April 2018, 1767. See also Transcript, Dante De Gori, 26 April 2018, 1796.

²⁸⁹ FPA, 'FPA Conduct Review Commission Hands Down Determination for Sam Henderson Case' (Media Release, 11 October 2018).

²⁹⁰ Transcript, Dante De Gori, 26 April 2018, 1821.

²⁹¹ Transcript, Philip Kewin, 26 April 2018, 1841.

²⁹² See Exhibit 2.236, Witness statement of Terrence McMaster, 10 April 2018, 4–8 [32]–[71]. See also Transcript, Michael Wright, 20 April 2018, 1459; Transcript, Darren Whereat, 20 April 2018, 1546; Transcript, Sarah Britt, 23 April 2018, 1640.

took inadequate steps to make Dover aware of their concerns about those advisers.²⁹³

These are no more than particular illustrations of problems that arise from the existing disciplinary arrangements for financial advisers. I have no doubt those examples could be multiplied.

As I have said, 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. The financial advice industry currently lacks such a system. While ASIC has the power to ban financial advisers from providing financial services, the existing disciplinary arrangements for financial advisers are fragmented and ineffective, and are hampered by inadequate sharing of information and gaps between the overlapping roles of the different bodies referred to above.

A coherent system of professional discipline must be established for financial advisers. I begin by identifying some of the key features of such a system.

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

²⁹³ Transcript, Michael Wright, 20 April 2018, 1459–62; Transcript, Darren Whereat, 20 April 2018, 1546–8; Transcript, Sarah Britt, 23 April 2018, 1640–2.

In order to explain why I consider that such a system will address the issues that arise from the current fragmented disciplinary arrangements, it is necessary to say something further about the different and overlapping roles of the four types of bodies identified at the beginning of this section of the chapter.

I will take each of those types of bodies in turn.

4.1 Existing arrangements

4.1.1 AFSL holders

As mentioned earlier in this chapter, a key principle in CLERP 6 was to regulate intermediaries (including financial advisers) at firm level rather than at the individual level, in part to allow ASIC to target its resources efficiently.²⁹⁴ Thus, individual financial advisers do not generally hold AFSLs. Instead, an individual financial adviser will usually be:

- an employee of an AFSL holder;²⁹⁵
- an authorised representative of an AFSL holder;²⁹⁶ or
- an employee of an authorised representative of an AFSL holder.²⁹⁷

As has been mentioned elsewhere, the Corporations Act imposes obligations on AFSL holders in relation to the employees and authorised representatives who provide financial advice under their licence, including an obligation to take reasonable steps to ensure that their representatives comply with financial services laws.²⁹⁸

²⁹⁴ Background Paper No 7, 9.

²⁹⁵ Corporations Act s 911B(1)(a).

²⁹⁶ Corporations Act s 911B(1)(b).

²⁹⁷ Corporations Act s 911B(1)(c).

²⁹⁸ Corporations Act s 912A.

Thus, as ASIC submitted, primary responsibility for discipline lies with AFSL holders, who are responsible under the law for the conduct of their advisers.²⁹⁹

The chief means by which licensees detect both improper conduct and poor advice by their advisers remains regular and random auditing of advisers' files.

The efficacy of the audit depends first upon there being a complete and accurate file recording the dealings between adviser and client. As the examples studied in evidence show, there can be no effective audit if the adviser keeps control of the file and will not release it to the licensee.

Next, the audit must be designed to reveal significant defaults. The evidence in the second round of hearings showed that audits often were not designed this way. For example, for too long, AMP maintained an audit system in which issues of high importance (such as not pursuing the client's best interests) could be treated as 'immaterial' when forming the overall audit grading.³⁰⁰ No departure from the central duty of an adviser can properly be regarded as 'immaterial'.

The evidence also showed that, too often, bad audit results had no, or no significant, consequences for the adviser. For example, for too long, Westpac maintained a consequence management scheme under which point deductions for poor audit results were erased before the next audit would fall due.³⁰¹ A system of that kind did nothing to penalise bad work and nothing to encourage better work.

I doubt whether it is possible to prescribe a single, 'ideal' audit or consequence management system. Much will depend on the way that an AFSL holder structures its business. An effective system for a large licensee is likely to look different from an effective system for a small licensee.

²⁹⁹ ASIC, Module 2 Policy Submission, 15–16 [77]–[83].

³⁰⁰ See Transcript, Sarah Britt, 23 April 2018, 1620–2, 1647.

³⁰¹ See Transcript, Michael Wright, 19 April 2018, 1422.

However, it is likely that **more could be done to facilitate ‘better practice’ in this area. In particular, ASIC should consider whether there are ways that it could provide further guidance to the industry about ‘best practice’ in the design of audit and consequence management systems. If appropriate, that work could be informed by observations made in the course of the Close and Continuous Monitoring Program, an on-site supervisory approach taken by ASIC that commenced in October 2018.**

In circumstances where poor conduct is identified and consequences are applied, AFSL holders have done too little to share that information with others. Two particular problems should be noted.

First, licensees are not doing enough to communicate between themselves about the backgrounds of prospective employees. The ABA’s reference checking and information-sharing protocol is limited to signatories and not consistently applied.³⁰² Licensees also frequently fail to respond adequately to requests for references regarding their previous employees.³⁰³ Nor do they always take the information delivered to them seriously enough. The result is that financial advisers facing disciplinary action from their employer can shop around for another licensee to employ them.

Examples of the limited or inadequate disclosures made about former employees were observed in the course of hearings. When Dover Financial Services asked Westpac for information about the conduct of Mr Andrew Smith, Westpac said only that there was an ongoing investigation and that Westpac had ‘concerns’ about Mr Smith’s conduct.³⁰⁴ Of greater concern, when Dover asked an ANZ licensee (Millennium3) for information about Mr Christopher Harris’s conduct, Millennium3 did not provide Dover with any material information even though it had made a notification to ASIC in relation to Mr Harris.³⁰⁵

³⁰² Exhibit 2.248, 20 September 2016, ABA Financial Advice – Recruitment and Termination Reference Checking and Information Sharing Protocol, 1–2; Transcript, Louise Macaulay, 27 April 2018, 1918–19.

³⁰³ ASIC, Module 2 Policy Submission, 13 [64].

³⁰⁴ FSRC, *Interim Report*, vol 2, 176, 185; Transcript, Michael Wright, 20 April 2018, 1459–62.

³⁰⁵ FSRC, *Interim Report*, vol 2, 196; Transcript, Darren Whereat, 20 April 2018, 1547; Exhibit 2.149, undated, Letter from Millenium3 to Dover.

Compliance with the ABA's reference checking and information-sharing protocol (or, at least, requirements in the nature of those contained in the protocol) should be mandatory for all AFSL holders whose licence authorises the provision of financial advice. Submissions received from industry generally supported extending the operation of the protocol to all AFSL holders.³⁰⁶ Consideration could be given to making a breach of the protocol (or equivalent obligations) equivalent to a breach of financial services laws for the purposes of section 912A of the Corporations Act.

Second, licensees are not sufficiently sharing information with ASIC about advisers. Licensees may fail to report, or report late, their concerns about an adviser's conduct. Obviously that impedes ASIC's ability to enforce disciplinary sanctions on those who have breached the law. That is so even though licensees themselves depend on ASIC's Financial Adviser Register (FAR) for a definitive listing of banned advisers to indicate whether an adviser has a poor history.³⁰⁷

ASIC established the FAR in 2015.³⁰⁸ The Register is publicly available, and contains information about current and former financial advisers who have been active since 31 March 2015. ASIC maintains the Register using information provided by AFSL holders and authorised representatives. Unlike various other registers that it maintains, ASIC has no legal obligation to maintain a register containing all of the information in the FAR. Further, unlike registers in other industries, inclusion confers no particular legal status on a financial adviser. In particular, inclusion is not a precondition to providing financial advice.

In July 2015, ASIC began using its compulsory information-gathering powers to require AFSL holders to provide it with information about financial advisers in respect of whom licensees had 'serious compliance concerns'

³⁰⁶ See ASIC, Module 2 Policy Submission, 13–14 [63]–[67]; AMP, Module 2 Policy Submission, 22 [107]; NAB, Module 2 Policy Submission, 20 [81]; Westpac, Module 2 Policy Submission, 18 [79]–[80]; AFA, Module 2 Policy Submission, 19; FPA, Module 2 Policy Submission, 19–20.

³⁰⁷ Transcript, Andrew Hagger, 24 April 2018, 1672.

³⁰⁸ Exhibit 2.247, Witness statement of Louise Macaulay, 25 April 2018, 13 [35].

and ‘other compliance concerns’.³⁰⁹ 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.³¹⁰ Other compliance concerns include breaches of internal business rules or standards, adverse findings from audits, and conduct resulting in actual or potential financial loss to clients.³¹¹

The evidence in the Commission’s second round of hearings revealed a number of issues in the way that AFSL holders categorised compliance concerns it had identified as ‘serious’ concerns or ‘other’ concerns in their responses to ASIC.³¹² However, putting those problems of implementation to one side, I consider that there is significant value in information of this kind being reported to ASIC. Compliance concerns in relation to an individual adviser may not constitute a significant breach of an AFSL holder’s obligations, and therefore would not trigger the reporting requirement under section 912D of the Corporations Act. However, ASIC may consider that those concerns warrant some action being taken against the adviser. Unless it receives information about those concerns, it is difficult for ASIC to take that action. Information about compliance concerns from different licensees is also likely to reveal trends emerging in the industry, and enable ASIC to target its education and enforcement activities to address emerging issues.

The reporting of ‘serious compliance concerns’ by AFSL holders to ASIC should be formalised. Licensees should be required to report such concerns to ASIC on a quarterly basis. As I explain further below, mandatory reporting will also form an important part of a unified disciplinary system for financial advisers.

³⁰⁹ See Transcript, Andrew Hagger, 24 April 2018, 1672; Transcript, Louise Macaulay, 27 April 2018, 1925–6.

³¹⁰ See Transcript, Michael Wright, 19 April 2018, 1432.

³¹¹ See Transcript, Michael Wright, 19 April 2018, 1432.

³¹² See, eg, Transcript, Michael Wright, 19 April 2018, 1432–3; Transcript, Andrew Hagger, 24 April 2018, 1673–4.

One further point should be made. 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. As the evidence before the Commission showed, entities have not always done this. The result is that the damage done by an adviser may not come to light until long after the event, which works to the detriment of both the affected clients and the entity itself. It is necessary in principle, and better in practice, for entities discovering misconduct by an adviser to make whatever inquiries are reasonably necessary to determine the nature and full extent of the adviser's conduct.

Recommendation 2.7 – Reference checking and information sharing

All 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 ABA in its 'Financial Advice – Recruitment and Termination Reference Checking and Information Sharing Protocol'.

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.

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; and
- where there is sufficient information to suggest that an adviser has engaged in misconduct, tell affected clients and remediate those clients promptly.

4.1.2 ASIC

In its submission following the second round of the Commission's hearings, ASIC said that, as a regulator, its role is to oversee advisers' compliance with the law and not to supervise or monitor their work.³¹³ It said that primary responsibility for discipline lies with licensees, who are responsible under the law for the conduct of their advisers.³¹⁴ That is undoubtedly correct. In my view, however, and as I said in the *Interim Report*, ASIC's enforcement of the law with regard to individual advisers is an important part of the disciplinary system. It is for that reason that a robust approach to enforcement is critical.

Financial services licensees that breach those sections of the Corporations Act that impose the best interests duty (section 961B), oblige the provision of appropriate advice (section 961G), warn of incomplete or inaccurate advice (section 961H), and require giving priority to the client's interests (section 961J), are liable to civil penalty.³¹⁵ Licensees must take reasonable steps to ensure that representatives of the licensee comply with those sections (sections 961B, 961G, 961H and 961J).³¹⁶ Authorised representatives are themselves liable to civil penalty for contravention of any of those sections.³¹⁷ Clients who suffer loss or damage because of a breach of the sections can recover compensation,³¹⁸ and the court dealing with an action under that section can make any of several other kinds of order.³¹⁹

³¹³ ASIC, Module 2 Policy Submission, 16 [80].

³¹⁴ ASIC, Module 2 Policy Submission, 15 [78].

³¹⁵ Corporations Act s 961K.

³¹⁶ Corporations Act s 961L.

³¹⁷ Corporations Act s 961Q.

³¹⁸ Corporations Act s 961M.

³¹⁹ Corporations Act s 961N.

As I observed in the *Interim Report*, these civil penalty provisions have seldom been invoked. No civil penalty proceedings had been instigated in the five years before Ms Louise Macaulay (Senior Executive Leader of ASIC's Financial Advisers Team) gave her evidence about these issues in the second round of the Commission's hearings.³²⁰ Ms Macaulay said of civil penalty proceedings generally, that they 'are time-consuming and resource intensive for ASIC', that 'their outcome is not proximate to the time of the misconduct' and that '[t]heir deterrent effect is limited by the (currently modest) size of the available penalty'.³²¹ More particularly, in the context of financial advice, she pointed out that a civil penalty order, of itself, does not include a banning order. These observations about civil penalty proceedings must be considered in the light of whether other ways of dealing with breaches of the provisions are speedier, less time-consuming or more effective in deterring similar conduct.

The chief regulatory tool ASIC has used in connection with financial advice has been the power to make a banning order prohibiting a person from providing any, or any specified, financial services either permanently or for a specified period.³²² Since 2008, ASIC has made 350 banning orders, of which 229 were made in relation to financial advisers.³²³ Just under half of those banning orders were permanent orders.³²⁴

As Ms Macaulay explained, the process of making a banning order takes time. The time between ASIC becoming aware of the conduct that might warrant making a banning order and deciding to investigate the matter may vary from 'a couple of months' to 'any length of time up to a year'.³²⁵ It may take six to 12 months to get a brief to the delegate and the delegate may

³²⁰ Transcript, Louise Macaulay, 27 April 2018, 1915.

³²¹ Exhibit 2.247, Witness statement of Louise Macaulay, 25 April 2018, 16 [51].

³²² Corporations Act ss 920A–920B.

³²³ Exhibit 2.247, Witness statement of Louise Macaulay, 25 April 2018, 5 [20]. See also Transcript, Louise Macaulay, 27 April 2018, 1914. The figures given in Exhibit 2.247 were said not to include banning orders made by a Court in civil proceedings or undertakings not to provide financial services given pursuant to EUs.

³²⁴ Transcript, Louise Macaulay, 27 April 2018, 1914.

³²⁵ Transcript, Louise Macaulay, 27 April 2018, 1911.

take five months to make the decision.³²⁶ Add to those times any appeal to the Administrative Appeals Tribunal or any proceedings for judicial review and the whole process may take anything up to two years.

No doubt, as Ms Macaulay said, banning orders serve a purpose of protecting the public. But a regulator's choice of regulatory steps should not be treated as requiring exercise of only one form of power. There are cases where more than one power can and should be exercised. The process of making a banning order may be every bit as long as the pursuit of civil penalties. Court processes may prove to be more costly, if the action is fought. But chosen wisely, cases pursuing civil penalty may be prosecuted to conclusions that lead to a public denunciation of conduct that has breached the law. And public denunciation of unlawful conduct is a deterrent and educative tool that is important to the proper regulation of the whole of the relevant regulated community (here financial advisers and advice licensees).

4.1.3 Industry associations

Just as there is no requirement for individual financial advisers to be registered by ASIC, there is also no requirement for advisers to be members of any particular industry association. Nevertheless, many financial advisers choose to be members of one or more of these associations. There are several bodies for advisers to choose from, including the FPA and the AFA.

Both the FPA and the AFA seek to advance the cause of financial advisers generally. Each seeks to promote the creation and growth of financial planning and advice as a profession. Both the FPA and AFA now have processes and systems for disciplining members. But the evidence before the Commission did not show that either the FPA or the AFA currently plays any significant role in maintaining or enforcing proper standards of conduct by financial advisers.

As I observed in the *Interim Report*, neither ASIC nor licensees are sharing information with industry associations. Both the FPA and the AFA find out about members under ASIC investigation from media releases and news stories. Licensees almost never report their concerns about advisers

³²⁶ Transcript, Louise Macaulay, 27 April 2018, 1911.

to industry associations. The two associations do not share disciplinary information between themselves. Members of the public are generally unaware of the FPA and AFA, and are more likely to take their complaint to a dispute resolution body than report advisers to the industry bodies. The result is that industry bodies now have little basis on which to play any effective disciplinary role.

Neither do advice licensees currently look to the associations for that purpose. Licensees may encourage advisers to join a professional association. But licensees do not routinely tell either association of misconduct by advisers.

The FPA's treatment of the complaint made to it about the conduct of Mr Henderson in connection with Ms McKenna (referred to above) did not instil confidence in FPA's disciplinary arrangements, at least as they stood when the Commission took evidence about the matter. The process described in evidence was prolonged, opaque and directed more to settling an agreed outcome to the complaint than imposing proper standards of conduct by members. And, as noted earlier, Mr Henderson chose not to renew his membership of FPA when he did not get his preferred outcome. Mr Dante De Gori, the CEO of the FPA, said that the failure to pay membership dues does not terminate the membership of a member against whom a complaint remains outstanding. Even if that is so, and even if the FPA were to expel the member concerned, it seems that the expulsion would be of little or no moment to a self-employed financial adviser.

Financial advisers are not currently required to belong to an association, and though some employers of employed financial advisers require it, few if any specify which. Advisers are free to switch between associations at any time, or, as Mr Hagger put it, 'go down the road to another association' if they are expelled.³²⁷ The FPA and AFA therefore actively engage in recruitment of members from the industry and, to some necessary extent, from each other. Membership fees are their chief source of revenue.

³²⁷ Transcript, Andrew Hagger, 24 April 2018, 1671.

Representatives of each association said that promoting the profession was one of its key functions.³²⁸ These characteristics sit uncomfortably with those of effective discipline that include objectivity, consistency and compulsion, and the tension was clearly borne out in the case of Mr Henderson and the FPA.

Mr De Gori said that the only compulsory sanction available to the FPA is to expel members. To encourage members to comply with disciplinary decisions, the association may threaten to name them as the subject of its proceedings, although generally, names are kept confidential. The AFA has undertaken only two disciplinary matters since 2013, both of which resulted in a reprimand.³²⁹

The Code of Ethics being developed by FASEA will come into force in January 2020.

If, as both the FPA and AFA hope, industry associations become monitoring bodies under the Corporations Act, much will depend upon how they perform those tasks. The monitoring bodies will play an important part in setting the tone and the culture of those who act as financial advisers.

4.1.4 FASEA and the Code of Ethics

As noted earlier, recent legislation³³⁰ seeks to advance the ‘professionalism’ of financial advice: by requiring higher education and training standards;³³¹ and by establishing FASEA³³² and requiring compliance³³³ with a Code of Ethics to be prepared by FASEA³³⁴ and monitored by a ‘monitoring body’.³³⁵

³²⁸ Transcript, Dante De Gori, 26 April 2018, 1819; Transcript, Philip Kewin, 26 April 2018, 1828.

³²⁹ Exhibit 2.230, Witness statement of Philip Kewin, undated, 14–15.

³³⁰ *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* (Cth).

³³¹ Corporations Act Pt 7.6 Div 8A ss 921B–921D.

³³² Corporations Act s 921X.

³³³ Corporations Act s 921E.

³³⁴ Corporations Act s 921U.

³³⁵ Corporations Act ss 921G–921T.

When the amended regulatory provisions come into effect, all advisers will be required to become members of a code monitoring body. Advisers will be prohibited from changing associations while under investigation by a monitoring body, and all breaches of the Code will have to be reported to ASIC and the adviser's licensee. Breaches of the Code and any sanctions will be listed on the FAR.³³⁶

In these ways, the new scheme will deal directly with several of the issues raised above. The requirement to share information is welcome. The restriction on advisers changing schemes mid-investigation should limit the evasion of disciplinary processes that is otherwise possible in a system where multiple bodies administer one code of ethics. However, advisers not under investigation but looking for a lighter touch will still be free to switch monitoring bodies. The consistency between various code monitoring bodies in enforcing discipline will therefore be important.

It is important to recognise the proper place of the proposed Code of Ethics. Codes of ethics are not laws. Codes of ethics are important to fostering public confidence and practitioner integrity in a profession. They are composed by industry practitioners according to agreed industry processes. Laws, by contrast, are the product of a public process conducted under the authority of democratic institutions. It is laws, and not codes of ethics, that are the proper repositories for basic norms of conduct. This qualitative disparity mandates a difference in approach to contraventions of each.

While codes of ethics have a part to play in setting professional standards of behaviour, the industry must be conscious of their boundaries. The investigation and punishment of breaches of law should not be outsourced to private bodies. Licensees and industry bodies should not try to resolve breaches of law by advisers internally, but must notify ASIC or other appropriate authorities. A breach of the code of ethics must not be allowed to obscure, or be treated as more significant than, a breach of the law.

Though laws and professional codes serve different normative purposes, the discipline they impose can have similar objectives. Both ASIC and the FPA emphasised the protection of the public as their overriding

³³⁶ Treasury, Module 2 Policy Submission, 15 [94].

disciplinary aim. For that reason, they may not take action, for example, against an unscrupulous adviser who has ceased to practice.

Disciplinary powers do have a protective aspect. In some cases, protecting the public will be a critical aspect of disciplinary action. But the imposition of discipline in a civil or even a professional setting usually, by analogy with criminal sentencing, serves multiple purposes. Among those purposes will ordinarily be purposes of punishment, denunciation, and the identification of conduct that breaches applicable norms. To characterise disciplinary action as serving *only* to protect the public is wrong. Not only is the characterisation wrong, it hides the need for regulatory bodies to give proper weight to the other purposes that are to be achieved by taking regulatory action.

4.2 A new approach to discipline

As I said at the start of this section of the chapter, a coherent system of professional discipline must be established for financial advisers. The system should have the following key features.

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

I say more about each of those features below.

4.2.1 Mandatory individual registration

A requirement of individual registration as a condition of practice is common to most professions. For example, health practitioners (including doctors and nurses) must be registered with the Australian Health Practitioner Regulation Agency (AHPRA).³³⁷ Lawyers must be admitted to practise, and hold practising certificates.³³⁸ Architects and teachers must be registered with a relevant state or territory registration body.³³⁹

Mandatory individual registration is also a feature of other regulated occupations. For example, a person may not practise as a tax agent unless he or she is registered with the Tax Practitioners Board,³⁴⁰ and a person may not practise as a migration agent unless he or she is registered with the Migration Agents Registration Authority.³⁴¹

Mandatory individual registration for financial advisers is likely to have a number of benefits.

- It will formalise the existing FAR, and ensure that valuable information about financial advisers is made available to the public.
- It will facilitate the introduction of a central disciplinary body for financial advisers, focused on the conduct of individual advisers and complaints about individual advisers.
- It will ensure that the central disciplinary body can impose sanctions that have effect even if an adviser leaves a particular AFSL holder or professional association.
- It will facilitate the introduction of additional requirements for advisers directed at raising standards in the industry. To give two examples, compliance with continuing professional development requirements could be made a precondition for renewal of registration, and disclosure of

³³⁷ See the Health Practitioner Regulation National Law.

³³⁸ See, eg, Legal Profession Uniform Law.

³³⁹ See, eg, *Architects Act 1991* (Vic), Pt 3 and *Education and Training Reform Act 2006* (Vic), Div 3 of Pt 2.6.

³⁴⁰ See the *Tax Agent Services Act 2009* (Cth).

³⁴¹ See *Migration Act 1958* (Cth), Pt 3.

particular matters relating to fitness to provide financial advice could be required on renewal of registration.

Introducing a system of mandatory individual registration may also assist in impressing upon financial advisers that they occupy a position of trust, and that their entitlement to continue to occupy that position of trust depends on their obeying the law and other standards applicable to them.

In its submissions following the second round of hearings, ASIC addressed the possibility of introducing a 'dual licensing system' for financial advisers, in which individual financial advisers would be registered not just with the AFSL holder, but with ASIC too. ASIC said that any such system must address two issues:³⁴²

- first, the possibility that individual licensing of financial advisers may dilute the responsibility of a licensee and create ambiguity and uncertainty about the relative responsibilities between a licensee and ASIC; and
- second, that the close scrutiny involved in an individual licensing regime would require substantial resources to administer effectively.

While the dual licensing system that ASIC addressed in its submissions is somewhat different from the system of individual registration that I propose, it is appropriate that I say something about both matters raised by ASIC.

The answer to the first point is that, under a system of individual registration, AFSL holders would maintain all of their existing obligations in relation to financial advisers. The new system would not detract in any way from the existing obligations of AFSL holders who employ financial advisers or appoint authorised representatives. Rather, it would ensure that financial advisers who fail to adhere to the standards expected of them would face consequences that extend beyond their employment with or appointment by a particular licensee, and affect their capacity to provide financial advice more generally.

³⁴² ASIC, Module 2 Policy Submission, 18 [92].

This is not so different from the arrangements that govern other professions. In most cases, a system of individual registration and discipline exists alongside the consequence management frameworks of employers. So, for example, an employee solicitor who misappropriates client funds may expect to face both disciplinary consequences from the relevant statutory body, and employment consequences from his or her law firm.

The answer to the second point is that ASIC already maintains a register of financial advisers (the FAR). It is difficult to see how formalising that register, and making registration a precondition to providing financial advice, will add significantly to the cost of maintaining the existing register.

I accept that if ASIC is given other functions in connection with the registration of financial advisers (such as assessing whether advisers are fit and proper persons to provide financial advice), fulfilling those functions may require additional resources. However, whether any such additional functions are conferred on ASIC is a question for Government. If any additional functions are conferred, at least part of the cost of providing those functions could be recouped through a requirement to pay an annual registration fee.

4.2.2 A single, central disciplinary body

A single, central disciplinary body for financial advisers is important because it will ensure that appropriate disciplinary consequences are imposed where a licensee fails to impose them, and that the disciplinary consequences imposed on a financial adviser can extend beyond the adviser's employment with or appointment by a particular licensee.

ASIC currently has the power to make banning orders, which extend beyond an adviser's relationship with a particular licensee. But there are several reasons why I do not consider it appropriate to continue to rely on ASIC's existing powers as the sole means by which to impose disciplinary consequences that extend beyond a particular licensee.

First, a banning order will not be an appropriate response every time a financial adviser fails to adhere to the standards expected of him or her. There is an important role for less serious sanctions in demonstrating that particular conduct is unacceptable, and encouraging or requiring individuals to change their behaviour. But, as discussed above, apart from banning

orders, ASIC has few powers that it can use to take action against individual advisers.

Second, because a banning order is a serious sanction, and because ASIC has limited resources, ASIC tends to direct its investigation and enforcement activities to the most obviously serious cases. While this is understandable, it means there may be cases where legitimate complaints warranting some form of disciplinary action are not investigated. A body dedicated to the investigation of matters concerning individual advisers could be expected to consider a broader range of cases than ASIC currently does.

Third, as explained above, the process involved in making a banning order is time-consuming. This is, again, a reflection of the more serious nature of the cases in which banning orders are imposed. It might be expected that most cases dealt with by a new disciplinary body could be dealt with more expeditiously.

In making this recommendation, I do not wish to be overly prescriptive about the form that the new disciplinary body should take, the powers that it should have, or (with the exception of the system of mandatory and voluntary notifications discussed below) the relationships that it should have with other bodies – in particular, ASIC and the code monitoring bodies. It may be that this new body is the most appropriate entity to perform the functions currently planned to be assigned to the code monitoring bodies under the Corporations Act.

However, as will be evident from what I have written, I consider that the body should have available to it a range of sanctions varying in severity, the most serious of which must be the cancellation of the registration of a financial adviser.

4.2.3 Mandatory and voluntary notifications

A system of mandatory and voluntary notifications would require AFSL holders to report particular matters to the disciplinary body, and permit other stakeholders to report matters to that body.³⁴³

³⁴³ Such a system currently exists for health practitioners: see Divs 2 and 3 of Pt 8 of the Health Practitioner Regulation National Law.

The system of mandatory notifications is necessary to overcome the existing issue with licensees failing to share information with ASIC and with professional associations. I have already recommended that licensees should be required to report serious compliance concerns about advisers to ASIC on a regular basis. I consider that, at a minimum, licensees should also be required to report this information to the disciplinary body. Licensees could also be required to report other compliance concerns about advisers to the disciplinary body.

The system of voluntary notifications is necessary to overcome the existing lack of clarity about where consumers should most appropriately direct complaints about financial advisers. Complaints could be directed to, and dealt with by, the disciplinary body. It may be that an early step in dealing with each complaint (other than complaints that are plainly without substance) is to contact the adviser's licensee and invite a response.

As I have said, the system that I propose is not intended to detract in any way from the existing obligations of AFSL holders in relation to the advisers they employ and authorise. AFSL holders should continue to have primary responsibility for monitoring and disciplining advisers. The aim of the disciplinary system is to ensure that advisers who engage in misconduct face appropriate consequences, and that where appropriate, the consequences imposed on advisers extend beyond their association with a particular licensee. The disciplinary body may decide to take no action in relation to a particular adviser if it considers that the consequences already imposed by the adviser's licensee are appropriate.

Recommendation 2.10 – A new disciplinary system

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; and
- allows clients and other stakeholders to report information about the conduct of financial advisers to the disciplinary body.

Conclusion

The financial advice industry is part way through transformation from an industry dedicated to the sale of financial products to a profession concerned with the provision of financial advice. The interests of Australians who seek financial advice require that that transformation be completed. That will not be an easy task, but it is necessary. It will require:

- taking steps to deal with those involved in the charging of ‘fees for no service’, and to ensure that it does not happen again;
- reducing the conflicts of interest that pervade the industry; and
- introducing a credible and coherent disciplinary system for financial advisers.

Once those changes have been made and have settled, it will be time to ask whether the quality of financial advice has improved, and whether financial advisers are behaving like professionals. It will also be necessary to ask whether remaining carve outs, exceptions and safe harbour provisions continue to be justified.

4. Superannuation

Introduction

The superannuation sector of the financial services industry is important, not only to the many individuals who participate in it as members of superannuation funds, but also to the nation. Superannuation is important to individuals because it will affect, even determine, how they live after retiring from work. It is important to the nation because of the size of the superannuation savings pool, and how that pool is invested. And it is also important to the nation because the greater the capacity for individuals to support themselves from their superannuation savings in retirement, the smaller will be the total claims on public welfare outlays of all kinds, such as aged pensions, housing and health.

At March 2018, superannuation savings comprised assets worth about \$2.6 trillion: more than 140% of Australia's nominal gross domestic product in the four quarters to March 2018.¹

At June 2017, more than 14.8 million Australians had a superannuation account.² About 40% held more than one account.³ Superannuation represents about half of household financial assets.⁴

Regulated superannuation funds are organised as trusts. The trustee holds assets for the benefit of members or, on the death of a member, for dependants or beneficiaries of that member.

There are three types of superannuation trust: self-managed superannuation trusts (regulated by the ATO), exempt public sector superannuation schemes (regulated by Commonwealth, state or territory

¹ Background Paper No 22, 6, Box 1.

² Background Paper No 22, 8 [3.1].

³ Background Paper No 22, 8 [3.1].

⁴ Background Paper No 22, 4–5.

legislation) and APRA-regulated funds regulated by the Australian Prudential Regulation Authority (APRA) under the *Superannuation Industry (Supervision) Act 1993* (Cth) (the SIS Act).

To understand the issues that have been considered by the Commission, it is necessary to trace the main legislative and other steps that have been taken to arrive at the regulatory regime that has applied at relevant times.

1 Some history

Before 1986, there was no compulsory superannuation system in Australia. In the June 1986 National Wage Case, the Conciliation and Arbitration Commission awarded an increase of 3% of ordinary earnings to be paid into superannuation accounts.⁵

In the following year, 1987, the Commonwealth Parliament enacted the *Occupational Superannuation Standards Act 1987* (Cth) (the OSSA Act) and established the Insurance and Superannuation Commission to administer the Act. Regulations made under the Act set operating standards for superannuation funds.

In 1992, the Parliament enacted legislation establishing the Superannuation Guarantee, in effect, making superannuation contributions by employers compulsory.⁶ Starting at 3%, the Superannuation Guarantee rate is now 9.5% and will rise to 12% by 1 July 2025.⁷

In 1993, the Parliament repealed the OSSA Act and enacted the SIS Act.

As enacted, the SIS Act provided, and it continues to provide, that if the governing rules of a superannuation entity did not contain covenants to the effect of covenants set out in the Act, the rules were taken to do so. The covenants were all expressed as covenants by the trustee,

⁵ *National Wage Case June 1986* (1986) 14 IR 187, 212–19; Background Paper No 23, 3.

⁶ *Superannuation Guarantee Charge Act 1992* (Cth) and *Superannuation Guarantee (Administration) Act 1992* (Cth). See also, *Roy Morgan Research Pty Ltd v Commissioner of Taxation* (2011) 244 CLR 97.

⁷ Background Paper No 23, 3.

and have since been amended, but in general terms they were and remain covenants that include covenants of honesty,⁸ care, skill and diligence,⁹ as well as a covenant to perform the trustee's duties, and exercise the trustee's powers 'in the best interests of the beneficiaries'.¹⁰ The Act provided, and still provides, that the trustee of a regulated superannuation fund must ensure that the fund is maintained *solely* for one or more specified purposes.¹¹ Those purposes can be summarised as being the provision of retirement benefits and the provision of benefits in respect of a member after the member's death.¹² This provision of the Act is often referred to as 'the sole purpose test'.

Following the Wallis Inquiry, APRA was established in 1998, and took over responsibility for prudential supervision of the banking, superannuation and insurance sectors of the financial services industry. Administrative responsibility for **self-managed superannuation funds** (SMSFs) was given to the ATO.

In 2004, the SIS Act was amended to require all **registrable superannuation entities** (RSEs) to be licensed.¹³

Until 2005, industrial awards providing for superannuation contributions generally nominated the fund that was to receive the contributions. Commonly, the nominated fund was an industry fund.¹⁴ The *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2005* (Cth) permitted most employees to choose the superannuation fund that would receive their superannuation contributions. Today, if an employee does not nominate a fund, and the default fund is not specified in a relevant industrial instrument, it is the employer who will select the default fund. Treasury told the Commission that 'around one million working Australians cannot

⁸ See now SIS Act s 52(2)(a).

⁹ See now SIS Act s 52(2)(b).

¹⁰ See now SIS Act s 52(2)(c). As the SIS Act was originally enacted, the covenant was 'to ensure' that the trustee's duties and powers were performed and exercised in that way.

¹¹ SIS Act s 62.

¹² SIS Act s 62(1)(a).

¹³ *Superannuation Safety Amendment Act 2004* (Cth).

¹⁴ Background Paper No 23, 5.

currently choose their own fund, as their “choice” is deemed through an enterprise bargaining arrangement or workplace determination.”¹⁵

In 2009, the Government appointed a panel, chaired by Mr Jeremy Cooper, to review the governance, efficiency, structure and operation of Australia’s superannuation system. The 1997 Wallis Inquiry report had taken as a ‘key tenet’ that superannuation fund members should be treated as rational and informed investors. The Cooper Review challenged that proposition.¹⁶

The Cooper Review concluded that ‘a compulsory system needs to be able to cater for ... different degrees of engagement: the significant proportion of members who are not engaged with their super, or in a position to make the sorts of decisions required of them; and the informed, financially literate, or well-advised members.’¹⁷ Hence, the Review recommended the creation of a new type of superannuation product – **MySuper** – and re-casting the architecture of the superannuation industry to recognise four types of members. The Review described those members as:

- ‘... [M]embers who simply want someone else to take care of it all for them. MySuper is particularly designed to cater to these members.
- ... [M]embers who want to exercise choice over the investment strategies applied to their superannuation balances, but want to have their accounts administered for them. These members can elect to be in the choice segment, though they might decide that a MySuper product meets their needs and elect to have their money invested there (or in a combination of MySuper and choice products).
- ... [Members], and the number has increased sharply in recent years, who choose to be fully responsible for the investment and administration of their superannuation arrangements. These members can choose to operate an SMSF.

¹⁵ Background Paper No 23, 6.

¹⁶ Cooper Review, Final Report, 8.

¹⁷ Cooper Review, Final Report, 9.

- ... [M]embers who have lost their superannuation account. The objective here is to reconnect members and their accounts quickly and efficiently and to introduce measures that make this less likely to occur in future'.¹⁸

The Review said that the 'MySuper component of the choice architecture model aims to provide a simple, cost effective product with a single, diversified portfolio of investments for the vast majority of Australian workers (roughly 80% of members) who are in the default option in their current fund'.¹⁹

What is now Part 2C of the SIS Act (sections 29R–29XC) makes provision for MySuper products and was inserted in the Act in 2012.²⁰ The substantive provisions took effect from 1 July 2013. The stated intention is that all MySuper products 'will be simple products sharing common characteristics'.²¹ The characteristics, specified in section 29TC, include that the fund have a 'single diversified investment strategy'.²²

The Act provides fee rules for MySuper products²³ and imposes some additional obligations on trustees and directors of trustees of funds that offer a MySuper product.²⁴

Under the Superannuation Guarantee legislation, employers need to pay contributions for an employee without a chosen fund into a fund that offers a MySuper product if they are to avoid becoming liable to pay an increased superannuation guarantee shortfall.²⁵ In addition, if a person is a member of an RSE (other than a defined benefit member) and a contribution is made to the fund for the benefit of that person, and the person has not given the trustee 'a direction that the contribution is to be invested under one or more

¹⁸ Cooper Review, Final Report, 10–11.

¹⁹ Cooper Review, Final Report, 11.

²⁰ *Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012* (Cth) and *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012* (Cth).

²¹ SIS Act s 29R(1).

²² SIS Act s 29TC(1)(a).

²³ SIS Act ss 29V–29VE.

²⁴ SIS Act ss 29VN, 29VO.

²⁵ SIS Act s 29R(4).

specified investment options' the trustee *must* treat the contribution as a contribution to be paid into a MySuper product of the fund.²⁶ Contravention of the provision is an offence.²⁷

An RSE licensee may offer a MySuper product only with the authority of APRA.²⁸

2 Trustees' obligations to members

2.1 The trustees' covenants

In order to understand the issues about superannuation that the Commission examined, it is necessary to explain briefly the obligations imposed on trustees of superannuation funds.

In addition to statutory obligations,²⁹ important obligations are imposed on trustees by covenants under the SIS Act.³⁰

Section 52(1) of the SIS Act provides that the governing rules of an RSE are taken to contain certain covenants. Of particular relevance to the work of the Commission were the following covenants:

- to exercise, in relation to all matters affecting the entity, 'the same degree of care, skill and diligence as a prudent superannuation trustee would exercise in relation to an entity',³¹

²⁶ SIS Act s 29WA.

²⁷ SIS Act s 29WA(3).

²⁸ SIS Act s 29T.

²⁹ In particular, eg, the obligations imposed on trustees who offer a MySuper product in ss 29VN and 29VO of the SIS Act. See also the proposed new Prudential Standards released by APRA on 13 December 2017 relating to member outcomes: APRA, *Strengthening Superannuation Member Outcomes* (13 December 2018) APRA <www.apra.gov.au/strengthening-superannuation-member-outcomes>.

³⁰ The covenants, and obligations, imposed under the SIS Act are cumulative: SIS Act s 51A.

³¹ SIS Act s 52(2)(b).

- to perform the trustee's duties and exercise the trustee's powers in the best interests of the beneficiaries;³²
- where there is a conflict of interests and duties:
 - to give priority to the duties to and interests of the beneficiaries;
 - to ensure that the duties to the beneficiaries are met;
 - to ensure that the interests of the beneficiaries are not adversely affected; and
 - to comply with the prudential standards in relation to conflicts;³³
- and
- not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising its functions or powers.³⁴

These covenants are central to the proper conduct of the trustee of an RSE. The trustee's covenants are buttressed by the provision, in section 52A, that the governing rules of an RSE, of which the trustee is a body corporate, are to be taken to contain covenants by each director of the corporate trustee to parallel effect (obliging the director to exercise care, skill and diligence; perform duties and exercise powers in the best interests of beneficiaries; deal with conflicts in the same way as the trustee must; and not enter into any contract or do anything else that would prevent proper performance of duties or hinder exercise of powers).

2.2 Best interests of members and conflicts of interest

The best interests covenant is simply stated. Yet the conduct examined by the Commission, and submissions made by trustees, suggested that some trustees had difficulty understanding when and how the covenant applied.

³² SIS Act s 52(2)(c).

³³ SIS Act s 52(2)(d).

³⁴ SIS Act s 52(2)(h).

For example, one group of trustees said that the duty is not an overarching obligation to act in members' best interests.³⁵ They said that the covenant operated to qualify the performance of a particular duty, or the exercise of a particular power.³⁶ Whether or not that is a complete statement of the law, describing the covenant in this way is apt to mislead. It suggests that the covenant has only limited application. Yet whenever a trustee acts it will be performing a duty or exercising a power, and an obligation to perform duties and exercise powers necessarily covers omissions. A trustee cannot avoid its obligations by doing nothing. It follows that any suggestion that the covenant has only limited application is not right.

The same trustees emphasised the alleged complexity of the covenant and the need to consider all of the circumstances.³⁷ Another group of trustees listed six matters 'by way of example of the complex considerations' that can arise.³⁸ The tenor of this submission was that accurately identifying a breach of the covenant was fraught with difficulty. Yet the 'complex considerations' it pointed to were straightforward matters, such as recognising the importance of the superannuation context and accepting that the application of the covenant will depend upon the circumstances of the case.³⁹ Again, such observations are more likely to confuse than to assist.

At the other extreme was a trustee who, in response to a letter from APRA, suggested that 'the so-called pub test' was a 'proxy' for members' best interests.⁴⁰ The reduction of members' best interests to this yardstick is likely to mislead for other, more obvious, reasons.

It should be concerning to regulators that professional trustees apparently struggle to understand their most fundamental obligation. No doubt a trustee must consider all relevant circumstances when deciding what

³⁵ NAB and NULIS, Module 5 Case Study Submission, 5 [20].

³⁶ NAB and NULIS, Module 5 Case Study Submission, 5 [20].

³⁷ NAB and NULIS, Module 5 Case Study Submission, 18 [101], 19–20 [105]–[106].

³⁸ CFSIL and Avanteos, Module 5 Case Study Submission, 17 [50(c)].

³⁹ CFSIL and Avanteos, Module 5 Case Study Submission, 17 [50(c)].

⁴⁰ Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, Exhibit SG-1-40 [APRA.0007.0002.1765 at .1769].

is in the best interests of beneficiaries.⁴¹ It may also be accepted that the role of a professional trustee is complex, and that a trustee is not responsible for every outcome that turns out to be ‘unbeneficial’ to members.⁴² But that does not make the covenant incomprehensible or its content unknowable. Assertions of complexity must not obscure or confuse the obligations imposed on a trustee. The concept of acting in members’ best interests is not hard to understand.

A trustee ‘must do the best they can for the benefit of their beneficiaries, and not merely avoid harming them’.⁴³ This can be achieved if a trustee keeps the best interests of beneficiaries ‘front of mind’ at all times. The case studies revealed that, all too often, trustees did not. Usually, they did not because a conflict arose between the beneficiaries’ interests and the interests of the trustee or another person or entity.

It is therefore necessary to say something about the covenant in section 52(2)(d) of the SIS Act. Again, the covenant is simply stated: it requires the trustee to prioritise the beneficiaries’ interests where a conflict arises.⁴⁴

By contrast to their approach to section 52(2)(c), most RSE licensees had little difficulty identifying what section 52(2)(d) requires. Their written submissions said that it could be met by ‘management frameworks’ and policies intended to ‘identify’ and ‘manage’ conflicts.⁴⁵

In addition to the obligation imposed by section 52(2)(d), Prudential Standard SPS 521 requires that a trustee’s conflicts management framework provide ‘reasonable assurance that all conflicts are being

⁴¹ *Cowan v Scargill* [1985] Ch 270, 287–8. See *Finch v Telstra Super Pty Ltd* (2010) 242 CLR 254, 270–1 [32]–[33].

⁴² *Manglicmot v Commonwealth Bank Officers Superannuation Corporation* (2010) 239 FLR 159, 179; *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Ltd* (2006) 15 VR 87, 110–11 [118].

⁴³ *Cowan v Scargill* [1985] Ch 270, 295; *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Ltd* [2006] 15 VR 87, 108 [107].

⁴⁴ *Bray v Ford* [1896] AC 44, 51–2; *Breen v Williams* (1996) 186 CLR 71, 93, 108, 135.

⁴⁵ AMP, Module 5 Case Study Submission, 6 [21]; NAB and NULIS, Module 5 Case Study Submission, 7 [34]; IOOF, Module 5 Case Study Submission, 19–20 [88].

clearly identified, *avoided* or prudently managed'.⁴⁶ I emphasise *avoidance* because the surest way to prevent a breach of the covenant is to avoid the potential conflict entirely. Yet the case studies showed that trustees rarely sought to avoid a conflict.

I accept that section 52(2)(d) and SPS 521 contemplate the existence of conflicts of interest. But care needs to be taken not to assume that their *identification* and purported *management* satisfies the obligations in the section. Rarely did entities identify how the interests of beneficiaries were prioritised over others that conflicted. None said that the trustee should have avoided the conflict in the first place. Instead, trustees relied on policies that attempted to identify and manage the conflict. As discussed further below, those policies were often ineffective.

Most of the case studies to which I am referring involved conflicts between the duties to members and the interests of, or the duties owed to, the owner of the trustee company. But it is important to recognise that conflicts can and do arise in profit-for-member funds as well as retail funds. In the case of profit-for-member funds, shareholders or nominating organisations of the trustee may have, and may seek to pursue, interests that differ from the interests of members.

One particular kind of case about conflict of interest merits separate consideration: the case in which the trustee undertakes competing obligations as both trustee of a superannuation fund and as responsible entity of a managed investment scheme, and thus becomes a 'dual-regulated entity'.

2.2.1 Dual-regulated entities

The moment a trustee tries to wear two hats, conflicts will arise. The duties the trustee owes to members of the superannuation fund are not the same as the duties it will owe as responsible entity of a managed investment scheme and the duties will be owed to two different classes of members.

⁴⁶ APRA, Prudential Standard SPS 521, 15 November 2012, [15] (emphasis added); see also [8].

Conflicts of this kind only arise because a trustee undertakes the obligations of responsible entity. Taking on those obligations may be seen as yielding some commercial convenience for the group of companies concerned.⁴⁷ But those considerations do not outweigh the practical consequences for the trustee's performance of its duties to its members.

The solution is simple: the trustee of an RSE should not be permitted to assume any obligations other than those arising from or in the course of its performance of the duties of trustee.⁴⁸ A prohibition of that kind would prevent a trustee from acting as a dual-regulated entity. But it would go further. It would prevent a trustee from undertaking *any* obligation that does not arise out of its holding the office of trustee. The wider prohibition is desirable because it deals directly with the fundamental issue.

To be clear, an RSE licensee may be the trustee of more than one superannuation fund. Acting as the trustee of another superannuation fund is unlikely to give rise to unmanageable conflicts. But a trustee should not be permitted to take on obligations of any other kind.

Recommendation 3.1 – No other role or office

The trustee of an 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.

It is necessary to say something more about the position of the trustees of retail funds.

2.2.2 Conflicts of interest and the trustees of retail funds

The evidence led in the Commission, and my remarks above, might be understood as suggesting that it is not possible for the trustee of a retail fund to perform its covenants to act in the best interests of members and to give priority to their interests over the interests of related parties or any

⁴⁷ Westpac, Module 5 Policy Submission, 19–20 [69]–[71]; CFSIL and Avanteos, Module 5 Policy Submission, 23 [126].

⁴⁸ APRA, Module 5 Policy Submission, 25 [73]; ASIC, Module 5 Policy Submission, 28 [135].

other person. I do not consider that the evidence showed that a trustee of a retail fund *cannot* fulfil its duties. The evidence showed that there are some recurring issues and difficulties to which trustees and the regulators need to give close and continuing attention.

The essential character of the conflict that confronts the trustee of any fund established for the profit of its parent company or corporate group is the conflict between the commercial interest of the parent company – to maximise profit – and the trustee’s obligation to give priority to the duties to, and interests of, the beneficiaries. The conflict may emerge in any number of different ways.

One way the conflict may emerge is in the choosing of what entities should perform services in connection with the administration or investment of the fund, and fixing the fees or other remuneration that is to be paid to those entities. It is in the interests of the parent company to maximise the profits earned by the administration company. But the trustee’s duty is to minimise the amount it must pay for proper administration services.

As a result, dealings between the trustee and other entities related to the trustee of the fund always require special consideration. There will always be two groups of questions. First: how and why was the related entity *chosen* to provide the particular service? Were external entities considered? Second: how was the *price* for the service struck? Has the trustee compared what is offered from within the corporate group with the performance and pricing offered by entities outside the corporate group?

Another way the conflict may emerge is in the day-to-day administration of the fund. One obvious case is when the trustee depends upon information supplied to it by administrators or others connected with the fund’s parent company. As the case studies show, the information supplied to the trustee may be based upon premises that in some way or another reflect the commercial interests of the parent company, whether that is a direct interest in maximising profit or some less direct interest such as maintaining the goodwill of advisers aligned with the parent company. Unless those premises are exposed, the trustee may take the information that it is given at face value and base the decision it takes upon an incomplete understanding of what courses of action may be available to it.

Trustees can fulfil their duties to members only if they recognise that the interests of the fund's parent company and the interests of members are not only different but are often opposed. There are three consequences.

First, disclosure of conflicts of interests on its own is not enough.

Information supplied in product disclosure statements will often tell those joining a retail fund that the trustee has arrangements with related entities and will plainly reveal to intending members that the fund is organised and run for the profit of its parent company. Disclosure of that kind is, of course, essential. But **the statutory duty to comply with the RSE licensee law and to perform properly the duties of the trustee demands action, not just disclosure.**⁴⁹

Second, as the best interests covenant makes plain, the trustee's obligation is to perform its duties and exercise its powers in the best interests of the beneficiaries. Each time a trustee makes an arrangement for others to act in connection with the administration or investment of the fund constitutes an act done in performance of the trustee's duties and in the exercise of its powers. **Hence, both the instigation and maintenance of every arrangement about administration and investment must be judged against the best interests of members.**

Having chosen a related entity to provide services to the fund, the trustee must also be conscious of the conflicts of interest that unavoidably arise, particularly where a trustee relies on a related entity to perform core functions such as investment and management of the fund. To varying degrees, trustees who gave evidence to the Commission acknowledged the conflicts generated by such arrangements. But, again, the solutions they proposed involved policies, together with contracts expressed to enable oversight and service delivery,⁵⁰ which too often proved to be ineffective.

Outsourcing of the trustee's day-to-day administration and management of a fund to a related entity, or indeed, any third party, requires ongoing care and diligence on the part of a trustee. Where it is relying on information provided by the related entity, it must test the information it receives and seek further

⁴⁹ SIS Act s 29E(1)(a) and (b).

⁵⁰ AMP, Module 5 Case Study Submission, 2 [8]; NAB and NULIS, Module 5 Case Study Submission, 4 [15].

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.

Third, regulators must be astute to observe whether trustees are giving 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’.⁵¹ 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.⁵²

2.2.3 Frameworks for managing conflicts

As already observed, many retail trustees seek to identify and manage conflicts of interest, rather than avoid them.

For example, AMP submitted that the trustees ‘ensure their responsibilities and obligations to members are met by the terms of their outsourcing arrangements, the work of Trustee Services, the use of the Business Monitoring Model (BMM) framework and other complementary monitoring activities’.⁵³ Similarly, NULIS said it engaged an administrator to act as its service provider. That administrator was legally liable for breaches of its contractual obligations in its capacity as administrator, which are required to be reported under the Administration Agreement.⁵⁴

⁵¹ APRA, Prudential Standard SPS 231, 15 November 2012, [16].

⁵² See Recommendation 4.14.

⁵³ AMP, Module 5 Case Study Submission, 2 [8].

⁵⁴ NAB and NULIS, Module 5 Case Study Submission, 4 [15].

The issue, however, is not whether such arrangements exist on paper. Conflicts of interest cannot be managed through box-ticking processes. The issue is how those arrangements are implemented in practice. As explained in Volume 2, all too often these arrangements failed to operate effectively. For example, the AMP trustees endorsed plans prepared by a related party for the transfer of **accrued default amounts** to MySuper products. The trustees were not told about, and did not enquire about, the related party's detailed commercial consideration of the effect that the timing of transfers would have on the profits of the AMP Group. Nor did they enquire about the effect of the proposed timing on their members. In another example, AMP's Trustee Services team considered that member fees were too high. But it also considered that this was a matter for the AMP product team, not the trustee, to address. In such cases, the existence of the BMM framework did not result in adequate management of conflicts.

Although regulators should stand ready to protect members' interests when trustees cannot, or will not, they do not always do so. In 2017, APRA conducted a review of the BMM and characterised it as 'robust'.⁵⁵ As explained in more detail in Volume 2, this characterisation suggests that APRA may not have grappled with how the trustees' arrangements worked in practice, and what impact those arrangements had on members. In his evidence to the Commission, Mr Byres acknowledged that the evidence received by the Commission and 'subsequent discussions' revealed that 'the application of the framework was not as one would expect it to be'.⁵⁶

More broadly, Mr Byres said that in its supervision, APRA's focus had been on whether regulated entities had robust frameworks and policies, on the basis that 'if you have a good set of frameworks and policies and your audit and compliance function are doing their job ... things should broadly work as intended'.⁵⁷ However, he acknowledged that a 'general lesson' for APRA was that it needed to consider how to 'get deeper' and identify where frameworks and policies were not effective. He said that the AMP case study examined by the Commission was an example of where APRA's

⁵⁵ Exhibit 5.291, 7 April 2017, Letter from APRA to Sansom, 3.

⁵⁶ Transcript, Wayne Byres, 30 November 2018, 7471.

⁵⁷ Transcript, Wayne Byres, 30 November 2018, 7470.

approach had been inadequate, and that a deeper examination had been required.⁵⁸

The number of retail trustees who have failed to manage conflicts effectively, despite having elaborate written frameworks in place, suggests that this is not an isolated issue. No doubt APRA can and should ‘get deeper’ in its supervision and take appropriate steps to remedy issues with particular trustees. But something more is required. As the Productivity Commission identified, strategic conduct litigation – that is, bringing strategic enforcement action to both address the immediate member harm, and to deter future conduct – appears at times to be ‘missing in action’ in the superannuation industry.⁵⁹

It is important to notice, therefore, that following the Commission’s taking of evidence, in August 2018, about some issues concerning the IOOF Holdings Ltd group of companies, APRA commenced proceedings in the Federal Court of Australia, on 6 December 2018, against IOOF Investment Management Ltd (IIML), Questor Financial Services Pty Ltd, and five individuals holding senior positions at IOOF.⁶⁰ By those proceedings, APRA seeks declarations that IIML and Questor breached their duties as trustees and contravened various provisions of the SIS Act by failing to exercise their powers in the best interests of the beneficiaries of the superannuation funds and failing to give priority to the interests of beneficiaries over the interests of all other persons. APRA seeks declarations that two of the individuals (Mr Christopher Kelaher, Managing Director of IOOF Holdings Ltd and Mr George Venardos, Chairperson of the company) contravened some provisions of the SIS Act and further seeks disqualification orders under section 126H of the SIS Act. As against the three other individual defendants (Mr David Coulter, the Chief Financial Officer, Mr Paul Vine, the General Manager – Legal, Risk and Compliance and Company Secretary, and Mr Gary Riordan, the Group General Counsel) APRA seeks disqualification orders under section 126H of the SIS Act.

⁵⁸ Transcript, Wayne Byres, 30 November 2018, 7470.

⁵⁹ Productivity Commission, Report 91, *Superannuation: Assessing Efficiency and Competitiveness*, 21 December 2018, 459.

⁶⁰ *APRA v Christopher Francis Kelaher & Ors* (FCA, NSD 2274/2018).

These proceedings having been instituted, I will say nothing about what emerged in evidence before the Commission about events and circumstances referred to in the papers filed by APRA in the Federal Court.

2.2.4 Conflicts of interest and industry funds

As already noted, it is not only the trustees of retail funds that encounter conflicts of interest. So, too, the trustees of industry funds, and ‘profit-for-member’ funds more generally, must also recognise and deal with conflicts between the interests of members and the interests of shareholders or nominating organisations.

A deal of attention was given to the ‘Fox in the Henhouse’ advertising program sponsored by industry funds. The principal focus was upon the best interests and sole purpose obligations of the trustees of those funds that contributed to the cost of making and broadcasting of the advertisement. I have dealt with those aspects of the matter in Volume 2 of this Report and do not seek to add to or repeat what is said there about those issues.

Instead, I observe that those who criticised funds who contributed to the costs associated with that advertisement can be seen as making a complaint that has its roots in notions of conflict of interest: what is seen as the conflict between duties to members and the interests of some shareholders or nominating organisations of industry fund trustees. As I record in Volume 2, I do not find that the conduct of the trustees might have amounted to misconduct or that it was conduct falling short of community standards and expectations.

The events were of a kind, however, that some suggested should lead to some rule prohibiting funds from engaging in certain kinds of ‘political’ advertising.⁶¹ I do not favour the adoption of a rule of that kind. Even if a rule of that kind could be made (and I do not stay to examine how the implied freedom of political communication might apply) it is not a rule that I consider should be made. Rather, **I consider that the existing rules, especially the best interests covenant and the sole purpose test, set the necessary standards. Those standards should be applied according to their terms and without more specific elaboration.**

⁶¹ See, eg, ANZ, Module 5 Policy Submission, 1 [3].

2.2.5 Extend best interests duty?

I do not consider that the difficulties the trustee of a retail fund will encounter in complying with the best interests covenant and the covenant that it give priority to members' interests over all others would be lessened by extending the class of persons who owe members those obligations. As has been noted, directors of the trustee owe parallel obligations.⁶² And both the trustee's and the directors' obligations focus upon the performance of duties and exercise of powers, in effect, in execution of the trust.

Formulating the duties that would be imposed on other entities is not without difficulty. What would be the content of the duty that might be imposed on (say) the shareholders of the trustee company? Would it be to exercise some or all of their powers *only* in the interests of the members of the fund of which the company is trustee? What would be the content of the duty that would be imposed on (say) a company retained by the trustee to perform some administrative function or functions for the trustee? Would it be to perform its duties under the administration agreement in the best interests of members? Unless the duties were to be framed in a way that imposed on these other entities duties of the same kind as a trustee owes members, how would imposing those duties make a difference? And, even if the duties imposed were to be to the same effect as the duties that a trustee now has, the same question must be asked. How would imposing those duties make a difference?

No matter what duties other persons may owe to members of the superannuation fund, the trustee would still be bound by its duties. The bare fact that others have correlative duties would not relieve the trustee of its duties. It would still have to take the necessary steps to ensure that what its shareholders and administrators were doing did not cause it, the trustee, to be in breach of its obligations. And, at least in the case of administration arrangements, the agreements made between trustees and administrators now commonly provide that the administrator must act in a way that will not adversely affect the trustee's performance of *its* duties.

⁶² SIS Act s 52A. See also the additional obligations imposed on trustees and directors of trustees in respect of MySuper products by ss 29VN and 29VO of the SIS Act.

Rather than introduce a new layer of regulation, necessarily accompanied by an increased regulatory enforcement task, I think it better to focus upon the existing and central requirements: that trustees of superannuation funds (and their directors) perform *their* obligations. I do not consider that meeting those central requirements would be assisted by making persons other than the trustees (and the directors of corporate trustees) subject to parallel obligations. To do so would, I think, serve only to allow blame-shifting and to distract from the close attention that must be given to the performance of trustees and their directors.

2.2.6 Prohibit ‘for-profit’ funds?

The most radical response to address difficulties encountered by the trustees of for-profit superannuation funds would be to prohibit, or at least inhibit, the carrying on of a superannuation fund for profit.⁶³ For the reasons that follow, I do not favour proposals of that kind.

It would be a very large step to say that the only persons or groups of persons who can conduct a superannuation fund are those who will not seek any return on their investment in the venture. To take a step of that kind now would have several effects.

First, it would eliminate one set of existing participants in the market and thereby reduce the competitive forces at play in the overall industry. Second, it would insulate existing not-for-profit participants from whatever competitive pressures are exerted by the threat of large for-profit entities entering this part of the financial services market and providing some new and better offering to consumers. Eliminating either or both of those competitive forces is undesirable and is probably reason enough to reject the idea.

But whether or not that is right, I am not persuaded that the trustees of funds established for the profit of the parent company cannot perform their duties to act in the best interests of members and give members’ interests priority over those of the parent company. As is apparent from what I have

⁶³ See, eg, AustralianSuper, Module 5 Policy Submission, 9 [40]–[41]; TWUSuper, Module 5 Policy Submission, 20 [94].

said in Volume 2 of this Report, I accept that trustees of for-profit funds have not always performed their duties. Further, I accept that the trustees of for-profit funds encounter particular difficulties in the performance of their duties. And I accept that trustees and regulators must give close and continuing attention to these issues. But neither separately nor together do these observations cause me to conclude that outright prohibition of for-profit funds is the only, or even preferable, solution to be adopted.

2.2.7 Structural separation

It may be said that some form of 'structural separation' between product manufacture and product sales is a necessary response to the issues about conflicts that have been identified in connection with for-profit superannuation funds. The separation suggested would require the party dealing with consumers (the trustee of the fund) to be controlled and managed separately, in the least, from the party or parties that manufacture the **financial products** that the trustee will acquire, and also perhaps, from the party or parties that carry out administrative, investment or insurance functions for the trustee.

Separation of the general kind described would preclude a trustee from investing the whole of the fund, as some retail funds now do, in insurance products issued by a life company associated with the parent company of the fund. It would also preclude the trustee from dealing with entities associated with the parent company of the fund to provide investment, administrative, insurance, or other services for the fund.

The premise for enforcing structural separation in any of the ways described must again be that it will reduce the nature and scale of the conflicts between the trustee's duties and the profit interest of the parent company. But, so long as the parent company seeks to make a profit there must come a point at which the interests of members and the interests of the parent company collide. It is in the interests of the members to maximise *their* returns; it is in the interests of the parent company for it to maximise *its* return.

The only way in which that conflict can be resolved is by the trustee fulfilling its duties. And to do that the trustee will have to compare what its related entities offer in investment, administrative and insurance services with what others in the market would provide and at what cost they would provide it.

Structural separation would also be a large step to take, as it would affect every person who is currently a member of any one of a significant number of funds. Apart from the members holding MySuper accounts with the relevant entities, all of those members would have chosen the fund in question. If, for any reason, those members consider it would be in their interests to move funds, they can do so. **I am not persuaded that a case has been made for imposing some form of structural separation on RSEs.**

2.3 Dealings with members' funds

2.3.1 Deduction of advice fees from superannuation accounts

One of the key elements contributing to the charging of fees for no service was the invisibility of the charges made. In almost every case the fees were charged directly to the person's investment accounts – often enough to the person's superannuation account.

On its face, it may seem odd that such fees were being deducted from superannuation accounts at all. No doubt the trustee of the fund may resort to the funds held in order to reimburse the trustee for outgoings incurred in the course of performance of the trust. No doubt the trustee may resort to the funds held to meet fees owing by members to the trustee under the rules of the fund. Hence fees like administration fees are properly charged to members' accounts.

But ongoing service fees payable to an advice licensee or the authorised representative of an advice licensee are neither outgoings that the trustee incurs in performance of the trust nor fees charged to members under the rules of the fund. They are fees charged under a contract the member has made with the advice licensee or the authorised representative for provision of advice.

More often than not, trustees of RSEs have permitted payment out of a member's account of fees certified by either the advice licensee or the authorised representative to be fees for advice about the member's superannuation arrangements. But in many cases, the services to be provided by the adviser have been so loosely defined that the advice provided may, but need not, include advice about whether to alter the client's financial plans or arrangements about post-retirement income.

I consider that using superannuation money to pay for such broad financial advice is not consistent with the sole purpose test prescribed by section 62 of the SIS Act. That requires the trustee of an RSE to '*ensure that the fund is maintained solely*'⁶⁴ for identified purposes. All of the core purposes specified hinge on the provision of benefits upon a member's death or retirement. So understood, it is not consistent with the sole purpose test for a trustee to apply funds held by the trustee in paying fees charged by an adviser to consider, or re-consider, how best the member may order his or her financial affairs generally or may best make provision for post-retirement income.

It follows that the nature of the advice that may properly be paid for from a superannuation account is limited to advice about particular actual or intended superannuation investments. This may include such matters as consolidation of superannuation accounts, selection of superannuation funds or products, or asset allocations within a fund. It would not include broad advice on how the member might best provide for their retirement or maximise their wealth generally. Any practice by trustees of allowing fees for these latter kinds of financial advice to be deducted from superannuation accounts must end.

As (in my view) this is what the law already requires, no further amendment is necessary. But I would modify the general rule in respect of MySuper accounts, and permit no deduction for advice fees of any kind. The simpler the arrangements about MySuper, the better. It is difficult to imagine circumstances in which a member would require financial advice about their MySuper account. If a member wants financial advice, the cost of that advice should be charged to and paid by the member directly.

⁶⁴ Emphasis added.

Recommendation 3.2 – No deducting advice fees from MySuper accounts

Deduction of any advice fee (other than for intra-fund advice) from a MySuper account should be prohibited.

It is now necessary to say something about ongoing advice fees.

2.3.2 Ongoing advice fees

Given the limited nature of the advice that may be paid for from a superannuation account, it might be thought that there are few circumstances in which paying fees for *ongoing* advice of that kind would be in the best interests of a member.

Perhaps a superannuation member invested through a platform would benefit – or believe they would benefit – from ongoing financial advice in respect of their superannuation investments. But such benefits would be relatively modest, and would accrue to relatively few members. As I said at the outset, the invisibility of ongoing advice fees was a key element in the charging of fees for no service. As long as ongoing service fees are permitted, some risk of members being charged fees for no service will endure. It may be that the benefits of eliminating that risk, by prohibiting ongoing service fees from superannuation altogether, outweigh any limited benefits these arrangements may provide.

I acknowledge the submissions from some entities that prohibiting ongoing advice fees would reduce access to financial advice for some (or many) Australians.⁶⁵ But if the recipient will not pay the fee that the adviser charges except out of a superannuation account, what does that say about the value to the recipient of the advice that is given? Does it show that the taxation treatment of superannuation contributions and benefits are driving the matter? And if they are, what does that reveal about how the recipient values the advice that is given?

⁶⁵ ANZ, Module 5 Policy Submission, 7 [41], 8–9 [44], 9 [46]; CFSIL and Avanteos, Module 5 Policy Submission, 20 [108]; NAB and NULIS, Module 5 Policy Submission, 16–17 [72]–[75]; Westpac, Module 5 Policy Submission, 18 [66]–[67].

Absent some convincing explanation from those who seek to maintain a system of charging fees against superannuation investments, the most likely conclusion must be that what is proffered by the adviser is not seen by the recipient as warranting the fee the adviser charges. And if that is right, the proposition that *needed* advice will not be given loses most if not all of its force.

However, if ongoing advice fees continue to be permitted, they should be tightly controlled in at least two ways. First, as I have said above, the advice in respect of which fees may be charged is limited to advice about particular superannuation investments. Because this is what the law already requires, no change is necessary. And second, consistent with what is written in the chapter on financial advice, any such ongoing advice arrangements should require annual renewal. Two years without confirmation that the member wishes the arrangement to continue is too long.

Two years is too long not only for the member, but also for the trustee. As the case studies showed, the existence of ongoing advice fee arrangements poses a danger to trustees: if they permit ongoing advice fees to be deducted, and no service is provided, they are likely to be in breach of their obligations under the SIS Act. Accordingly, **the trustee itself – separate from the advice licensee – should also receive annual confirmation of the member’s agreement to keep paying fees.** A prudent trustee would require nothing less.

If ongoing advice fees are to be retained, an issue arises as to the treatment of ongoing fee arrangements made before Division 3 of Part 7.7A of the *Corporations Act 2001* (Cth) (the Corporations Act) came into operation. For completeness, I should say that I would neither preserve those arrangements further nor provide any **grandfathering arrangements** to qualify the general principles I now propose. **Consistent with what I have said in the chapter on financial advice about ongoing fee arrangements, I would introduce the new rules with effect from a time that would give no more than 12 months’ notice of their coming into effect.** The choice of 12 months is dictated by the proposal made in that chapter that ongoing fee arrangements be renewed annually.

Finally, nothing I have said above (including in respect of MySuper) relates to what is known as ‘intra-fund advice’: the provision of advice that is not personal advice, to members of a particular fund about their interest in that

fund, where the cost of the advice is charged collectively to members of the fund in accordance with the SIS Act.⁶⁶ It was not suggested that any misconduct arose from such arrangements and I say nothing about them.

Recommendation 3.3 – Limitations on deducting advice fees from choice accounts

Deduction of any advice fee (other than for intra-fund advice) from superannuation accounts other than MySuper accounts should be prohibited unless the 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.

2.3.3 Paying grandfathered commissions

As I have explained, both in the Introduction to this Report and in the chapter on financial advice, and as reflected in Recommendation 2.4, **I would bring the grandfathering arrangements made at the time of the Future of Financial Advice (FoFA) reforms to an end. The time for transition has passed.**

2.4 Governance

2.4.1 Board composition

Proper governance of superannuation funds is of critical importance. Directors of the trustee of an RSE have important responsibilities. Debates about the desirable composition of the boards of trustees often proceed by seeking to differentiate between directors according to their association with a shareholder or a nominating organisation of the trustee. Distinctions of that kind may distract attention from what I consider to be the central issue: the need for the board of a trustee to be skilled and efficient in the proper supervision of the fund in the best interests of members.

⁶⁶ SIS Act s 99F.

Superannuation can no longer be seen only as a compact between employees and one or more employers or only as a compact between organised labour and capital. There are two reasons. First, as explained at the start of this chapter, superannuation is important to the *whole* nation. Superannuation arrangements are more than private bargains. Second, the central principles governing superannuation arrangements are, and must remain, the best interests of members and the sole purpose test. Neither of those principles refers to the interests of those who stood behind the establishment of the fund or those who continue to stand behind it. Neither of those principles permits pursuit of any objective other than the best interests of members.

Notions of ‘representative’ directors, as distinct from ‘independent’ directors do not sit easily with these basic principles. All directors of the trustee of an RSE owe the same duties, including, to perform their duties and exercise their powers as directors of the trustee in the best interests of the beneficiaries: *the members*.⁶⁷ Whatever may be the processes for the nomination or selection of directors, all directors must meet the best interests obligation. And in meeting that obligation all directors must give priority to the interests of members over the interests of *any* other person (including whatever person or body may have nominated the director to serve in that office).

As superannuation funds become larger and more complicated, the greater the need also grows for a skilled and efficient board of directors. The greater the need for board skills, the more pressing it is for nomination and appointment processes to recognise those needs expressly. And the more pressing it is for boards to make effective provision for regular and orderly board renewal and replacement.⁶⁸

I do not consider that these matters are best dealt with by prescriptive rules about board numbers or composition or prescriptive rules about nomination or selection processes. Rules of that kind have sometimes sought to use the notion of ‘independence’ as the relevant criterion. But rules prescribing board numbers or composition or prescribing particular forms of nomination

⁶⁷ SIS Act s 52A(2)(c).

⁶⁸ Cf Financial Reporting Council, *The UK Corporate Governance Code*, July 2018, 8, Principles J, K and L.

or selection processes distract attention from the basic requirement of ensuring that the board is, as far as possible, constituted, at all times, by directors who, *together*, will form a skilled and efficient board.

The reference to the board being constituted in such a way *at all times*, is important. Board change and renewal is essential but must be managed properly. The unexpected or wholesale turnover of trustee directors is to be avoided. Equally, term limits are a critical part of the proper management of board change and renewal. Change and renewal will bring fresh eyes to bear upon the direction of the trust and bring fresh interrogation of, and challenge to, management of the trust. Many funds now have term limits for board members but some have applied those limits only prospectively, leaving some board members in place for too long.

I do not think that the matters I have mentioned about board composition and appointment are best dealt with by legislative change. More particularly, they point firmly away from trying to develop some system of board appointment analogous to the processes applied in a publicly listed company. But they are matters to which funds seeking to apply sound governance principles need to give attention.

All the matters I have mentioned concern the proper governance of the fund. Proper governance is, in my view, a matter for the prudential regulator APRA to supervise. I will return to the subjects of governance and supervision later in this chapter in the course of considering whether the **Banking Executive Accountability Regime** (BEAR) regime should be extended to the superannuation sector.

Before doing so, however, there is one other aspect of governance of the trustees of RSEs that should be examined: mergers.

2.4.2 Mergers

Trustees of RSEs that offer a MySuper product must determine annually that there is sufficient scale, in terms of assets and beneficiaries, such that the financial interests of beneficiaries are not disadvantaged relative to the financial interests of beneficiaries in MySuper products of other RSEs.⁶⁹ Proper application of the annual scale assessment should invite

⁶⁹ SIS Act s 29VN(b).

the attention of some trustees to whether their members would benefit from merging the fund with another to create a fund of larger scale, with more assets and more beneficiaries.

In its report about superannuation the Productivity Commission proposed a number of other steps designed to encourage mergers.⁷⁰

The case studies examined in evidence pointed towards some recurring issues arising in consideration of possible mergers. In particular, the evidence pointed to processes related to board composition of the merged funds as being important to the success or failure of some merger proposals. Of course those examining a possible merger of funds must consider how the merger will be effected and how the merged fund will be both managed and governed. Who will constitute the board of the new entity? Who will decide who is to be the CEO of the new entity? Who will decide how the new entity will be administered and who will manage investments? All these, and more, may be proper questions for those considering a possible merger.

But the determining question must be what is in the best interests of *members*. The determining question cannot be whether one or more of those who are directors before the merger will have a place on the new board.

Likewise, care must be taken when considering whether proposals about board nomination and selection procedures for the board of the new entity are assessed according to the interests of members, or the interests of shareholders or nominating organisations of the merging trustees. On what basis can it be said that an external entity retaining control of a number of seats on the board of the trustee of the merged funds is in the interests of members? The moment the argument is framed in terms of 'control' it must be apparent that the interests of the controller are being considered above the interests of the members. And that is not consistent with the duties of the directors of the funds that are contemplating a merger. It is to fail to give priority to the interests of members over all other interests. As stated above, the formation of a new board is to be guided by the objective of constituting

⁷⁰ Productivity Commission, Report 91, *Superannuation: Assessing Efficiency and Competitiveness*, 21 December 2018, 453-4.

a board comprising directors who, together, will form a skilled and efficient board.

Having discussed matters of governance related to board composition and mergers, the question then arises of what should be done if a trustee does not act in accordance with the principles that have been laid out. At the time of writing, a Bill to make a number of changes to the SIS Act, including giving APRA a power to issue directions to RSE licensees, had been introduced into the Parliament but had not yet been passed.⁷¹ It may be that, in particular circumstances, addressing a stalled merger would be an appropriate use of such a power.

Finally, it is possible that in the circumstances of a particular proposed merger, a shareholder or nominating organisation could interfere despite the best efforts of the trustee (such as by refusing some consent required under the trustee's constitution). It is to be hoped that such extreme situations will be rare. Should such a situation occur, it would be for the trustee to take the necessary steps to ensure that its shareholders did not cause it, the trustee, to be in breach of its obligations.

2.5 Selling superannuation

2.5.1 No hawking

Superannuation is not a product to be sold. It is a compulsory product. All employees must have a superannuation account. Too many employees have more than one account. Steps taken to induce persons to hold multiple accounts should be actively discouraged. And persons having existing arrangements should not be induced to change those arrangements unless there is good reason to make the change.

Ideally all employees would make informed and rational choices about their superannuation arrangements. But many employees are not, and will not become, engaged enough to make those decisions. As the Cooper Review

⁷¹ Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2017 (Cth).

said, '[t]here are some members who simply want someone else to take care of it all for them'.⁷²

As I pointed out in the Introduction to this Report, share hawking has long been prohibited because it too readily allows the fraudulent or the unscrupulous to prey upon the unsuspecting.⁷³ The root of the problem is that the acquirer is 'unsuspecting'. That is, the acquirer comes to the unsolicited offer of shares (or, by extension, any complex financial product), unprepared, unable to look critically at what he or she is told, and often not knowing what questions to ask.

Those problems are no less acute in connection with superannuation. The person to whom an unsolicited offer is made will very often not be in a position to judge the merit of what is offered. In particular, that person will seldom if ever be in a position to compare what he or she is offered with what he or she already has under some existing superannuation arrangement.

And that is why the attempts by ANZ and CBA to sell superannuation in bank branches under a 'general advice' model (considered in more detail in Volume 2 of this Report) may have contravened the law. In the circumstances in which the offer was made, the customer to whom an offer was made may wrongly have assumed that the seller thought that the product was suitable for the particular customer's needs, when, in fact, the seller had no basis on which to form any view about suitability. The customer may have taken what was said as personal advice that took account of the customer's particular needs and circumstances.

As a result, despite some submissions to the contrary,⁷⁴ I do not accept that the unsolicited offer of a superannuation product is appropriate or in the interests of consumers.

⁷² Cooper Review, Final Report, 10.

⁷³ United Kingdom, *Report of the Company Law Amendment Committee* (Cmnd 2657) 1926, 48 [92].

⁷⁴ See, eg, ANZ, Module 5 Policy Submission, 2 [13]; CFSIL and Avanteos, Module 5 Policy Submission, 14 [76]; Westpac, Module 5 Policy Submission, 6 [18].

All forms of unsolicited offering of superannuation arrangements should be prohibited. The prohibition should not prevent trustees or related entities advertising generally the availability of the fund.

The general prohibition now made by section 992A(1) of the Corporations Act (that a person must not offer financial products for issue or sale in the course of, or because of, an unsolicited meeting with another person) and the associated prohibition in section 992A(3) against telephone selling ought to apply to superannuation.

Most superannuation interests are ‘financial products’ for the purposes of the section.⁷⁵ However, on its face, the section does not appear to prevent a bank or other entity from offering a superannuation product to a customer where the customer has voluntarily entered a branch, or telephoned the bank or entity, in relation to a matter that is unrelated to superannuation.

The Australian Securities and Investments Commission (ASIC)’s Regulatory Guide 38 says that ‘a meeting or telephone call requested by a consumer is only solicited for any financial products ... that are reasonably within the scope of the request’.⁷⁶ The Regulatory Guide gives a number of examples, including where a consumer telephones their bank and leaves a message for someone to call them about obtaining a credit card. The Regulatory Guide concludes that if, during the subsequent telephone call, the call centre operator offers to sell or issue a managed investment product to the consumer then ‘[g]enerally, the telephone call would be unsolicited for the offer of the managed investment product.’⁷⁷

I agree that this is how the law should work. But I am not convinced that this interpretation emerges from the words or context of this section of the Act. I therefore recommend that the section be amended to put the matter beyond doubt.

⁷⁵ Section 764A(1)(g) of the Corporations Act provides that ‘a superannuation interest within the meaning of the SIS Act is a “financial product”.’ There is a limited exception for exempt public sector superannuation schemes: see Corporations Act s 765A(1)(q); Corporations Regulations 2001 (Cth) regs 7.1.05 and 7.1.06B.

⁷⁶ ASIC, Regulatory Guide 38, 2005, 11 [A3.1].

⁷⁷ ASIC, Regulatory Guide 38, 2005, 11 [A3.2(c)(c)].

As I said in the Introduction, it should be made plain that a solicited meeting, telephone call, or other contact to discuss one type of financial product may not be used for the unsolicited offering of some other type of product. Put another way, contact with a person during which a superannuation interest is offered will be considered ‘unsolicited’ if the person did not attend the meeting, make the telephone call, or initiate the contact for the purposes of entering into negotiations relating to the offer of a superannuation interest.⁷⁸ While common banking products such as transaction accounts and credit card accounts may be considered as one type of product, superannuation products and classes of insurance product are, and should be treated as, distinct product types.

Recommendation 3.4 – No hawking

Hawking of superannuation products should be prohibited. That is, the unsolicited offer or sale of superannuation should be prohibited except to those who are not retail clients and except for offers made under an eligible employee share scheme.

The law should be amended to make clear that contact with a person during which one kind of product is offered is unsolicited unless the person attended the meeting, made or received the telephone call, or initiated the contact for the express purpose of inquiring about, discussing or entering into negotiations in relation to the offer of that kind of product.

2.5.2 Nominating a default fund

Because some employees, especially those who are young and working part-time, do not make informed choices about their superannuation arrangements, default arrangements are essential. As the Cooper Review said, ‘MySuper is particularly designed to cater to those members’.⁷⁹

I pause to note that I agree with the Productivity Commission that default superannuation accounts should only be created for new workers, or

⁷⁸ Cf Australian Consumer Law s 69.

⁷⁹ Cooper Review, Final Report, 10.

workers who do not already have a superannuation account.⁸⁰ And that default account should then be carried over, or ‘stapled’, to members as they move jobs. The proliferation of unnecessary default accounts is not in the interests of members.

Inevitably, funds compete to be nominated as default funds. If the relevant default fund is not fixed by some industrial instrument, competition between funds will focus on securing nomination of the fund by employers.

The evidence given in the Commission showed that some large funds spend not insignificant amounts to maintain or establish good relationships with those who will be responsible for nominating the default fund for their employees. Money is spent on entertainment and sporting events at which the relevant relationships can be made and enhanced.

Section 68A of the SIS Act provides that a trustee of an RSE, or an associate of a trustee, must not (among other things) supply or offer to supply goods or services to a person ‘on the condition that one or more of the employees of the person will be, or will apply or agree to be, members of the fund’. Current practice by some funds to provide those responsible for nominating default superannuation funds with entertainment or tickets to sporting events may be considered to be the supply of goods or services to a person *in connection with* one or more of the employees of that person becoming a member of the fund. But it is not a supply on that *condition*. The fund goes no further than supply with the *hope* that this may happen and therefore is not in contravention of the Act by doing so.

For this reason, as section 68A now stands, it does not achieve its intended purpose of preventing funds ‘treating’ employers in order to gain members. Its effectiveness is further limited by the fact that the only consequence of a breach is that a person who suffers loss or damage because of the contravention may bring an action against the offender.

What I have called the ‘treating’ of employers should not be permitted. Permitting it means that decisions made by employers about default funds may be affected by considerations that should be irrelevant.

⁸⁰ Productivity Commission, Report 91, *Superannuation: Assessing Efficiency and Competitiveness*, 21 December 2018, 65.

It was suggested that such a prohibition would disproportionately disadvantage industry super funds, who, unlike many retail funds, must operate without the benefit of established banking relationships with employers.⁸¹ Even if that were so, I do not accept that trustees should be permitted to attempt to influence employers' decisions through irrelevant considerations.

I accept that eliminating these particular considerations as irrelevant will not ensure that employers act only on relevant considerations. It must be recognised that their decisions may not be guided only by a proper assessment of what would be in the best interests of their employees. But the manner in which default funds should be fixed goes beyond my Terms of Reference and I do no more than note that there is a more general issue beyond the particular question about the operation of section 68A that is now under consideration.

If, as I consider should be the case, there is to be an effective prohibition against funds 'treating' employers, the model for legislation lies in statutory prohibitions against the treating of electors. Legislation of that kind prohibits supply of goods or services where the supply is made with a forbidden purpose or the supply may have the forbidden effect. Section 68A should be amended in that way by prohibiting supply where the supply may reasonably be understood by a recipient to be made with a purpose of having the recipient nominate the fund as a default fund, or having one or more employees of the recipient apply or agree to become members of the fund.

Breach of the prohibition should be a civil penalty provision, enforceable by ASIC. The application of consequences for breach should not depend upon the existence and motivation of persons who have suffered loss.

Of course, if employers were not put in the position of determining an employee's default fund, the necessity for section 68A would cease. If there are to be changes made to the arrangements for default accounts, that would call for a re-evaluation of section 68A. But such a change is beyond the scope of my inquiry. And in the absence of change, section 68A should be strengthened.

⁸¹ Industry Super Australia Pty Ltd, Module 5 Policy Submission, 6 [21].

Recommendation 3.5 – One default account

A person should have only one default account. To that end, machinery should be developed for ‘stapling’ a person to a single default account.

Recommendation 3.6 – No treating of employers

Section 68A of the SIS Act should be amended to prohibit trustees of a regulated superannuation fund, and associates of a trustee, doing any of the acts specified in section 68A(1)(a), (b) or (c) where the act may reasonably be understood by the recipient to have a substantial purpose of having the recipient nominate the fund as a default fund or having one or more employees of the recipient apply or agree to become members of the fund.

The provision should be a civil penalty provision enforceable by ASIC.

2.6 Accessibility

As is too often the case with other aspects of financial services, some Australians encounter difficulties gaining access to and making effective use of some aspects of the superannuation system. In particular, Aboriginal and Torres Strait Islander peoples encounter needless difficulties to do with identification and about binding death nominations.

2.6.1 Identification

In July 2016, the Australian Transaction Reports and Analysis Centre (AUSTRAC) published guidelines that allowed entities (including superannuation funds) to follow particular identification and verification procedures for Aboriginal and Torres Strait Islander peoples that would avoid some of the difficulties that would otherwise be encountered. Evidence in the Commission suggested that these procedures may not always be followed by all entities.

There is no reason for any entity not to have practices and procedures of these kinds and there is no reason for any entity not to have trained staff to use them.

2.6.2 Binding death benefit nominations

A question arose in the course of the Commission's proceedings about whether the law as it now stands permits Aboriginal and Torres Strait Islander peoples to make binding death nominations in respect of their superannuation that reflect the kinship structures of the peoples concerned. As Treasury pointed out in its submissions, nominations can be made in respect of a person with whom the nominator has 'an interdependency relationship'.⁸² The notion of an interdependency relationship is broad. Lest there be doubt, however, **I urge consultation with relevant Aboriginal and Torres Strait Islander peoples about whether they, as the relevant users of the system, see difficulties about binding death benefit nominations that should be met.**

2.6.3 Early release of superannuation benefits for severe financial hardship

The Commission also sought submissions on whether superannuation funds that do not currently permit the early release of superannuation on the basis of severe financial hardship should do so.⁸³ A number of submissions indicated that they should.⁸⁴

At the time of writing, Treasury was actively considering reform of the rules governing the early release of superannuation benefits on compassionate and severe financial hardship grounds.⁸⁵ In December 2017, Treasury released an issues paper entitled *Early Release of Superannuation Benefits Under Compassionate and Financial Hardship Grounds and for Victims*

⁸² Treasury, Module 5 Policy Submission, 20–1 [95]–[96].

⁸³ FSRC, Module 5 Closing Submissions, 174 [640].

⁸⁴ AustralianSuper, Module 5 Policy Submission, 3 [12]; ANZ, Module 5 Policy Submission, 5 [30]; Westpac, Module 5 Policy Submission, 9 [30]; NAB, Module 5 Policy Submission, 12 [52]; CFSIL and Avanteos, Module 5 Policy Submission, 16 [88]; FSU, Module 5 Policy Submission, 18 [125]; ASIC, Module 5 Policy Submission, 14 [74]; CHOICE, Module 5 Policy Submission, 17.

⁸⁵ Treasury, *Review of the Early Release of Superannuation Benefits* (15 December 2018) Treasury <<https://static.treasury.gov.au/uploads/sites/1/2018/11/Issues-Paper-Early-Release-of-Superannuation-1.pdf>>.

of Crime Compensation.⁸⁶ In November 2018, Treasury released a further issues paper containing findings and draft proposals.⁸⁷ Responses to this further issues paper are to be provided by 15 February 2019.⁸⁸ In those circumstances, I do not consider that it is necessary or desirable to make any recommendations on this matter.

It is now necessary to say something about the regulation of superannuation.

3 Regulatory framework

As is noted elsewhere in this Report, especially in the chapter about the Regulators, the ‘twin peaks’ model of regulation was designed so that, generally, APRA is responsible for prudential regulation and ASIC for regulation of conduct and disclosure.

3.1 A different regulatory task

Superannuation presents particular regulatory issues. It is a compulsory product. All who are employed, and very many of those who have been employed, will have superannuation arrangements. Superannuation performance directly affects the public purse by reducing the call on social security payments and other public welfare measures including, but not limited to, housing, care and health measures.

Unlike other financial products (where the main regulatory focus will be upon the circumstances in which the product is acquired and on the continued ability of entities to meet their obligations) the regulatory focus

⁸⁶ Treasury, *Early Release of Superannuation Benefits Under Compassionate and Financial Hardship Grounds and for Victims of Crime Compensation* (December 2017) Treasury <<https://static.treasury.gov.au/uploads/sites/1/2017/12/c2017-t246586-Consultation-Paper.pdf>>.

⁸⁷ Treasury, *Review of Early Release of Superannuation Benefits: Further Consultation and Draft Proposals* (November 2018) Treasury <<https://static.treasury.gov.au/uploads/sites/1/2018/11/Issues-Paper-Early-Release-of-Superannuation-1.pdf>>.

⁸⁸ Treasury, *Review of the Early Release of Superannuation Benefits* (15 December 2018) Treasury <<https://static.treasury.gov.au/uploads/sites/1/2018/11/Issues-Paper-Early-Release-of-Superannuation-1.pdf>>.

for superannuation must extend to the *outcomes* that will be delivered to members. The superannuation provider makes no promise about what its future performance will be, but the quality of its performance is important not only to members but also to society generally. And because obtaining proper future outcomes is important, the regulatory task extends beyond issues of disclosure (at and after the time of acquisition of an interest in the product that is offered), and issues of risk management. The importance of *outcomes* in the regulation of superannuation is reflected in two prudential standards APRA has proposed⁸⁹ and the Bill presently before Parliament that seeks to introduce an obligation on trustees to perform an ‘outcomes assessment’ for MySuper products.⁹⁰

In 2010, the Cooper Review recommended that APRA’s mandate be broadened to include the task of overseeing and promoting the efficiency of the funds it regulates and the system in which it operates.⁹¹ It proposed that APRA be given general standards-making power in relation to superannuation in order, among other things, to ‘drive efficiencies in the industry’,⁹² and ‘improve transparency of outcomes’.⁹³

In 2012 and 2013, changes were made to the SIS Act to alter the obligations of superannuation trustees and directors to insert, relevantly, sections 29VN and 29VO, and to give APRA the power to issue prudential standards in relation to superannuation.⁹⁴

More recently, the Productivity Commission said, in its report on superannuation⁹⁵ that ‘[c]onduct regulation arrangements for the

⁸⁹ See, eg, APRA, *Response to Submissions, Strengthening Superannuation Member Outcomes*, December 2018, 4.

⁹⁰ Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No.1) Bill 2017 (Cth) Sched 1.

⁹¹ Cooper Review, Final Report, Ch 10, Recommendation 10.1, 310.

⁹² Cooper Review, Final Report, Ch 10, Recommendation 10.2, 311.

⁹³ Cooper Review, Final Report, Ch 4.

⁹⁴ *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth) and *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013* (Cth). See also Background Paper No 25, 14–17.

⁹⁵ Productivity Commission, Report 91, *Superannuation, Assessing Efficiency and Competitiveness*, 21 December 2018, 459.

superannuation system are confusing and opaque, with significant overlap and no clear delineation between the roles of APRA and ASIC'. It observed that 'APRA is best placed to focus on licensing and authorisation to promote high standards of system and fund performance', while ASIC is best placed to regulate the (mis)conduct of trustees and advisers, and to oversee the appropriateness of products (including to particular target markets) and disclosure.⁹⁶ No less importantly, it suggested that '[r]egulators also need to be more confident and member-focused in the manner in which they regulate – becoming “member champions”... The role of regulators is ultimately to protect member interests.'⁹⁷

In a Background Paper prepared for the Commission, Professor Pamela Hanrahan identified the regulatory overlap as explained by 'the steady expansion of APRA's responsibilities into areas of non-financial risks, which often crosses into the realm of conduct regulation'.⁹⁸ Hence, Professor Hanrahan said, maladministration of a superannuation fund involving breach of the laws governing use of members' funds,⁹⁹

if it is detected by regulators, may potentially trigger protective, remedial or enforcement action by APRA – for breach of the RSE licensing laws, breach of prudential standards, or breach by the trustee or its directors of the SIS Act duties and statutory covenants – and by ASIC – for breach of AFS licensing laws, breach of the SIS Act statutory covenants relating to reporting and disclosure, or breach by the directors of their Corporations Act duties as directors of the RSE licensee.

There is, therefore, evident scope for doubt about which regulatory agency will and should act in a given circumstance. Not only that, the powers and remedies available to the two agencies are not identical.¹⁰⁰

⁹⁶ Productivity Commission, Report 91, *Superannuation, Assessing Efficiency and Competitiveness*, 21 December 2018, 43.

⁹⁷ Productivity Commission, Report 91, *Superannuation, Assessing Efficiency and Competitiveness*, 21 December 2018, 43.

⁹⁸ Background Paper No 25, 23.

⁹⁹ Background Paper No 25, 24.

¹⁰⁰ Background Paper No 25, 24.

3.2 The present division

All trustees of APRA-regulated funds must be RSE licensees under the SIS Act.¹⁰¹ Most RSE licensees hold an **Australian Financial Services Licence** (AFSL) under Part 7.6 of the Corporations Act.¹⁰²

The SIS Act establishes the general framework for the regulation of superannuation funds. Regulations made under the SIS Act provide elaborate operating standards for trustees.¹⁰³ The Corporations Act deals with provision of financial services by and to superannuation trustees, mandatory disclosure requirements and dispute resolution arrangements. The ASIC Act sets out the consumer protection laws for the financial services sector.

Section 6 of the SIS Act identifies which agencies administer the provisions of the Act. Some functions are given to ASIC and some to the ATO but, subject to those more particular exceptions, section 6 gives APRA the general administration of the central provisions of the SIS Act including the provisions about licensing of RSEs, trustees' and directors' covenants and the sole purpose test.

ASIC has the general administration of the Corporations Act,¹⁰⁴ and the licensing and other functions given to it by Chapter 7 of that Act.

3.3 Who should regulate?

One response to doubts or difficulties about the respective roles of APRA and ASIC in connection with superannuation would be to create a new and separate regulator responsible for all aspects of supervision and regulation of the superannuation industry. The size, complexity and importance of the industry may all be said to point towards that kind of step. But the superannuation industry has so many intersections with other parts of the financial services industry that creation of a new and separate regulatory authority is likely to create more problems than it would solve.

¹⁰¹ Background Paper No 25, 25.

¹⁰² Background Paper No 25, 29.

¹⁰³ Superannuation Industry (Supervision) Regulations 1993 (Cth); Background Paper No 25, 8.

¹⁰⁴ Corporations Act s 5B.

Superannuation entities are becoming very important participants in Australia's capital markets. There is, I believe, much force in APRA's submission that '[a] superannuation-only regulator would be unlikely to have a broad perspective on risks and linkages within the broader financial sector, which will become increasingly important as RSE Licensees consolidate, become more complex, and engage in more sophisticated activities such as direct lending and the provision of retirement products'.¹⁰⁵ As ASIC submitted, the 'superannuation system has evolved and is now at a level of maturity where accountability must be a key focus'.¹⁰⁶

Creation of a separate regulator for superannuation would mark a shift back towards the sectoral model of regulation that prevailed before, and was not favoured by, the Wallis Inquiry. In itself this would not be reason enough to reject the idea, but it is good reason to think carefully before adopting it. As Treasury pointed out in its submissions, the new regulator would have to deal with prudential and conduct issues and would almost certainly take its initial cohort of staff from APRA and ASIC, thereby diminishing their resources.¹⁰⁷ And, of course, there would inevitably be a period of transition between the old and new regulatory arrangements.¹⁰⁸

I do not favour the creation of a superannuation-only regulator. The twin peaks model of regulation should be maintained. Instead, I consider that the roles of APRA and ASIC in relation to superannuation should be adjusted.

3.4 Adjusting regulatory roles

In adjusting the roles of APRA and ASIC in relation to superannuation, it is very important not to draw lines in such a way that will leave gaps. If the consequence is, and it will be, that there is a degree of overlap between the remits of the two agencies, that outcome should be recognised and accommodated.

The adjustment to be made should accord with the general principle that APRA is to act as prudential regulator and ASIC as the conduct regulator.

¹⁰⁵ APRA, Module 5 Policy Submission, 9 [19].

¹⁰⁶ ASIC, Module 5 Policy Submission, 1 [5].

¹⁰⁷ Treasury, Module 5 Policy Submission, 33 [158].

¹⁰⁸ Treasury, Module 5 Policy Submission, 33 [159].

That is, as APRA described the respective roles of the agencies:

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 ...

As the conduct and disclosure regulator, ASIC's role in superannuation primarily concerns the relationship between RSE Licensees and individual consumers.¹⁰⁹

(I say more about this allocation of roles in the chapter on the regulators.)

Adjustment of this kind will result in the two agencies having common areas of interest. But each agency will have to look at those areas for different purposes and with a different perspective.

It is useful to return to the best interests covenant and conflicts of interest, which are likely to be of common interest for APRA and ASIC. These two themes frequently intersected in the case studies and often played out to the detriment of members, further emphasising the need for regulation and, where appropriate, enforcement.

3.4.1 Current enforcement of the trustees' covenants

Section 55(1) of the SIS Act provides that a person must not contravene the trustees' or the directors' covenants.¹¹⁰ But, as the SIS Act now stands, breach of a covenant attracts no penal consequence, civil or criminal.¹¹¹

¹⁰⁹ APRA, Module 5 Policy Submission, 8 [15]–[16].

¹¹⁰ Equally, ss 29VP(1) and 29VPA(1) provide that a person must not contravene the additional MySuper obligations imposed on trustees and directors respectively.

¹¹¹ The Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2017 (Cth) would provide, among other things, for breach of a director's covenant to be a civil penalty provision. Section 202 of the SIS Act now provides for when contravention of a civil penalty provision is an offence. To be an offence, the contravention must meet one of two additional elements: either the person contravenes the section dishonestly and intending to gain an advantage (for that or any other person), or the person contravenes the section intending to deceive or defraud someone.

A person who suffers loss or damage as a result of the breach may bring an action to recover the amount of that loss or damage but, if the action is against a director for breach of a director's covenant, the action may be brought only with the leave of the court.¹¹²

As the law now stands, APRA may be able to say that the conduct that breaches one of the covenants is a breach of some prudential standard. It may be able to say that there has been a failure by the trustee to comply with the condition on its licence to act as an RSE – that its duties as a trustee are properly performed.¹¹³ It may be able to direct the RSE licensee to comply with that condition.¹¹⁴ But on their face, these enforcement measures are less direct than they should be, given the central importance of the obligations.

3.4.2 Changing enforcement of covenants

The covenants are, as I have said, central to the proper administration of a superannuation fund. Their proper application is a matter of both prudential and regulatory importance.

I have no doubt that the SIS Act should be amended to make breach of the covenants set out in sections 52 and 52A of the SIS Act and the analogous obligations imposed by sections 29VN and 29VO of the SIS Act civil penalty provisions. And if that is done, section 202 of the SIS Act should be left to operate according to its terms, making it an offence to breach those covenants or those provisions if either of the additional elements prescribed by that section are established.¹¹⁵

As at November 2018, a Bill to make a number of changes to the SIS Act, including making breach of section 52A and section 29VO civil penalty provisions, had been introduced into the Parliament but had not yet been passed.¹¹⁶

¹¹² SIS Act ss 29VP(3), 29VPA(3), 55(4), 55(4A).

¹¹³ SIS Act s 29E(1)(b).

¹¹⁴ SIS Act s 29EB.

¹¹⁵ The additional elements are either acting dishonestly and intending to gain an advantage or intending to deceive or defraud someone.

¹¹⁶ Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2017 (Cth), Sched 3.

Because performance of the covenants has both a prudential significance and a significance for members of the fund, both APRA and ASIC should be able to take action in respect of breaches of the covenants.

More often than not, I would expect that ASIC would be the agency that would take any enforcement action. This would be consistent with ASIC's existing responsibility for enforcing similar obligations imposed on the responsible entities of managed investment schemes.¹¹⁷ It would also be consistent with ASIC's existing regulation of AFSLs. RSE licensees are also AFSL holders, and have obligations that ASIC is responsible for enforcing, such as the obligation under section 912A to provide services 'efficiently, honestly and fairly'. Conduct that may give rise to a breach of the covenants may also breach the trustee's obligations under its AFSL; in such circumstances it would make sense for ASIC to deal with the breaches holistically.

That being said, APRA's prudential supervision of RSEs may be the most likely means by which issues about performance of the covenants emerge. It will not be often that individual members of a fund, or groups of members, come to be aware of facts and circumstances that may show a breach by the trustee. It is therefore essential that APRA retain the ability to take action in the case of a breach. Hence, the exercise of powers by the two agencies should be complementary, not conflicting.

The way in which dual regulation should occur is discussed more fully in the chapter dealing with the regulators.

Recommendation 3.7 – Civil penalties for breach of covenants and like obligations

Breach of the trustee's covenants set out in section 52 or obligations set out in section 29VN, or the director's covenants set out in section 52A or obligations set out in section 29VO of the SIS Act should be enforceable by action for civil penalty.

¹¹⁷ Corporations Act s 601FC.

Recommendation 3.8 – Adjustment of APRA and ASIC’s roles

The roles of APRA and ASIC with respect to superannuation should be adjusted, as referred to in Recommendation 6.3.

3.5 Regulators and trustees’ conflicts of interest

As the course of evidence before the Commission shows, trustees have not always ‘managed’ conflicts of interest by giving priority to the duties to, and interests of, beneficiaries over the duties to, and interests of, other persons. Decisions have been made which, at the very least, have tried to accommodate both the interests of members and the interests of entities associated with the entity, that is either the holding company of a group of which the trustee is part, or that can be seen as the ‘sponsor’ of the fund.

This attempt to accommodate the conflicting interests has been achieved in some cases, by entities within the group that have the day-to-day administration of the fund controlling the information that goes to the trustee. So, for example, a trustee was asked to approve a proposed program for transferring accrued default amounts to a MySuper product without the trustee having been informed that the administrator had taken the decision only after considering how the proposed program would accord with the interests of aligned advisers.¹¹⁸ And there were other cases in which the administration entity within a group did not pass information on to the trustee that, on its face, bore upon what decision would be in the best interests of all members.¹¹⁹

In still other cases, the trustee company took decisions that not only did not give priority to members’ interests, but sought to accommodate both members’ interests and the interests of others.

¹¹⁸ AMP case study: vol 2.

¹¹⁹ For example, NULIS decided to maintain grandfathered commissions in the context of a successor fund transfer based on a management paper. That paper referred to the possibility of increased costs from member attrition due to adviser dissatisfaction, but did not attempt any estimate of the cost nor consider the amount members would continue to pay. Similarly, a management paper provided to the board of IIML about proposed pricing changes did not contain relevant information, such as IIML’s experience with grandfathering or how many members were paying trail commissions, to allow the board to make an informed decision.

Again, particular instances of matters of this kind must be of immediate concern to both APRA as prudential regulator and ASIC as conduct regulator. Again, they are matters that are more likely to be uncovered by APRA in the course of its supervisory work than to be the subject of direct complaint to ASIC. But they are, as I have said, matters that go to the very heart of the trustee's performance of its central duties.

Both APRA and ASIC should have power to act in respect of matters of these kinds. I would expect that, more often than not, ASIC would be the agency that would take any enforcement action. But APRA must perform its supervisory functions. RSEs cannot and will not meet what APRA has called their 'financial promises' without adhering closely to the trustees' covenants and the sole purpose test.

3.6 Governance, regulation and supervision

As I have explained earlier in this chapter, I consider that there should be an adjustment of the roles APRA and ASIC have in relation to superannuation. And, as I have said, the role of each agency should accord with the general principle that APRA is to act as prudential regulator and ASIC as the conduct regulator.

Governance of superannuation funds inevitably raises both prudential and conduct issues. Proper governance of a fund is critical to the fund's performance. That is, proper governance is necessary in order to fulfil the basic promise of a superannuation fund that the trustee will administer the fund in the best interests of members, and in particular, in the best *financial* interests of members.

Particular governance failures must be identified. More often than not, failures may be detected by the prudential regulator in the course of its prudential supervision. But however detected, particular failures of governance must be examined by the regulator and made the subject of the appropriate regulatory response. It is this last step that is necessary if trustees of RSEs are to be held properly accountable for their failures of governance.

Failures of governance are reflected in particular decisions that are made with respect to the administration and investment of the fund. The larger superannuation funds are now large enterprises dealing with very large sums of money.

There is no reason in principle why the directors and the senior executives of at least the large superannuation funds should not be subject to statutory obligations of a kind generally similar to those imposed on members of the board and banking executives by the BEAR – to conduct the responsibilities of their positions:

- by acting with honesty and integrity, and with due skill, care and diligence;
- by dealing with APRA and ASIC in an open, constructive and co-operative way; and
- by taking reasonable steps in conducting those responsibilities to prevent matters from arising that would adversely affect the prudential standing or prudential reputation of the fund.¹²⁰

I say that there is ‘no reason in principle’ not to impose obligations of this kind on the board and the senior executives of a superannuation fund on the simple basis that if the BEAR is seen as a necessary step in the proper supervision and regulation of (at least some of the) banks, proper supervision and regulation of superannuation funds needs no less. And imposing these obligations should not increase the regulatory burden to any significant extent.

This last point should be explained.

A necessary step in implementing provisions of the kind under consideration is to identify who in the regulated entity has senior executive responsibility for certain functions. Those responsibilities should either already be identified or, at least be readily identifiable. If that is correct, and it should be, preparation of accountability statements and accountability maps, though a burden, should not be a large burden. Performance of the obligations would then entail no reporting or recording beyond what prudent administration would require anyway.

¹²⁰ Cf Banking Act s 37CA(1).

The advantage of this course of action is that the imposition of the obligations clarifies what is expected of the relevant senior executives. And it would provide additional and important standards against which the prudential regulator and the conduct regulator may examine the conduct of the affairs of the fund by both its board and by its senior management. (I say ‘additional’ standards because, of course, the trustees’ and directors’ covenants and obligations set standards against which the conduct of the trustee and its directors are to be judged.)

Recommendation 3.9 – Accountability regime

Over time, provisions modelled on the BEAR should be extended to all RSE licensees, as referred to in Recommendation 6.8.

Conclusion

Superannuation trustees are responsible for the compulsory and voluntary retirement savings of millions of working Australians. This responsibility comes with important obligations to act in the best interests of members and to give priority to the interests of members above all others. Trustees are not always discharging those obligations, often causing financial detriment to members. Trustees must improve the performance of their duties. Their role should be restricted in order to avoid conflicts, including by precluding them from acting as dual-regulated entities and prohibiting them from the ‘treating’ of employers. And trustees and their most senior executives should be accountable, in the same way that **authorised deposit-taking institutions** are accountable under the BEAR.

Members’ interests must be protected. The deduction of fees for financial advice from their accounts should be limited to ensure that such advice is provided only when necessary and to minimise the prospect of fees being deducted for services that were not provided. For MySuper accounts, no deductions for ongoing advice fees should be permitted. The unsolicited offer, or hawking, of superannuation products to individuals should also be prohibited.

Finally, the roles and powers of APRA and ASIC should be adjusted to enable better supervision of superannuation entities and more effective enforcement of the duties owed by trustees and by directors of trustees.

5. Insurance

Introduction

In its public hearings, the Commission focused upon the life insurance and general insurance industries, not on the marine or health insurance industries. This focus was consistent with the complaints made to the Commission, with the misconduct and conduct falling below community expectations disclosed by entities in their responses to my initial inquiries, and with the material provided to the Commission by the Australian Securities and Investments Commission (ASIC) and the Financial Ombudsman Service (FOS).

I begin by making some general observations about the history of insurance in Australia, and, in particular, the life and general insurance industries.

1 History

The general insurance industry began in Australia in about the 1830s.¹ From the 1870s, the commercial insurance industry grew rapidly.² By the early twentieth century, the focus of the Australian insurance industry was life insurance, fire insurance and marine insurance (which had by then been an important form of insurance for many centuries in England).³ In 1904, there were 37 insurance companies operating in Australia, 22 of which were British, 11 of which were Australian, and three of which were based in New Zealand.⁴ Many of those companies continue to exist in some form today.⁵

¹ Background Paper No 14, 31 [2.1].

² Background Paper No 14, 31 [2.2].

³ Background Paper No 14, 29–31 [1.1]–[1.7], [2.1].

⁴ Background Paper No 14, 31–2 [2.2].

⁵ Background Paper No 14, 32 [2.2].

In the first half of the twentieth century, a number of states developed their own state insurance (non-tariff) companies.⁶ Some of these companies have since become purely commercial enterprises.⁷

The Federal Parliament did not become actively involved in regulating insurance until the passage of the *Insurance Act 1973* (Cth) (the Insurance Act).⁸ Since that time, a number of significant reforms have taken place. These include the introduction of the *Insurance Contracts Act 1984* (Cth) (the Insurance Contracts Act). That Act was passed in response to the Australian Law Reform Commission's 1982 report into insurance, which contained 'a detailed analysis of the common law and also a series of almost revolutionary recommendations for reform'.⁹ Most of the Commission's recommendations were given effect in the Insurance Contracts Act.¹⁰

As I will explain further below, the prudential regulation of insurers has developed separately, principally through the Insurance Act and the *Life Insurance Act 1995* (Cth) (the Life Insurance Act).¹¹

2 The life insurance industry

The life insurance industry is now a significant part of the Australian economy. In the year ending 31 March 2018, life insurers in Australia earned over \$18 billion in direct premiums from consumers.¹² At that time, the value of total assets held by life insurance companies in Australia was over \$230 billion.¹³

⁶ Background Paper No 14, 33 [2.6].

⁷ Background Paper No 14, 33 [2.6].

⁸ See the caveat in Background Paper No 14, 33 [3.1], and more generally at 34 [3.3].

⁹ Background Paper No 14, 33 [3.1].

¹⁰ Background Paper No 14, 33 [3.1].

¹¹ Background Paper No 14, 34 [3.3].

¹² Background Paper No 26, 15 [4].

¹³ Background Paper No 26, 15 [4].

Four main types of life insurance cover are sold in Australia:¹⁴

- *life cover*, which pays a benefit on the death of a policyholder;
- *total and permanent disability (TPD) cover*, which pays a lump sum to assist with rehabilitation and living costs if the policyholder becomes totally and permanently disabled;
- *income protection cover*, which replaces income lost by the policyholder through their inability to work due to injury or sickness; and
- *trauma cover*, which provides cover to the policyholder if they are diagnosed with a specified illness or injury.

These types of cover are sold in three main ways:

- *direct sales* – an insurer sells a life insurance product directly to the consumer without any personal financial product advice;
- *retail sales* – a financial adviser sells a life insurance product to the consumer; and
- *group sales* – the trustee of a superannuation fund, or an employer, purchases a group policy under which the fund members or employees have the benefit of cover.

It is useful to analyse the three ways in which life insurance cover is sold by reference to the number of policies sold and the premiums paid for policies sold. In the 2017 calendar year, 84% of policies were sold through the retail channel, 15% were sold through the direct channel, and only 1% were sold through the group channel.¹⁵ Of the premiums paid, however, retail sales represented 55%, group sales represented 40%, and direct sales represented only 5%.¹⁶

¹⁴ Background Paper No 29, 1 [1.2].

¹⁵ Exhibit 6.1, Undated, How Do Australians Buy Life Insurance.

¹⁶ Exhibit 6.2, Undated, Chart of Premiums from Sales of New Policies by Channel.

The figures quoted in respect of group sales record policies sold to superannuation trustees. When one looks instead at the number of insurance policies held within superannuation funds, it becomes clear that the majority of life insurance policies on issue in Australia are held through superannuation funds.¹⁷ I will say more about this in the final section of this chapter.

The life insurance industry has been undergoing, and continues to undergo, substantial change:

- In March 2016, Zurich Australia announced that it had entered into an agreement to acquire Macquarie Life's life insurance business.¹⁸
- In October 2016, NAB announced that it had completed the sale of approximately 80% of its life insurance business to Nippon Life Insurance Company.¹⁹ In May 2018, NAB announced that it would divest its ownership of MLC, including the remaining 20% stake in its life insurance business. This process is expected to be completed by the end of 2019.²⁰
- In September 2017, CBA announced the sale of its life insurance businesses in Australia (CMLA) and New Zealand (Sovereign) to AIA Group. On 2 July 2018, CBA announced the completion of the sale of Sovereign to AIA.²¹ The sale of CMLA to AIA is still pending regulatory approvals, and is now expected to be completed in the first half of 2019.²²

¹⁷ Peter Kell, 'Insurance in Super: The Regulators – What Do They Think?' (Speech delivered at the Association of Superannuation Funds of Australia Spotlight on Insurance, Sydney, Australia, 27 February 2018).

¹⁸ Zurich, 'Zurich Enters Agreement to Acquire Macquarie Life Insurance Business' (Media Release, 4 March 2016).

¹⁹ NAB, 'NAB Completes Sale of 80% of Life Insurance Business' (Media Release, 3 October 2016). See also Exhibit 6.13, Witness statement of Sean McCormack, 21 August 2018, 3 [16].

²⁰ Stephen Letts, 'National Australia Bank to Sell MLC as Another Bank Flees Wealth Management' (Media Release, 3 May 2018).

²¹ CBA, 'Completion of New Zealand Life Insurance Divestment' (Media Release, 2 July 2018).

²² CBA, 'Update on Life Insurance Divestments' (Media Release, 23 October 2018).

- In December 2017, ANZ announced the sale of its life insurance business, OnePath Life, to Zurich Financial Services Australia.²³
- In August 2018, Suncorp announced that it had entered into non-binding Heads of Agreement to sell its Australian life insurance business to TAL Dai-ichi Life Australia. Completion was expected to occur by the end of 2018.²⁴

These divestments are expected to lead to a consolidation in the Australian life insurance market, in circumstances where TAL and AIA are already significant players in that market.²⁵

3 The general insurance industry

A broad range of products are classified as 'general insurance' products, including:²⁶

- home insurance;
- contents insurance;
- motor vehicle insurance;
- travel insurance; and

²³ ANZ, 'ANZ Completes Simplification of Wealth Australia' (Media Release, 12 December 2017).

²⁴ Suncorp, 'Heads of Agreement to Sell Australian Life Insurance Business' (Media Release, 9 August 2018); TAL, 'TAL and Suncorp Finalise Binding Legal Agreement for the Acquisition of Suncorp's Australian Life Insurance Business' (Media Release, 4 September 2018).

²⁵ In the 2017 calendar year, prior to completion of the Suncorp and CBA divestments, TAL and AIA were the largest insurers by premiums paid by reference to life insurance policies in force, receiving approximately 17.4% and 16.7% of those premiums, respectively: Exhibit 6.3, Undated, Chart of Premium Income from Policies in Force. TAL and AIA also had the highest number of new policies during this period: Exhibit 6.5, Undated, Chart of Market Share of New Policies Sold, by Number of Policies.

²⁶ See generally Insurance Contracts Act ss 11(1) (definition of 'contract of life insurance') and 11(6).

- various types of ‘add-on’ insurance, including gap insurance and tyre and rim insurance.

In Australia, general insurance products are ordinarily sold in one of two ways. They may be sold directly to the customer, either online, by telephone, or in a branch. Alternatively, general insurance products may be sold through an intermediary such as a financial institution, car dealer, underwriting agency or insurance broker.

When general insurance is sold directly to a customer, or is sold through an intermediary other than an insurance broker, it will ordinarily be sold without financial advice or with general advice only. When it is sold through an insurance broker, the customer will usually have received personal financial advice.

3.1 Regulatory framework

The life insurance and general insurance industries are subject to several forms of regulation.

Both industries are subject to prudential regulation by the Australian Prudential Regulation Authority (APRA). Among other things, APRA is responsible for granting or refusing applications to carry on a life insurance or general insurance business in Australia.²⁷

In addition, most contracts of insurance are ‘**financial products**’ for the purposes of Chapter 7 of the *Corporations Act 2001* (Cth) (the Corporations Act).²⁸ By making an insurance contract, insurance companies are generally providing a ‘financial service’.²⁹ As a result, life insurance and general insurance businesses are generally required to hold an **Australian financial services licence** (AFSL), and are subject to financial services regulation under the Corporations Act and the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act). ASIC administers and enforces those provisions.

²⁷ Insurance Act s 12.

²⁸ See generally Corporations Act s 764A; Background Paper No 14, 56–7 [3.5]–[3.7]; Background Paper No 29, 16 [5.7]–[5.8].

²⁹ Background Paper No 14, 56 [3.6].

The Insurance Contracts Act governs contracts of insurance and proposed contracts of insurance, the proper law of which is or would be the law of a state or territory.³⁰ ASIC has the general administration of the Act.³¹

Section 13 of the Insurance Contracts Act obliges both parties to an insurance contract 'to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith'.³² Failure to comply with that provision is a breach of the Act.³³ If reliance on a provision of the contract of insurance would be a breach of the duty, the party may not rely on it.³⁴ If an insurer has failed to comply with the duty in the handling or settlement of a claim or potential claim, ASIC may exercise its powers under Subdivision C of Division 4 of Part 7.6 of the Corporations Act, or Subdivision A of Division 8 of that Part, as if the insurer's failure to comply were a failure to comply with a financial services law.³⁵ The first mentioned provisions deal with variation, suspension and cancellation of an AFSL; the second mentioned provisions deal with banning persons from providing financial services.

The Insurance Contracts Act also provides for the insured's duty of disclosure,³⁶ specifies the consequences of misrepresentations by an insured,³⁷ and provides for remedies for non-disclosure and misrepresentations.³⁸

The insurance industry has three industry codes of practice: the General Insurance Code of Practice, the Life Insurance Code of Practice, and the Insurance in Superannuation Voluntary Code of Practice.

³⁰ Insurance Contracts Act s 8.

³¹ Insurance Contracts Act s 11A.

³² Insurance Contracts Act s 13(1).

³³ Insurance Contracts Act s 13(2).

³⁴ Insurance Contracts Act s 14.

³⁵ Insurance Contracts Act s 14A(2).

³⁶ Insurance Contracts Act s 21.

³⁷ Insurance Contracts Act ss 23–27.

³⁸ Insurance Contracts Act ss 27A–33.

The General Insurance Code of Practice came into effect on 1 July 1995 and has since been revised several times.³⁹ It is a voluntary code that binds all subscribing general insurers.⁴⁰ All members of the Insurance Council of Australia (ICA) that offer products covered by the Code are required to subscribe to the Code. Other industry participants may also subscribe. There are currently 174 subscribers to the Code, comprising approximately 97% of the general insurance industry.⁴¹

Nearly all types of general insurance are covered by the General Insurance Code, including home insurance.⁴² The Code imposes obligations on general insurers when selling insurance, handling claims, dealing with third parties, managing catastrophes and handling complaints.⁴³ It also sets out timeframes for insurers to respond to claims and complaints.⁴⁴

The Code is monitored and enforced by a Code Governance Committee, an independent body comprised of a consumer representative, an industry representative and an independent chair.⁴⁵

The Life Insurance Code of Practice is binding on all members of the Financial Services Council (FSC) that issue life insurance policies, and on any other industry participant that adopts it.⁴⁶ The Code became binding on FSC members on 30 June 2017.⁴⁷ There are currently 26

³⁹ Exhibit 6.404, Witness statement of Robert Whelan, 27 August 2018, 11 [73].

⁴⁰ Background Paper No 14, 64 [5.1].

⁴¹ Code Governance Committee, *General Insurance in Australia 2016–17: Industry Practice and Code Compliance*, 6.

⁴² General Insurance Code of Practice ss 3.5–3.6.

⁴³ See generally Background Paper No 14, 65 [5.6].

⁴⁴ See, eg, General Insurance Code of Practice ss 7.16, 10.11–10.12 and 10.17–10.18.

⁴⁵ General Insurance Code of Practice, *Governance and Monitoring* (7 December 2018) General Insurance Code of Practice <<http://codeofpractice.com.au/governance-and-monitoring>>. See also General Insurance Code of Practice s 12.2.

⁴⁶ Life Insurance Code of Practice s 2.1.

⁴⁷ Exhibit 6.409, Witness statement of Sally Loane, 30 August 2018, 14 [9.1]; Background Paper No 29, 15 [5.4].

subscribers to the Code,⁴⁸ representing the majority of APRA-registered life insurers.⁴⁹

The Code imposes obligations on life insurers during the policy design phase,⁵⁰ when selling insurance,⁵¹ and during the claims process.⁵² It also includes provisions for dealing with consumers who require additional support.⁵³

Compliance with the Life Insurance Code of Practice is monitored by the Life Code Compliance Committee.⁵⁴ Subscribers to the Code must report significant breaches of the Code to the Committee, and must implement corrective measures as agreed with the Committee.⁵⁵

The Life Insurance Code of Conduct does not apply to superannuation fund trustees unless they specifically adopt it.⁵⁶ In late 2016, some industry bodies formed an Insurance in Superannuation Working Group to develop an industry code of practice for superannuation trustees.⁵⁷ The Insurance in Superannuation Voluntary Code of Practice came into effect on 1 July 2018.⁵⁸ It is a voluntary code dealing with matters such as benefit design, cessation of cover, claims handling, mechanisms for premium adjustment,

⁴⁸ FSC, *Code of Practice* (5 December 2018) FSC <www.fsc.org.au/policy/life-insurance/code-of-practice>.

⁴⁹ APRA, *Register of Life Insurance Companies* (5 December 2018) APRA <www.apra.gov.au/register-life-insurance-companies>.

⁵⁰ Life Insurance Code of Practice ss 3, 5.

⁵¹ Life Insurance Code of Practice s 4.

⁵² Life Insurance Code of Practice s 8.

⁵³ Life Insurance Code of Practice ss 6, 7.

⁵⁴ Life Insurance Code of Practice s 12.4.

⁵⁵ Life Insurance Code of Practice ss 13.4, 13.7.

⁵⁶ Life Insurance Code of Practice s 2.2.

⁵⁷ FSC, *Insurance in Super Working Group* (5 December 2018) FSC <www.fsc.org.au/policy/life-insurance/insurance-in-superannuation-working-group-iswg/>.

⁵⁸ FSC, *Insurance in Super Working Group* (5 December 2018) FSC <www.fsc.org.au/policy/life-insurance/insurance-in-superannuation-working-group-iswg/>.

communications with members and dispute resolution. Superannuation fund trustees who choose to adopt the Code agree to comply with the Code as early as they can, and by no later than 30 June 2021.⁵⁹

3.2 Limitations in the regulatory framework

In considering the conduct that was examined during the Commission's hearings, it is useful to begin with three important limitations in the regulatory framework.

First, as I have noted above, although most life and general insurance policies are financial products, and the selling of those policies is a financial service, the handling and settling of insurance claims is not.⁶⁰ This means that some of the general obligations imposed by section 912A of the Corporations Act – including, in particular, the obligation on an AFSL holder to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly – do not apply to the handling and settlement of insurance claims.

Second, most forms of life insurance are financial products but, as I explain further below, 'funeral expenses policies' are not.⁶¹

Third, because most insurance policies are financial products, insurance companies are bound by the extensive pre-contractual disclosure provisions of Chapter 7 of the Corporations Act including, for example, the obligations to provide product disclosure statements. But section 15 of the Insurance Contracts Act provides (in effect) that insurance contracts governed by that Act are not subject to the unfair contract terms (UCT) provisions of the ASIC Act.

Instead, as already noted, **the Insurance Contracts Act imposes the duty of utmost good faith by section 13(1). But that duty is enforceable by ASIC against the insurer principally through provisions permitting action in respect of the insurer's licence to operate – a very blunt**

⁵⁹ Insurance in Superannuation Voluntary Code of Practice s 3.6.

⁶⁰ See Corporations Regulations reg 7.1.33.

⁶¹ See Corporations Regulations reg 7.1.07D.

instrument of enforcement. The ASIC Enforcement Review Taskforce recommended that breach of section 13(1) attract a civil penalty.⁶²

The recommended change should be made. I will say more about the ASIC Enforcement Review Taskforce in the chapters concerning the regulators and other important steps.

4 Issues and responses

The issues arising from the case studies examined in the Commission's sixth round of hearings are described in detail in the discussion in Volume 2 of this Report. The issues can be organised as follows:

- issues relating to the manner of selling some insurance products (which were sometimes compounded by issues relating to the low value of particular insurance products);
- issues relating to the avoidance of insurance policies as a result of pre-contractual non-disclosure or misrepresentations;
- issues relating to the use of, and reliance upon, potentially unfair contract terms;
- issues relating to claims handling;
- issues relating to the lack of enforceability of code obligations; and
- issues relating to **external dispute resolution** (EDR).

I deal with each in turn.

Issues also arise in relation to group life insurance. Because of their close association with superannuation issues, I deal with them separately.

⁶² ASIC Taskforce Review, Report, 77–9, 90–1.

4.1 Manner of sale and types of products sold

4.1.1 How to sell: Advice about insurance products

As I said at the start of this chapter, most life insurance policies held outside of superannuation accounts are purchased through financial advisers. In the chapter concerning financial advice, I dealt with the issues that emerged in relation to the provision of financial advice – including advice in connection with insurance products. In particular, I dealt with the provision of poor advice, which I noted is too often the result of the conflicts of interest that pervade the financial advice industry.

Conflicts between an adviser's duty to his or her client and an adviser's interests are a particular issue where financial advice is given in connection with insurance products, because insurance products were excluded from aspects of the **Future of Financial Advice** (FoFA) reforms designed to address those conflicts.

In particular, as I explained in the chapter concerning financial advice, life insurance products (other than group life policies and life policies for members of default superannuation funds) and general insurance products were exempted from the ban on **conflicted remuneration** introduced by the FoFA reforms. Since 1 January 2018, that position in relation to life insurance products has changed. Volume-based benefits given to a licensee or representative in relation to information given on, or dealing in, a life risk insurance product are now subject to the ban on conflicted remuneration,⁶³ unless the benefit is a level commission within the applicable cap⁶⁴ and provides a 'clawback' arrangement if the policy is cancelled, not continued, or the policy cost is reduced in the first two years of the policy.⁶⁵

In 2021, ASIC will review the existing arrangements for commissions in relation to life insurance products. **In the chapter concerning financial**

⁶³ Corporations Regulations reg 7.7A.11B.

⁶⁴ For the calendar year 2018, 80% upfront commission and 20% trail commission, reducing to 70% upfront and 20% trail in 2019 and 60% upfront and 20% trail from 1 January 2020. See ASIC, ASIC Corporations (Life Insurance Commissions) Instrument, 2017/510 (Cth) Pts 2, 3; Corporations Act ss 963B–963BA; Corporations Regulations regs 7.7A.11C(1)(d), 7.7A.11D(1)(b).

⁶⁵ See ASIC, ASIC Corporations (Life Insurance Commissions) Instrument, 2017/510 (Cth) s 6.

advice, I said that, if that review indicates that the cap on commissions has not contributed to what is judged to be a significant degree of underinsurance, then I would urge ASIC to continue reducing the cap – ultimately, to zero. I also said that in three years' time, there should be a review of the measures that have been implemented to improve the quality of advice, and that that review should consider whether the continued exemption of general insurance products and consumer credit insurance (CCI) products from the ban on conflicted remuneration remains justified.

4.1.2 How to sell: Prohibit the unsolicited offer or sale of insurance products

As foreshadowed in the Introduction of this Report, and consistently with the Recommendation in the chapter about superannuation prohibiting the hawking of superannuation products, I would prohibit the unsolicited offer or sale of insurance products, except to those who are not retail clients and except for offers made under an eligible employee share scheme.⁶⁶

As I have explained, share hawking has long been prohibited because it too readily allows the fraudulent or the unscrupulous to prey upon the unsuspecting.⁶⁷ Some of the case studies considered in the fourth and sixth rounds of the Commission's hearings involved the offer or sale of insurance products in circumstances where the offeror was acting in a way that was (at the least) unscrupulous. With that said, as in the superannuation context, I consider that the root of the problem with unsolicited offers and sales of insurance is that the potential acquirer is 'unsuspecting'.

Most, if not all, of the case studies examined by the Commission involving the unsolicited sale of insurance pertained to hawking that occurred in a telephone call.⁶⁸ When the offeror called to offer their insurance product, the potential acquirer had little or no notice that an offer was likely to be made. The potential acquirer was therefore unlikely to have considered

⁶⁶ Corporations Act ss 992A(3A) and (3B).

⁶⁷ United Kingdom, *Report of the Company Law Amendment Committee*, Cmd 2657 (1926), 48 [92].

⁶⁸ This was the case in respect of the Select case study in the fourth round of the Commission's hearings, and the ClearView and Freedom case studies in the sixth round of hearings.

seriously whether they needed the product that was being offered. Further, the potential acquirer was unlikely to be armed with the information that they needed to allow them to assess critically the features of the (usually complex) product that was being offered. Without this information, the potential acquirer did not know what questions they needed to ask to test the truth of what was being said or to request the details necessary to assess the suitability of the product for their circumstances.

This final point was highlighted in the evidence of Mr Gregory Martin, the Chief Actuary and Risk Officer of the ClearView Group.⁶⁹ Asked whether it was ‘possible to sell life insurance in outbound calls in a way that [was] both financially viable and legally compliant’, Mr Martin said:⁷⁰

In retrospect I find it difficult to understand how you can reconcile those things ... it would be possible to make it legally compliant. My difficulty personally with it is I just don’t understand how a customer in a phone call that lasts 20 minutes can come to a view of ... understanding exactly what they’ve bought in a fairly complex sort of area of financial services.

Mr Martin distinguished that situation from the situation in which a consumer had researched the product that they wanted and then ‘rang in’ to buy it.⁷¹

In the course of the sixth round of hearings, the possible prohibition of the direct sale of life insurance was raised for consideration. To my mind, the preferable course is to prohibit generally the hawking of insurance products. To explain why this is so, I should say something about ASIC Report 587: *The Sale of Direct Life Insurance*, which was published in August 2018,⁷² and which was the subject of discussion during the hearings.

In that report, ASIC examined the practices of six insurers and three distributors who sold life insurance directly to consumers.⁷³ In order to examine those practices, ASIC reviewed hundreds of outbound sales calls conducted both before and after the Life Insurance Code of Practice came

⁶⁹ Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 1 [1].

⁷⁰ Transcript, Gregory Martin, 11 September 2018, 5402.

⁷¹ Transcript, Gregory Martin, 11 September 2018, 5402.

⁷² ASIC, Report 587, 30 August 2018.

⁷³ ASIC, Report 587, 30 August 2018, 4 [6].

into effect.⁷⁴ In ASIC's first review of sales calls – relating to calls made between 2010 and 2016 – ASIC found that all of the firms included in its review had engaged in pressure selling.⁷⁵ ASIC also found that sales calls frequently included 'inadequate explanations of future cost and product exclusions, [offers of] promotional gifts, and tactics to reduce informed decision-making'.⁷⁶

In ASIC's second review of sales calls – relating to calls made in July and August 2017, after the introduction of the Life Insurance Code of Practice – ASIC observed that sales conduct had improved.⁷⁷ ASIC nonetheless found that pressure selling techniques were used by some firms,⁷⁸ and that firms did not consistently provide adequate explanations of the likely future cost of the policy or of exclusions for pre-existing medical conditions.⁷⁹

ASIC concluded that the outbound sale of life insurance was 'more commonly associated with poor sales conduct and increase[d] the risk of poor consumer outcomes'.⁸⁰ Among other things, ASIC observed high cancellation rates of policies sold directly to consumers:

- ASIC found that 20% of all policies taken out between 2012 and 2017 were cancelled during the cooling-off period. ASIC considered that this may be taken to 'indicate that customers had immediately realised they had made a bad decision or had been pressured into buying a policy they did not need'.⁸¹
- ASIC also found that 'almost half of all policies held beyond the cooling-off period lapsed within three years'.⁸²

⁷⁴ ASIC, Report 587, 30 August 2018, 5.

⁷⁵ ASIC, Report 587, 30 August 2018, 7 [20].

⁷⁶ ASIC, Report 587, 30 August 2018, 7 [20].

⁷⁷ ASIC, Report 587, 30 August 2018, 7 [21]–[22].

⁷⁸ ASIC, Report 587, 30 August 2018, 8 [24].

⁷⁹ ASIC, Report 587, 30 August 2018, 8 [23].

⁸⁰ ASIC, Report 587, 30 August 2018, 58 [290].

⁸¹ ASIC, Report 587, 30 August 2018, 6 [11(a)].

⁸² ASIC, Report 587, 30 August 2018, 6 [11(c)].

ASIC said that claim outcomes for direct life insurance were poorer than for policies sold through other channels. Of the entities that ASIC reviewed, 27% of reported claims were withdrawn, 15% were declined, and 58% admitted.⁸³

Each of these matters is concerning. But they are not problems that arise because an insurer or a distributor deals directly with a consumer. Rather, they are problems that arise because individuals are offered complex financial products – sometimes very forcefully – when they have not turned their minds to, and do not have adequate information about, what value the product has for them. Hence, the most appropriate course is to prohibit the *unsolicited* sale of such products.

A number of entities broadly favoured this approach, including consumer groups⁸⁴ and at least one industry body.⁸⁵ Both ASIC and the Consumer Action Law Centre (CALC) expressed the view that the current regulatory regime governing the unsolicited sale of financial products is ‘inadequate to avoid consumer detriment’.⁸⁶ ASIC said that:⁸⁷

the anti-hawking prohibition in s[ection] 992A of the Corporations Act does not operate as a general prohibition against outbound and unsolicited sales calls, but only against offering a financial product in an unsolicited call when certain requirements (both before and during the call) are not met. The technical nature of the anti-hawking prohibition means that conduct will be exempt from the prohibition if the offeror complies with the technical requirements stipulated in the Corporations Act. Yet, even where there is compliance with these technical requirements, the risk of mis-selling and inappropriate consumer outcomes remains.

To similar effect, the Consumer Action Law Centre emphasised that the anti-hawking prohibition:⁸⁸

⁸³ ASIC, Report 587, 30 August 2018, 6 [12], [14].

⁸⁴ CALC, Module 6 Policy Submission, 16–17 [48]–[53]; FRLC, Module 6 Policy Submission, 13.

⁸⁵ AFA, Module 6 Policy Submission, 13.

⁸⁶ ASIC, Module 6 Policy Submission, 20 [74]; see also CALC, Module 6 Policy Submission, 17 [51].

⁸⁷ ASIC, Module 6 Policy Submission, 20 [74].

⁸⁸ CALC, Module 6 Policy Submission, 17 [51].

allows unsolicited selling if the seller meets certain requirements. For ClearView, and perhaps other insurers, the watered-down anti-hawking requirement has seen unsolicited selling take place within structures and systems which do not ensure compliance with the law. This type of non-compliance is an inevitable risk of any laws which are relatively complex and contain loopholes which may enable businesses to go further with their practices than the ‘spirit’ of the law dictates. The anti-hawking provision is an example of laws being complicated by industry lobbying. Laws such as these, which have been heavily influenced by industry interests rather than implementation of evidence-based policy solutions, are ineffective at protecting people from harm.

I agree with both sets of observations.

Of the submissions that opposed a prohibition on unsolicited offering or selling, at least two submitted that **financial services entities** should be permitted to offer financial products to existing customers or members in the course of, or because of, an unsolicited meeting.⁸⁹ Consistently with the views that I have expressed in the chapter on superannuation, I do not consider that such an approach should be adopted. It would not prevent the detriments I have identified. I emphasise that I do not intend to place any restriction on the ability of insurers to contact current policyholders in relation to *existing* policies, including in order to notify policyholders that their insurance cover will shortly lapse.⁹⁰ But hawking insurance products should be generally prohibited.

Before leaving this topic, I add one point. To make the proposed prohibition on unsolicited offer and sales effective, and to eliminate some arguments about what is ‘unsolicited’,⁹¹ it is desirable to introduce a statutory definition of that concept. The definition should have a breadth that achieves the purpose of the prohibition. To that end, the definition might usefully be based upon the definition now used by ASIC: that a meeting or telephone call is unsolicited ‘unless it takes place in response to a

⁸⁹ See, eg, NAB, Module 6 Policy Submission, 7–9 [26]–[28]; AIST, Module 6 Policy Submission, 9 [10]. See also ICA, Module 6 Policy Submission, 12–13.

⁹⁰ Cf FSU, Module 6 Policy Submission, 5 [33]–[36].

⁹¹ As not infrequently occurred in the context of the anti-hawking provision: see, eg, Transcript, Gregory Martin, 10 September 2018, 5336–44.

positive, clear and informed request from a consumer'.⁹² And, as I have explained in the chapter on superannuation, it should be made plain that a solicited meeting, call or contact to discuss one type of product may not be used for the unsolicited offering of some other type of product.

Recommendation 4.1 – No hawking of insurance

Consistently with Recommendation 3.4, which prohibits the hawking of superannuation products, hawking of insurance products should be prohibited.

4.1.3 Specific steps in respect of particular products

A number of case studies considered the sale of low value products, including funeral insurance for the very young,⁹³ accidental death and accidental injury insurance, and add-on insurance sold in connection with motor vehicle purchases or credit transactions. Each of these were products that had to be 'sold', often very aggressively, by those who were paid commissions for every sale made. Each of them is a product that yields high profits for the issuer, almost always because the claims ratio is very low.

Many of the problems raised in connection with the sale of low value products will be met by prohibiting the unsolicited sale of financial products. Doing that should remove the pressure now associated with the sale of the products and should allow consumers to think more carefully about purchasing the product.

There are two products where I think that further steps are necessary. I outline those steps below, and then say something about ASIC's proposed design and distribution obligations and product intervention powers.

⁹² ASIC, Regulatory Guide 38, 2005, 9 [A2.1] (emphasis in original).

⁹³ FSRC, *Interim Report*, vol 2, 443–57.

Funeral insurance

The present exclusion of some forms of funeral insurance from the definition of ‘financial product’ should be brought to an end.⁹⁴

As I explained in the *Interim Report*, the Commission took evidence about two types of funeral insurance: funeral life policies and funeral expenses policies.⁹⁵ A consumer buying a funeral life insurance policy nominates a benefit amount (typically between \$5,000 and \$20,000) payable, on the death of the nominated life, to a person nominated by the policyholder.⁹⁶ The recipient may apply the benefit as the recipient thinks fit.⁹⁷ By contrast, a funeral expenses policy will pay funeral costs up to a nominated limit.⁹⁸ Funeral expenses may be less than the nominated limit of cover.⁹⁹ Both types of policy are frequently sold directly to consumers.¹⁰⁰

As I observed in the *Interim Report*, the statistics gathered by ASIC as at 30 June 2014 suggest that funeral insurance policies sold directly to consumers are of little value.¹⁰¹ Those statistics indicate that at that time, there were about 430,000 policies covering about 740,000 insured lives.¹⁰² In the 2014 financial year, more than 12,500 claims were accepted by insurers.¹⁰³ The amount paid out in claims was about one-third of the value of premiums collected over the same period. In the preceding year, the proportion was one-fifth.¹⁰⁴

⁹⁴ Amongst other things, this will allow the prohibition on unsolicited selling to apply to these products.

⁹⁵ FSRC, *Interim Report*, vol 1, 262–3. See also ASIC, Report 454, 29 October 2015, 11 [26(b)].

⁹⁶ FSRC, *Interim Report*, vol 1, 263.

⁹⁷ FSRC, *Interim Report*, vol 1, 263.

⁹⁸ FSRC, *Interim Report*, vol 1, 263; see also ASIC, Report 454, 29 October 2015, 11 [26(b)].

⁹⁹ ASIC, Report 454, 29 October 2015, 11 [26(b)], 27 [84]; Exhibit 4.151, April 2014, ASIC Analysis of the Funeral Insurance Sector in Australia as at 30 June 2013, 13 [50], 14.

¹⁰⁰ ASIC, Report 454, 29 October 2015, 9 [16].

¹⁰¹ FSRC, *Interim Report*, vol 1, 263.

¹⁰² FSRC, *Interim Report*, vol 1, 263; ASIC, Report 454, 29 October 2015, 14 [32].

¹⁰³ FSRC, *Interim Report*, vol 1, 263; ASIC, Report 454, 29 October 2015, 14 [35].

¹⁰⁴ ASIC, Report 454, 29 October 2015, 14 [35].

There was a high rate of policy cancellations.¹⁰⁵ Most insurers identified the cost of premiums as the most common reason for cancellation.¹⁰⁶

To those statistics, I added the observations that many consumers hold policies with stepped premiums increasing with age,¹⁰⁷ and that many funeral insurance products carry ‘the potential for consumers to pay more in premiums over the life of the policy than they will receive as a benefit when they die’.¹⁰⁸

Both the ASIC Report and the evidence given in the Commission’s fourth round of hearings indicated that Aboriginal and Torres Strait Islander people, especially those living regionally or remotely, may have been particularly likely to be sold funeral insurance policies in circumstances where those policies held little value for them.¹⁰⁹

In the *Interim Report*, I explained that both funeral life policies and funeral expenses policies are life policies under the Life Insurance Act and contracts of life insurance under the Insurance Contracts Act.¹¹⁰ However, as mentioned above, funeral expenses policies are carved out from the definition of ‘financial product’ by section 765A(1)(y) of the Corporations Act and regulation 7.1.07D of the Corporations Regulations 2001 (Cth). The effect of this carve out is that providers of funeral expenses policies are not required to hold AFSLs, are not bound by the general obligations contained in section 912A of the Corporations Act and are not presently restrained by the **anti-hawking provision**.

¹⁰⁵ FSRC, *Interim Report*, vol 1, 263; ASIC, Report 454, 29 October 2015, 16 [38]–[39].

¹⁰⁶ ASIC, Report 454, 29 October 2015, 16 [40].

¹⁰⁷ FSRC, *Interim Report*, vol 1, 263; ASIC, Report 454, 29 October 2015, 19 [46].

¹⁰⁸ ASIC, Report 454, 29 October 2015, 20 [47]; see also FSRC, *Interim Report*, vol 1, 263.

¹⁰⁹ ASIC, Report 454, 29 October 2015, 18 [43]; Transcript, Lynda Edwards and Nathan Boyle, 3 July 2018, 3747–52.

¹¹⁰ FSRC, *Interim Report*, vol 1, 264.

The exclusion of funeral expenses policies from the definition of ‘financial product’ cannot be justified. All forms of funeral insurance should be subject to the same regulatory regime and supervision. This is particularly important given the concerns that I hold about the value of these types of products. Many submissions received by the Commission expressed a similar view.¹¹¹ The Corporations Regulations should be amended accordingly.

As I explained in the *Interim Report*, some doubts have been raised about whether the consumer protection provisions of Part 2, Division 2 of the ASIC Act apply to funeral expenses policies, by reason of section 12BAA(8)(o) of that Act (it being accepted that the provisions do apply to funeral life policies). A number of submissions received by the Commission indicate that the ASIC Act provisions should be understood as applying to funeral expenses policies.¹¹² Nonetheless, the submissions express the view that the ASIC Act should be amended to put beyond doubt that the consumer protection provisions do apply to such policies.¹¹³ For the reasons set out above, I agree that the ASIC Act should be amended in this way.

By taking these steps – bringing funeral expenses policies within the definition of ‘financial product’, confirming that they are within the reach of the consumer protection provisions of the ASIC Act, and, more generally, prohibiting the unsolicited sale of these products – I consider that many of the problems raised in ASIC Report 454 and in the fourth round of hearings will be resolved.¹¹⁴

¹¹¹ See ASIC, Module 4 Policy Submission, 14 [32], [33(a)]; ASIC, Interim Report Submission, 30 [139(a)]; APRA, Module 4 Policy Submission, 7 [24]; CALC, Module 4 Policy Submission, 3 [12]; CALC, Interim Report Submission, 44 [192], 45 [4.14]–[4.15]; FCA, Module 4 Policy Submission, 4 [15]; FRLC, Interim Report Submission, 15; Legal Aid NSW, Interim Report Submission, 19–20.

¹¹² FSRC, *Interim Report*, vol 1, 264. Cf ASIC, Module 4 Policy Submission, 19 [43]; CALC, Module 4 Policy Submission, 5 [16]; Legal Aid NSW, Interim Report Submission, 20.

¹¹³ See also ASIC, Module 4 Policy Submission, 19 [43]; CALC, Module 4 Policy Submission, 5 [16]; CALC, Interim Report Submission, 44 [193]; FCA, Module 4 Policy Submission, 5 [16]; Legal Aid NSW, Interim Report Submission, 20.

¹¹⁴ See, eg, Transcript, Nathan Boyle, 3 July 2018, 3750.

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’; and
- put beyond doubt that the consumer protection provisions of the ASIC Act apply to funeral expenses policies.

Add-on insurance

I consider that two further steps should be taken in respect of the sale of add-on insurance. First, I consider that add-on insurance should generally be sold under a deferred sales model, with the exception of policies of comprehensive motor insurance. Under a deferred sales model, insurers or their representatives would be required to wait for a specified period of time before attempting to sell add-on insurance products to their customers. Second, I consider that caps on commissions should be introduced for add-on insurance sold in connection with the sale of a motor vehicle.

Turning first to the need for a deferred sales model, in the chapter on banking, I explained that I considered that the sale of add-on insurance, including add-on insurance offered in connection with the sale of motor vehicles, should move to a deferred sales model. As I said above, I exclude from this proposal policies of comprehensive motor insurance.

This proposal is consistent with ASIC’s proposal in its Consultation Paper 294: *The Sale of Add-on Insurance and Warranties Through Caryard Intermediaries*.¹¹⁵ That proposal built on a substantial amount of earlier work done by ASIC,¹¹⁶ and was motivated by concerns that:¹¹⁷

¹¹⁵ ASIC, Consultation Paper 294, 24 August 2017, 6 [6(a)].

¹¹⁶ ASIC, Consultation Paper 294, 24 August 2017, 8 [13]–[16].

¹¹⁷ ASIC, Consultation Paper 294, 24 August 2017, 11–12 [30].

- add-on insurance products represent poor value for consumers;
- insurers pay more in commissions than in claims;
- consumer outcomes are considerably worse than in markets where there is meaningful competition; and
- consumers are at risk of unfair sales and adverse outcomes.

The justification for a deferred sales model in this context was neatly explained by ASIC:¹¹⁸

In the current sales environment, combining the sale of the car, finance and add-on products into one process restricts the capacity of consumers to consider these matters and make rational, informed purchasing decisions. The deferred sales model aims to address this by inserting a pause into the sales process.

We consider that a well-designed model would give consumers additional time to navigate the complexities of add-on products and facilitate improved decision making.

In its submissions in response to the policy questions arising from the sixth round of hearings, ASIC made substantially similar points.¹¹⁹ ASIC said that it intended to conduct further consultation before finalising the details of its proposed model, and that it ultimately planned to implement that model ‘primarily by using its existing statutory powers to modify provisions of the Corporations Act’.¹²⁰

Other submissions received by the Commission also supported the move towards a deferred sales model for add-on insurance sold in connection with motor vehicles.¹²¹

¹¹⁸ ASIC, Consultation Paper 294, 24 August 2017, 48 [181]–[182].

¹¹⁹ ASIC, Module 6 Policy Submission, 23–4 [87]–[93].

¹²⁰ ASIC, Module 6 Policy Submission, 24 [89]–[90].

¹²¹ As to the industry peak bodies, see FSC, Module 6 Policy Submission, 17 and ICA, Module 6 Policy Submission, 15–16 and Attachment 1. As to the consumer groups, see CALC, Module 6 Policy Submission, 20–1 [64]–[68]; Consumer Credit Insurance Legal Service (WA), Module 6 Policy Submission, 9–10 [4.13]–[4.17]; FRLC, Module 6 Policy Submission, 16–17; Legal Aid NSW, Module 6 Policy Submission, 3–4.

The move towards a deferred sales model for add-on insurance is not confined to the motor vehicle context. The 2019 Code of Banking Practice will introduce a deferred sales model in respect of CCI for credit cards and personal loans sold in branches or over the phone.¹²² The purpose of this reform is said to be to reduce ‘the risk that a consumer will feel pressured to purchase the CCI product, or purchases a CCI product that does not meet their needs’.¹²³

As will be apparent from what I have said, these changes will not cover the field. In particular, they will not deal with add-on insurance products sold in branches or over the phone in connection with home loans,¹²⁴ or with add-on insurance products that are purchased online.¹²⁵

This raises difficulties of the kind the Productivity Commission recently acknowledged in its report into competition in the Australian financial system:¹²⁶

At present, the regulatory paradigm [for add-on insurance] appears to involve ASIC in a game of whack-a-mole with insurers and their retailing partners. Legislators cannot expect the regulator to be effective in this game.

The observations made by the Productivity Commission in that report indicate that the problems evident in the motor vehicle add-on and CCI add-on contexts extend across the add-on insurance market.¹²⁷

To deal with these issues at a systemic level, the Productivity Commission proposed introducing a deferred sales model for all add-on insurance products, ‘with a consultation period to deal with solid cases for exceptions’.¹²⁸ Several submissions to this Commission supported

¹²² 2019 Code cls 67–68.

¹²³ ASIC, Media Release 17-255MR, 1 August 2017.

¹²⁴ See generally Productivity Commission, Report No 89, 29 June 2018, 429.

¹²⁵ As to which, see ASIC, Media Release 17-255MR, 1 August 2017.

¹²⁶ Productivity Commission, Report No 89, 29 June 2018, 430.

¹²⁷ Productivity Commission, Report No 89, 29 June 2018, 415.

¹²⁸ Productivity Commission, Report No 89, 29 June 2018, 430.

that approach.¹²⁹ The Productivity Commission has recommended establishing ‘a Treasury-led working group to take this objective forward’.¹³⁰ I agree that a Treasury-led working group should develop an industry-wide deferred sales model, and that it should be implemented as soon as reasonably practicable.

Second, evidence given in the Commission’s sixth round of hearings showed that the levels of commissions paid to motor vehicle dealers in connection with the sale of add-on insurance products contributed to the mis-selling of those products.¹³¹ In its September 2016 report on the sale of add-on insurance through dealers, ASIC noted that, in the 2015 financial year, the commissions paid to dealers for the sale of add-on insurance products were as high as 79% of the premium.¹³² ASIC also observed that the amounts paid in *commissions* on these products exceeded the amounts paid out to customers who made claims.¹³³

One reason why commissions paid to dealers were so high was that insurance companies competed with each other to gain market share of distribution networks. Mr Benjamin Bessell, who gave evidence about the sale of add-on insurance policies by Swann Insurance through dealers, said that Swann viewed the *dealers* as its customers, rather than the consumer who purchased the insurance policy.¹³⁴

In 2017, in recognition of the problems created by the high commissions paid to dealers, the ICA prepared a submission to the Australian Competition and Consumer Commission (the ACCC) proposing that insurers cap commissions at 20% of the premium.¹³⁵ The ACCC refused to authorise

¹²⁹ See ASIC, Module 6 Policy Submission, 23 [87], 24 [91]; FSC, Module 6 Policy Submission, 17–18; CALC, Module 6 Policy Submission, 20 [64]; FRLC, Module 6 Policy Submission, 17; Professors Allan Fels AO and David Cousins AM, Module 6 Policy Submission, 8. Cf ICA, Module 6 Policy Submission, 17.

¹³⁰ Productivity Commission, Report No 89, 29 June 2018, 431.

¹³¹ See, in particular, Transcript, Robert Whelan, 21 September 2018, 6408.

¹³² ASIC, Report 492, 12 September 2016, 16 [55].

¹³³ ASIC, Report 492, 12 September 2016, 17–18 [61]–[62].

¹³⁴ Transcript, Benjamin Bessell, 18 September 2018, 6098.

¹³⁵ Transcript, Robert Whelan, 21 September 2018, 6399, 6401, 6407.

that proposal.¹³⁶ Since then, some insurance companies have taken steps to reduce the level of commissions paid to dealers.¹³⁷ But, because general insurance products and CCI products are exempt from the ban on conflicted remuneration, there is no requirement for any of those companies to limit the amount of commissions paid.

Mr Robert Whelan, the Executive Director and CEO of the ICA, accepted that commissions and volume-based bonuses paid to dealers are a significant cause of the problems that ASIC identified in its reports about the sale of add-on insurance through motor vehicle dealers. He also accepted that given many dealers were dependent on revenue from commissions, commissions and volume-based payments were particularly likely to create incentives to engage in poor sales practices.¹³⁸

In circumstances where the peak industry body recognises that commissions can create these issues, and where the industry has indicated willingness in the past to limit the level of commissions paid to dealers, I recommend that a cap be imposed on the amount of commissions paid to motor vehicle dealers in relation to the sale of add-on insurance products. Like the existing arrangements for commissions paid in relation to life insurance products, I recommend that the level of the cap should be determined from time to time by an ASIC legislative instrument.

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.

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.

¹³⁶ Transcript, Robert Whelan, 21 September 2018, 6407.

¹³⁷ Transcript, Robert Whelan, 21 September 2018, 6408.

¹³⁸ Transcript, Robert Whelan, 21 September 2018, 6408.

Product intervention, disclosure and design

Before leaving the topic of low value insurance products, it is important to say something about ASIC's proposed design and distribution powers and product intervention powers.

As I explained in the chapter on financial advice, if the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 (Cth) is passed, it will give ASIC powers that may go some way to altering the kinds of, and the characteristics of, products that may be sold, including low value products.

As Treasury explained, the design and distribution obligations:¹³⁹

will require product issuers (such as insurers) to develop a 'target market determination' that will specify the target market for each of their products. This target market must be such that the product will likely be consistent with the likely objectives, financial situation and needs of customers within that target market.

The effect of these obligations is that if an issuer designs a product that does not meet the likely objectives, financial situation and needs of any customers – or only does so for such a narrow target market, so as to be commercially unviable – the issuer is effectively precluded from offering that product.

These obligations will also require issuers 'who distribute their own products and third-party distributors to take reasonable steps, such that the way they market, advise on or sell products is consistent with the target market determination for that product'.¹⁴⁰

The proposed product intervention power is, therefore, a complementary power 'to make a range of intervention orders to prohibit specified conduct in relation to financial or credit products, [and] to proactively reduce the risk of significant consumer detriment'.¹⁴¹

¹³⁹ Treasury, Module 6 Policy Submission, 2 [11]–[12].

¹⁴⁰ Treasury, Module 6 Policy Submission, 3 [16].

¹⁴¹ Treasury, Module 6 Policy Submission, 4 [20].

I say that the introduction of these powers may go ‘some way’ to altering the kinds and characteristics of the products that may be sold because there are some restrictions on the breadth of the proposed powers. **The design and distribution powers do not now extend to credit products. More significantly for present purposes, those powers do not extend to financial products that are not regulated by the Corporations Act, but are regulated by Division 2 of Part 2 of the ASIC Act.¹⁴² The product intervention powers have a broader reach, but nonetheless do not extend to all ASIC Act products.¹⁴³ It is not apparent why the powers should not extend, as ASIC has requested, to all financial products and credit products within ASIC’s regulatory responsibility.¹⁴⁴**

In its present form, the proposed statutory regime imposes some restrictions on ASIC’s exercise of its product intervention powers. One restriction is that ASIC must be satisfied that a financial product ‘has resulted in, or will or is likely to result in, significant detriment to retail clients’.¹⁴⁵ ‘Significant detriment’ is said to include ‘the nature and extent of the detriment’, ‘the actual or potential financial loss to retail clients resulting from the product’ and ‘the impact that the detriment has had, or will or is likely to have, on retail clients’.¹⁴⁶ Another restriction is that the product intervention order is, generally speaking, limited to a period of 18 months,¹⁴⁷ although that period can be extended.¹⁴⁸ A third is that ASIC is required to consult prior to making a product intervention order.¹⁴⁹

¹⁴² ASIC, Submission to Government, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018, August 2018, 14 [52], 19 [64].

¹⁴³ ASIC, Submission to Government, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018, August 2018, 28 [90].

¹⁴⁴ ASIC, Submission to Government, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018, August 2018, 21 [69], 28 [89]–[90].

¹⁴⁵ Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill cl 1023D(1)(b).

¹⁴⁶ Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill cl 1023E(1).

¹⁴⁷ Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill cl 1023G(2)(a).

¹⁴⁸ Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill cl 1023H.

¹⁴⁹ Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill cl 1023F.

I do not mention these restrictions for the purpose of calling into doubt the value of the proposed design and distribution powers and product intervention powers, or the relevance and importance of the limitations imposed. Rather, I mention them to make the point that the powers go some way to altering the kinds and characteristics of products that may be sold, but may not solve all of the problems and issues that can arise in connection with the sale of low value products.

ASIC has said that it intends to use its product intervention powers to intervene in the sale of accidental death insurance if it remains concerned about consumer outcomes.¹⁵⁰ ASIC should also consider whether it should intervene in the sale of accidental injury insurance or funeral insurance if it continues to hold concerns about consumer outcomes.¹⁵¹

4.2 Pre-contractual non-disclosure and misrepresentations

Part IV of the Insurance Contracts Act governs disclosures and misrepresentations by an insured. The TAL case study raised serious questions about whether the provisions contained in that Part strike an appropriate balance between the interests of insurers and insureds.

I consider that two amendments are necessary.

- First, I consider that Part IV of the Act should be amended in respect of consumer insurance contracts. For those types of contract, I consider that the duty of disclosure should be replaced with a duty to take reasonable care not to make a misrepresentation to an insurer. Any necessary consequential amendments should be made to the remedial provisions contained in Division 3.

¹⁵⁰ ASIC, Report 587, 30 August 2018, 17 [79]. See also the analysis of the witness statements provided to the Commission relating to accidental death policies at Transcript, Senior Counsel Assisting, 12 September 2018, 5527–33.

¹⁵¹ See generally ASIC, Report 454, 29 October 2015, 18 [43].

- Second, I consider that section 29(3) of the Insurance Contracts Act 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.

I set out my views on each of these matters in turn.

4.2.1 The duty of disclosure

The TAL case study demonstrated the difficulties of placing a duty on consumers seeking insurance to disclose to their potential insurer, before the contract of insurance is entered into, information about the matters specified by section 21 of the Insurance Contracts Act.

Section 21 provides that:¹⁵²

an insured has a duty to disclose to the insurer, before the relevant contract of insurance is entered into, every matter that is known to the insured, being a matter that:

- (a) the insured knows to be a matter relevant to the decision of the insurer whether to accept the risk and, if so, on what terms; or
- (b) a reasonable person in the circumstances could be expected to know to be a matter so relevant ...

The effect of section 21 has been modified by sections 21A and 21B of the Insurance Contracts Act in respect of ‘eligible contracts of insurance’.

If a contract is an ‘eligible contract of insurance’,¹⁵³ then the insured’s duty of disclosure will be governed by section 21A (in relation to disclosures made before a contract is entered into) or by section 21B (in relation to disclosures made before a contract is renewed). These provisions are complex, but in simple terms, they operate so that prior to the entry into, or renewal of,

¹⁵² Insurance Contracts Act s 21(1).

¹⁵³ ‘Eligible contracts of insurance’ are prescribed by regulation to include contracts for motor vehicle insurance, home buildings insurance, home contents insurance, sickness and accident insurance, CCI and travel insurance, if certain conditions are met: Insurance Contracts Regulations reg 6(2). Other types of contracts of insurance may also qualify in particular circumstances, under reg 6(3).

a contract, an insurer may request that an insured answer one or more specific questions that are relevant to the insurer's decision about whether to accept the risk (and if so, on what terms).¹⁵⁴

If, following such a request, the insured discloses each matter that is known to them and that a reasonable person could be expected to have disclosed in the circumstances, then the insured will be taken to have complied with their duty of disclosure.¹⁵⁵ If the insurer does not make any request at all, the insurer is taken to have waived compliance with the duty of disclosure.¹⁵⁶

Sections 21A and 21B do not in terms apply to all consumer contracts for insurance. The classes of contract specified to be 'eligible contract[s] of insurance' under regulation 6(2) of the Insurance Contracts Regulations 2017 (Cth) are wholly or predominantly classes of general insurance contracts. The practices of individual life insurers *may*, but will not necessarily, lead them to fall within the further definition of 'eligible contract of insurance' contained in regulation 6(3) of the Insurance Contracts Regulations. It is not apparent to me why life and general insurance contracts have been treated differently.¹⁵⁷

If a consumer contract of insurance is not governed by sections 21A or 21B of the Insurance Contracts Act, then it will fall to be governed by the duty of disclosure contained in section 21 of the Act.

In my view, the duty of disclosure presently contained in section 21 of the Act does not recognise the breadth and depth of the gap between what a consumer knows and what an insurer knows. That is, the duty fails to recognise the extent of the information asymmetry between a consumer and an insurer. And that gap is not closed by referring to what 'a reasonable person in the circumstances could be expected to know to be a matter so relevant'.¹⁵⁸ It is not closed because the question will always arise *after* the insurer has said that certain information *was* relevant and has said *why* it is

¹⁵⁴ Insurance Contracts Act ss 21A(2), 21B(3).

¹⁵⁵ Insurance Contracts Act ss 21A(5), 21B(7).

¹⁵⁶ Insurance Contracts Act ss 21A(3), 21B(4).

¹⁵⁷ See Explanatory Memorandum, Insurance Laws Amendment Bill 1997 (Cth), 31 [117], which explains the rationale for introducing s 21A in a way that appears equally applicable to general and life insurance contracts.

¹⁵⁸ Insurance Contracts Act s 21(1)(b).

relevant. The question will be asked and answered after the event (ex post) rather than before the event (ex ante). Or, putting the same points another way, a duty framed in this way fails to recognise that insurers are always better placed than an insured to identify the categories of information that they consider to be relevant to their decision of whether to insure a risk.¹⁵⁹

These issues were considered by the UK Law Commission and the Scottish Law Commission in their 2009 report entitled *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation*.¹⁶⁰ The report recognised that framing the duty in the way now reflected in section 21 of the Insurance Contracts Act has its roots in common law developments in the course of the eighteenth and nineteenth centuries that were later codified by the UK Parliament in 1906.¹⁶¹ But times (and the parties to insurance contracts) have since changed markedly. Insurance is no longer the province of a mercantile class. It is a universal product.

A summary accompanying the joint report of the two British Law Commissions explained that:¹⁶²

The current law requires a consumer to volunteer information about anything which a ‘prudent insurer’ would consider relevant. This no longer corresponds to the realities of a modern mass consumer insurance market. Most consumers are unaware that they are under a duty to volunteer information. Even if they are aware of it, they usually have little idea of what an insurer might think relevant.

¹⁵⁹ See similar observations in CALC, Module 6 Policy Submission, 33–4 [127]–[131] and FRLC, Module 6 Policy Submission 31–2; see also Professors Allan Fels AO and David Cousins AM, Module 6 Policy Submissions, 10–11.

¹⁶⁰ The Law Commission and The Scottish Law Commission, *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation* (2009), 14 [2.20]. It should be noted that there had been previous calls for reform in this area: The Law Commission and The Scottish Law Commission, *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation – Joint Report – Summary* (2009), 2 [1.8].

¹⁶¹ The Law Commission and The Scottish Law Commission, *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation – Joint Report – Summary* (2009), 2 [1.6].

¹⁶² The Law Commission and The Scottish Law Commission, *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation – Joint Report – Summary* (2009), 1 [1.2]–[1.3].

It is clearly important that insurers receive the information they need to assess risks. Most insurers, however, now accept that they should ask questions about the things they want to know ...

The joint report observed that one practical manifestation of these issues was that:¹⁶³

policyholders may be denied claims even when they act honestly and reasonably. Our survey of ombudsman cases shows that some insurers continue to use extremely general questions, where it is not clear what information the insurer is seeking. It is easy for consumers to misunderstand such questions, and therefore give inaccurate answers, even if they are doing their best to answer truthfully.

These observations apply as much in Australia as they do in the United Kingdom.

The UK Law Commission and the Scottish Law Commission recommended that legislation be passed to replace the duty of pre-contractual disclosure with a duty to take reasonable care not to make a misrepresentation to an insurer.¹⁶⁴ In 2012, the UK Parliament enacted the *Consumer Insurance (Disclosure and Representations) Act 2012* (UK), which introduced a duty in the terms recommended by the Law Commissions.¹⁶⁵ The Act applies to all consumer insurance contracts.¹⁶⁶

The Commission received a range of submissions on the topic of whether the duty of disclosure should be replaced with a duty to take reasonable care not to make a misrepresentation.

¹⁶³ The Law Commission and The Scottish Law Commission, *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation* (2009), 14 [2.20].

¹⁶⁴ The Law Commission and The Scottish Law Commission, *Consumer Insurance Law: Pre-Contract Disclosure and Misrepresentation – Joint Report – Summary* (2009), 1 [1.1].

¹⁶⁵ *Consumer Insurance (Disclosure and Representations) Act 2012* (Cth) s 2(1), (2), (4).

¹⁶⁶ In general terms, contracts of insurance between an insurer and ‘an individual who enters into the contract wholly or mainly for purposes unrelated to the individual’s trade, business or profession’: see *Consumer Insurance (Disclosure and Representations) Act* s 1 (definition of ‘consumer insurance contract’).

Several entities – including ASIC and a number of consumer bodies – considered that moving to a duty to take reasonable care not to make a misrepresentation would bring benefits.¹⁶⁷ Other entities – principally APRA, insurance industry bodies and insurers – did not consider that this sort of modification would be beneficial.¹⁶⁸ As I understood APRA's position, it was that to change the rules would affect the pricing of risk. It may. Even so, I favour making the change. It is of the essence of insurance that risk is spread between the holders of insurance. If the consequence of this change is that pricing may rise, the benefits of having more persons with *effective* insurance outweigh the detriments of increased pricing.

For the reasons given by the UK Law Commission and the Scottish Law Commission, I recommend that the Insurance Contracts Act 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. I consider that this style of duty is more appropriate for consumer insurance contracts than the duty that currently exists in section 21 of the Insurance Contracts Act. It is also substantially less complex than the modified forms of duty contained in sections 21A and 21B of the Insurance Contracts Act. A duty to take reasonable care not to make a misrepresentation to an insurer places the burden on an insurer to elicit the information that it needs in order to assess whether it will insure a risk and at what price. The duty does not require an individual to surmise, or guess, what information might be important to an insurer.

In saying this, I do not propose to affect the operation of section 21 in respect of other classes of contracts. My recommendation will likely result, however, in sections 21A and 21B of the Insurance Contracts Act having little or no work to do, and it may be thought desirable for those sections to be repealed.

¹⁶⁷ Westpac, Module 6 Policy Submission, 36–8 [118]–[125]; PIAC, Module 6 Policy Submission, 12; FRLC, Module 6 Policy Submission, 31–2; ASIC, Module 6 Policy Submission, 39–40 [163]–[165]; CALC, Module 6 Policy Submission, 33–5 [127]–[132]; Professors Allan Fels AO and David Cousins AM, Module 6 Policy Submission, 10–11.

¹⁶⁸ AAI Limited, Module 6 Policy Submission, 10 [46]–[47]; ANZ, Module 6 Policy Submission, 19–20 [87]–[88]; AMP, Module 6 Policy Submission, 20–1 [98]–[100]; ICA, Module 6 Policy Submission, 25–6; APRA, Module 6 Policy Submission, 3 [11]–[12]; AFA, Module 6 Policy Submission, 19–20.

Breach of the duty of an insured not to misrepresent will engage the provisions of Division 3 of Part IV of the Act (sections 27A–33). Some consequential amendments to those provisions will be needed to recognise that there will no longer be a duty, in some cases, to make disclosures, only a duty not to misrepresent. The particular form of those amendments need not be examined here.

4.2.2 Section 29(3) of the Insurance Contracts Act

As I have said, I consider that section 29(3) of the Insurance Contracts Act should be amended.

Before 2014, section 29(3) provided that:

If the insurer would not have been prepared to enter into a contract of life insurance with the insured on any terms if the duty of disclosure had been complied with or the misrepresentation had not been made, the insurer may, within 3 years after the contract was entered into, avoid the contract.

The effect of this framing was that an insurer could avoid a contract of life insurance for non-disclosure or as a result of a misrepresentation only if the insurer would not have entered into a contract with the insured on *any* terms.

Following the passage of the *Insurance Contracts Amendment Act 2013* (Cth),¹⁶⁹ the subsection was amended to take its current form. Subsection 29(3) now reads:

If the failure was not fraudulent or the misrepresentation was not made fraudulently, the insurer may, within 3 years after the contract was entered into, avoid the contract.

Given that a number of changes to section 29 were effected by the amending Act, the shift in the standard for avoidance may not be immediately apparent. However, the submissions to the Commission showed that the amendment has been understood, at least by some, as expanding the circumstances in which an insurer could avoid a contract of life insurance, so that a life insurer can now avoid a contract of life insurance

¹⁶⁹ See Sched 5, Pt 2 of the *Insurance Contracts Amendment Act 2013* (Cth).

if it can show that it would not have entered into *the same* contract of life insurance.¹⁷⁰ As explained in Westpac's submissions to the Commission:¹⁷¹

In effect, the removal of the words 'on any terms' meant that an insurer is no longer required to demonstrate that it would not have entered into a policy on alternative terms had the non-disclosure or misrepresentation not occurred.

When understood in this way, I consider that the amendment results in an 'avoidance' regime that is unfairly weighted in favour of insurers. A number of entities recognised that the effect of the 2013 amendments was to tilt the balance in favour of insurers.¹⁷²

I recommend that the position that existed prior to the amendment of section 29(3) be restored, 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. A change of this nature was supported by a number of consumer organisations¹⁷³ and by the FSC.¹⁷⁴

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

Part IV of the Insurance Contracts Act 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).

¹⁷⁰ See generally PIAC, Module 6 Policy Submission, 11; Westpac, Module 6 Policy Submission, 35–6 [114]–[116].

¹⁷¹ Westpac, Module 6 Policy Submission, 35–6 [116].

¹⁷² PIAC, Module 6 Policy Submission, 11–12; Slater + Gordon Lawyers, Module 6 Policy Submission, 13 [49]–[50]; Westpac, Module 6 Policy Submission, 35–6 [114]–[116]; CALC, Module 6 Policy Submission, 33 [125]–[126]; FRLC, Module 6 Policy Submission, 31. See more generally ASIC, Module 6 Policy Submission, 38–9 [160]–[162].

¹⁷³ See PIAC, Module 6 Policy Submission, 11–12; CALC, Module 6 Policy Submission, 33 [125]–[126]; FRLC, Module 6 Policy Submission, 31.

¹⁷⁴ The FSC proposed this as part of a broader package of reforms to s 29: see FSC, Module 6 Policy Submission, 26–7.

Recommendation 4.6 – Avoidance of life insurance contracts

Section 29(3) of the Insurance Contracts Act 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.

4.3 Unfair contract terms

In 2010, unfair contract terms (UCT) laws were introduced which apply to all sectors of the economy and to all businesses operating in those sectors who use standard form contracts in their dealings with consumers.¹⁷⁵ Since 2016, they have applied to standard form contracts made between businesses and small businesses.¹⁷⁶ The UCT regime contained in the ASIC Act applies to contracts for financial products and financial services.¹⁷⁷ UCT provisions do not apply to insurance contracts regulated by the Insurance Contracts Act. They should.

Speaking generally, the UCT regime renders void a term in a consumer or small business contract that is ‘unfair’, in the sense that it causes a significant imbalance in the contracting parties’ rights and obligations, it is not reasonably necessary to protect the legitimate interests of the party that receives the benefit of the term, and it would cause detriment to a party if it were relied upon.¹⁷⁸ The regime does not apply to certain types of contractual terms, including terms that define the ‘main subject matter’ of the contract, terms that set the upfront price payable under the contract, and terms that are required or permitted by law.¹⁷⁹

¹⁷⁵ Treasury, UCT Proposals Paper, June 2018, 1.

¹⁷⁶ Treasury, UCT Proposals Paper, June 2018, 1.

¹⁷⁷ ASIC Act s 12BF(1).

¹⁷⁸ ASIC Act s 12BG; Treasury, UCT Proposals Paper, June 2018, 3.

¹⁷⁹ ASIC Act s 12BI(1); Treasury, UCT Proposals Paper, June 2018, 3.

Despite the UCT provisions in the ASIC Act being expressed to apply to contracts for financial products and financial services, it does not now apply to contracts regulated by the Insurance Contracts Act.¹⁸⁰ As I have said, section 15 of the Insurance Contracts Act provides that a contract of insurance is not capable of being made the subject of relief under ‘any other Act’ on the ground that it is harsh, unconscionable, unjust, unfair or inequitable. Insurance contracts were excluded from the operation of the UCT regime on the basis that the Insurance Contracts Act included ‘its own protections for standard insurance contracts’, and because ‘insurance contracts may have special characteristics due to the nature of the risk involved which make them unsuitable for UCT protections’.¹⁸¹

In late 2017, the Government announced that it would extend the UCT regime to cover insurance contracts, and in June 2018, Treasury published a Proposals Paper outlining its proposed model.¹⁸²

Treasury’s paper summarises the extensive consideration that has been given in recent years – in Australia and overseas – to the question of whether UCT regimes should apply to insurance contracts.¹⁸³ I need not repeat here the details of those inquiries or the experiences in comparable overseas jurisdictions. The important point is that this body of work consistently tends in favour of the application of such a regime to insurance contracts. In my view, this is unsurprising. The considerations that render a UCT regime appropriate for other contracts for financial products and services apply equally to insurance contracts. None of the matters raised against the extension of the regime suggests to me that contracts regulated by the Insurance Contracts Act should stand apart from UCT provisions. It appears that the submissions received by Treasury in response to its

¹⁸⁰ Treasury, UCT Proposals Paper, June 2018, 1, 4.

¹⁸¹ Treasury, UCT Proposals Paper, June 2018, 4.

¹⁸² Treasury, UCT Proposals Paper, June 2018, 1.

¹⁸³ Treasury, UCT Proposals Paper, June 2018, 7–10.

paper tend in a similar direction,¹⁸⁴ as did the submissions received by the Commission.¹⁸⁵

The model proposed by Treasury would apply (with some modification) the existing UCT provisions of the ASIC Act to contracts regulated by the Insurance Contracts Act.¹⁸⁶ The proposal has two key elements.¹⁸⁷ The first is the amendment of section 15 of the Insurance Contracts Act. Treasury proposes that section 15 be amended to permit the ASIC Act UCT regime to apply to insurance contracts regulated by the Insurance Contracts Act.¹⁸⁸

The second key element is tailoring the UCT provisions in the ASIC Act to contracts of insurance, to accommodate some specific features of those contracts.¹⁸⁹ Treasury has proposed that this tailoring should include the following:¹⁹⁰

- defining the ‘main subject matter’ of an insurance contract narrowly, to encompass terms that describe what is being insured (for example, a house, a person or a car);
- clarifying that the ‘upfront price’ of the contract includes the premium and the excess payable, and that these matters will not be subject to review;

¹⁸⁴ Treasury, Module 6 Policy Submission, 7 [33].

¹⁸⁵ See, eg, Professors Allan Fels AO and David Cousins AM, Module 6 Policy Submission, 3, 9–10; AMP, Module 6 Policy Submission, 19 [92]–[93]; ANZ, Module 6 Policy Submission, 17–18 [76]–[79]; APRA, Module 6 Policy Submission, 6–7 [20]–[21]; ASIC, Module 6 Policy Submission, 36–7 [152]–[156]; CHOICE, Module 6 Policy Submission, 12; CALC, Module 6 Policy Submission, 31–2 [117]–[120]; FRLC, Module 6 Policy Submission, 29–30; FSC, Module 6 Policy Submission, 24–5; ICA, Module 6 Policy Submission, 21–4; Legal Aid NSW, Module 6 Policy Submission, 9–10; PIAC, Module 6 Policy Submission, 10; Westpac, Module 6 Policy Submission, 32–4 [106]–[108]. See also ACCC, Northern Australia Insurance Inquiry: First Interim Report, November 2018, x (Recommendation 6), 151.

¹⁸⁶ Treasury, UCT Proposals Paper, June 2018, 2.

¹⁸⁷ Treasury, UCT Proposals Paper, June 2018, 1.

¹⁸⁸ Treasury, UCT Proposals Paper, June 2018, 1–2.

¹⁸⁹ Treasury, UCT Proposals Paper, June 2018, 2.

¹⁹⁰ Treasury, UCT Proposals Paper, June 2018, 2.

- making clear that when assessing whether a term is unfair, ‘a term will be reasonably necessary to protect the legitimate interests of an insurer if it reasonably reflects the underwriting risk accepted by the insurer in relation to the contract and it does not disproportionately or unreasonably disadvantage the insured’; and
- expanding the range of remedial options that flow from a term being found to be unfair (so that the court may make orders other than the term being void).

Treasury’s submissions in response to the Commission’s policy questions following the sixth round of hearings indicate that Treasury is continuing to consider the key features of the model.¹⁹¹ Treasury identified four ‘key issues regarding policy design’ on which I consider it appropriate to express my views.¹⁹²

The first is whether the UCT regime should be located in the ASIC Act or the Insurance Contracts Act. I support Treasury’s suggestion in its Proposals Paper that the regime should be located in the ASIC Act.¹⁹³ As Treasury notes, there is evident benefit in having all provisions governing UCT in respect of financial products and services ‘located in a single piece of legislation’.¹⁹⁴

The second issue is the way in which the ‘main subject matter’ of a contract is framed.¹⁹⁵ The ASIC Act does not presently include a definition of the ‘main subject matter’ of a contract.¹⁹⁶ Most submissions to Treasury supported introducing a statutory definition, although views differed on what definition was appropriate.¹⁹⁷ Consumer groups appeared to favour the narrow definition proposed by Treasury, which, as noted above, would

¹⁹¹ Treasury, Module 6 Policy Submission, 7 [34]–[35].

¹⁹² Treasury, Module 6 Policy Submission, 7 [34]. See also Treasury, UCT Proposals Paper, June 2018, 12.

¹⁹³ Treasury, UCT Proposals Paper, June 2018, 11–12.

¹⁹⁴ Treasury, Module 6 Policy Submission, 7 [34].

¹⁹⁵ Treasury, Module 6 Policy Submission, 7 [34].

¹⁹⁶ Treasury, UCT Proposals Paper, June 2018, 14.

¹⁹⁷ Treasury, Module 6 Policy Submission, 7 [34].

include only terms that describe what is being insured.¹⁹⁸ Industry groups favoured a broader definition, which would include within the ‘main subject matter of the contract’ terms that ‘clearly define or circumscribe the insured risk and the insurer’s liability’.¹⁹⁹ In my view, the former approach is preferable. The purpose of extending the UCT regime to insurance contracts would be undermined if the broader definition endorsed by industry were adopted.

The third issue is said to be some uncertainty about how the UCT regime is to interact with the duty of utmost good faith contained in section 13 of the Insurance Contracts Act.²⁰⁰ I endorse Treasury’s suggestion that the two obligations should operate independently of each other.²⁰¹

The fourth and final issue is whether a 12 month transition period is adequate.²⁰² I offer no concluded view beyond saying that it is desirable not to delay their introduction or their coming into effect beyond what is reasonable.

When these reforms are implemented, I expect that they may have a material impact on some standard form insurance contracts. Taking just one example from the AAI case study relating to AAMI’s Complete Replacement Cover home insurance policy, I expect attention to be given to the application of the provisions to contractual terms like the second term in AAMI’s Supplementary Product Disclosure Statement, which provided:²⁰³

If we decide to pay you what it would cost us to rebuild or repair ... we will pay you ... the amount that we determine to be the reasonable cost of repairing or rebuilding. *The amount that we determine to be the reasonable cost will be the lesser amount of any quotes obtained by us and/or by you for the rebuild or repair. Discounts may be available to us if we were to rebuild or repair.*

¹⁹⁸ Treasury, Module 6 Policy Submission, 7 [34]; Treasury, UCT Proposals Paper, June 2018, 2.

¹⁹⁹ Treasury, Module 6 Policy Submission, 7 [34].

²⁰⁰ Treasury, Module 6 Policy Submission, 7 [34].

²⁰¹ Treasury, Module 6 Policy Submission, 7 [34].

²⁰² Treasury, Module 6 Policy Submission, 7 [34].

²⁰³ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, Exhibit GCD-4 (Tab 2) [SUN.0760.0200.0033] (emphasis added).

As Treasury indicated, ‘terms that permit an insurer to pay a claim based on the cost of repair or replacement that may be achieved by the insurer, but could not be reasonably achieved by the policyholder’, are terms that may be unfair.²⁰⁴

Recommendation 4.7 – Application of unfair contract terms provisions to insurance contracts

The unfair contract terms provisions now set out in the ASIC Act should apply to insurance contracts regulated by the Insurance Contracts Act. 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 should operate independently of the unfair contract terms provisions.

4.4 Claims handling

The handling and settlement of insurance claims, or potential insurance claims, is now carved out from the definition of ‘financial service’ by regulation 7.1.33 of the Corporations Regulations.²⁰⁵ As a result, some of the general obligations set out in section 912A of the Corporations Act, including in particular the obligation to do all things necessary to ensure that financial services are provided efficiently, honestly and fairly, do not govern the ways in which insurers:²⁰⁶

- make a decision about a claim, including investigating claims and interpreting policy provisions;
- conduct negotiations in respect of settlement amounts;
- prepare estimates of loss or damage, or likely repair costs; and
- make recommendations about mitigation of loss.

²⁰⁴ Treasury, UCT Proposals Paper, June 2018, 2.

²⁰⁵ See also Corporations Act s 766A(2).

²⁰⁶ See also ASIC, Module 6 Policy Submission, 27 [107].

In my view, there is no basis in principle for continuing to exclude claims handling from the definition of ‘financial service’. It is as much the provision of a financial service as any other financial service. And as ASIC rightly said:²⁰⁷

For consumers, the intrinsic value of an insurance product lies in the ability to make a successful claim when an insured event occurs.

A number of the case studies examined in the sixth round of hearings demonstrated the need to remove the ‘claims handling’ exemption. In the life insurance context, this was demonstrated by the CommInsure and TAL case studies. In the general insurance context, this was demonstrated by the Youi and AAI case studies, which related to the handling of home insurance claims following natural disasters or severe weather events.

Because of the claims handling exemption, ASIC is limited in the regulatory interventions it can take in this regard.²⁰⁸ Numerous submissions supported the removal of the claims handling exemption.²⁰⁹

There can be no basis in principle or in practice to say that obliging an insurer to handle claims efficiently, honestly and fairly is to impose on the individual insurer, or the industry more generally, a burden it should not bear. If it were to be said that it would place an extra burden of cost on one or more insurers or on the industry generally, the argument would itself be the most powerful demonstration of the need to impose the obligation. The argument can be made only if claims handling is not now conducted efficiently, honestly and fairly. And if that is the case, it should no longer be tolerated by the industry or by the law.

²⁰⁷ ASIC, Module 6 Policy Submission, 27 [110]; see also CALC, Module 6 Policy Submission, 24 [81].

²⁰⁸ ASIC, Module 6 Policy Submission, 27 [110]; see also CALC, Module 6 Policy Submission, 24 [81].

²⁰⁹ See, eg, Professors Allan Fels AO and David Cousins AM, Module 6 Policy Submission, 8–9; AFA, Module 6 Policy Submission, 15; AIST, Module 6 Policy Submission, 11–12 [17]; APRA, Module 6 Policy Submission, 7 [24]; CALC, Module 6 Policy Submission, 24 [79]–[82]; FPA, Module 6 Policy Submission, 12 [17]; FRLC, Module 6 Policy Submission, 18–19; FSU, Module 6 Policy Submission, 7 [55]–[56]; ISA, Module 6 Policy Submission, 3 [8]; Legal Aid NSW, Module 6 Policy Submission, 5.

I recommend that the Corporations Regulations be amended, so that the handling or settlement of insurance claims, or potential insurance claims, is no longer excluded from the definition of ‘financial service’. I recognise that the Government has commissioned Treasury to undertake work on this issue, and that Treasury is currently considering the preferable way forward.²¹⁰ No doubt the views I have expressed will be considered.

Recommendation 4.8 – Removal of claims handling exemption

The handling and settlement of insurance claims, or potential insurance claims, should no longer be excluded from the definition of ‘financial service’.

4.5 Status of Industry Codes

As I explained in the Introduction to this Report and in the chapter on banking, I consider it 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. In the insurance context, the provisions to be picked up and applied are those that govern the terms of the contract made or to be made between the insurer and the policyholder.

I have explained my reasons for this conclusion earlier in this Report, in both the Introduction and the chapter on banking. I will not repeat those reasons here beyond noting that, as Treasury has recognised, self-regulation through an industry code carries with it a number of limitations and difficulties, including that:²¹¹

- the standards set may not be adequate;
- not all industry participants may subscribe to, and be bound by, the code;
- monitoring and enforcement of compliance with the code may be inadequate; and

²¹⁰ Treasury, Module 6 Policy Submission, 8 [38], [40].

²¹¹ Treasury, Interim Report Submission, 9–10 [58].

- consequences for breach of the code may not be enough to make industry participants correct and prevent systemic failures in its application.

As in the context of banking, I would add one further point. The range and diversity of code obligations, and some developments at common law,²¹² may have contributed to there being some uncertainty about which provisions of industry codes may be relied upon, and enforced by, individuals. Uncertainty of this kind is highly undesirable. Participants in the financial services industry must know what rules govern their dealings.

To that end, I have recommended that the law²¹³ should be amended to provide that breach of an enforceable code provision will constitute a breach of the Act. The law should also be amended to provide for remedies that may follow from such a breach. Those remedies should be modelled on those now set out in Part VI of the *Competition and Consumer Act 2010* (Cth) (the Competition and Consumer Act).

As I explained in the chapter on banking, I anticipate that the process of identifying and rendering enforceable these code provisions will proceed in four steps:

- Industry should identify the provisions that it says govern the terms of the contract made or to be made between the financial services entity and the customer or guarantor.
- Industry should seek ASIC's approval of those provisions. If industry does not put forward its proposed enforceable code provisions in a timely manner, consideration will need to be given to whether a mandatory industry code should be established, using a similar process to that which currently exists under the Competition and Consumer Act.²¹⁴

²¹² *Brighton v Australia and New Zealand Banking Group Ltd* [2011] NSWCA 152; *Doggett v Commonwealth Bank of Australia* (2015) 47 VR 302.

²¹³ The Corporations Act may be the preferable option, given that it already contains ASIC's code approval power: see s 1101A.

²¹⁴ See Competition and Consumer Act s 51AE, and more generally Treasury, *Industry Codes of Conduct: Policy Framework*, November 2017, 14–15.

- ASIC should review the provisions put forward by industry. ASIC's role must go beyond being the passive recipient of industry proposals. Rather, ASIC should assess whether industry has appropriately identified, from the provisions contained in the code, those provisions that should be made enforceable. ASIC should also assess whether those provisions are expressed clearly and unambiguously, so as to be capable of enforcement.
- Once ASIC has approved the enforceable code provisions, they will be enforceable by statute. Those to whom the promises are made will be able to elect whether to enforce any breaches of those provisions through existing internal dispute resolution (IDR) or EDR mechanisms or through the courts. Use of IDR mechanisms would not constitute any election about future action, but use of EDR mechanisms will be treated as an election not to pursue court action unless good cause is shown to the contrary.

I explained each of those steps in some detail in the chapter on banking. However, I should say something more about the first and second steps here because of some particular features of the insurance codes.

The first and second steps require industry to identify the enforceable code provisions and to seek ASIC's approval of those provisions. The three insurance codes are still being developed. They are not at the same stage of maturity (or particular specificity) as the 2019 Banking Code.

As I have explained, the Life Insurance Code of Practice became binding on FSC members on 30 June 2017.²¹⁵ On 12 November 2018, the FSC released a further draft version of the Code for public consultation.²¹⁶ The draft explicitly identifies numerous areas 'where the content is new or where the policy intent has changed'.²¹⁷ These include, but are not limited to, issues relating to policy design and disclosure, sales practices and advertising, the use of health (including genetic) information and family

²¹⁵ Exhibit 6.409, Witness statement of Sally Loane, 30 August 2018, 14 [9.1]; Background Paper No 29, 15 [5.4].

²¹⁶ FSC, *FSC Life Insurance Draft Code of Practice 2.0* (5 December 2018) FSC <www.fsc.org.au/event-list/website-events/Code-Roadshow/>.

²¹⁷ FSC, *Consultation Draft: Life Insurance Code of Practice* (5 December 2018) FSC <www.fsc.org.au/event-list/website-events/Code-Roadshow/>, 1.

medical history, policy cancellation, claims handling, and the obligations of superannuation trustees.²¹⁸ The next iteration of the Code may be significantly different from the present version.

I have also noted that the Insurance in Superannuation Voluntary Code of Practice was introduced on 1 July 2018.²¹⁹ Superannuation fund trustees who have chosen to adopt the Code agree to comply with the Code as early as they can, and by no later than 30 June 2021.²²⁰ It appears that the FSC is presently contemplating incorporating the Insurance in Superannuation Voluntary Code of Practice into the next version of the Life Insurance Code of Practice.²²¹

At the time of the sixth round of hearings, the ICA was in the process of reviewing the General Insurance Code of Practice, with the intention of releasing a new version of that Code in 2019.²²²

Taken together, these points lead me to conclude that it is undesirable to require the insurance industry to seek to identify now (and give to ASIC) the provisions that it sees as being proposed enforceable code provisions. Instead, I recommend that in respect of the three insurance codes, the FSC, the ICA and ASIC 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 process will most likely occur in conjunction with the Insurance in Superannuation Voluntary Code of Practice becoming mandatory.

In the chapter on banking, I made two broader points about industry codes. I need to say something about each of those points here.

²¹⁸ FSC, *Consultation Draft: Life Insurance Code of Practice* (5 December 2018) FSC <www.fsc.org.au/event-list/website-events/Code-Roadshow/>, 9–11 [3.5A]–[3.6B]; 12–16 [4.1]–[4.3A], [4.11]; 17–19 [5.2A]–[5.5]; 23 [6.6A]; 25–31 [8.2]–[8.18]; 41–2 [13.9] and 43–4 [13.22]–[13.23].

²¹⁹ FSC, *Insurance in Super Working Group* (5 December 2018) FSC <www.fsc.org.au/policy/life-insurance/insurance-in-superannuation-working-group-iswg/>.

²²⁰ Insurance in Superannuation Voluntary Code of Practice s 3.6.

²²¹ FSC, *Consultation Draft: Life Insurance Code of Practice* (5 December 2018) FSC <www.fsc.org.au/event-list/website-events/Code-Roadshow/>, 2, Ch 2.

²²² Exhibit 6.404, Witness statement of Robert Whelan, 27 August 2018, 11 [73]; see also Transcript, Robert Whelan, 21 September 2018, 6398.

The first is that by creating a system of enforceable code provisions, I do not intend to modify or limit ASIC's existing, and more general, power under section 1101A of the Corporations Act to approve industry codes. As I have said, industry should continue to be given the option to seek general ASIC approval of its codes. To that end, I have recommended that the law be amended to provide that:

- ASIC's power to approve codes of conduct (relevantly) extends to codes relating to all APRA-regulated institutions, including insurers; and
- 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.

More broadly, I do not wish to interfere with the continued development of industry codes. The witness statements tendered in the sixth round of hearings indicated that the Life Insurance Code of Practice has played an important role in addressing previously problematic behaviours within that industry. The two clearest examples related to reducing the use of surveillance of claimants²²³ and reducing the use of outdated medical definitions.²²⁴ I consider it important that industry continue to identify opportunities for improvement. It is equally important for industry to commit, in its codes, to making those improvements.

The second point relates to the basic structure of IDR and EDR under the codes. In the chapter on banking, I said that subject to one caveat, I did not consider that any amendment was required to that structure.

The caveat I make in the context of insurance relates to the sanctions powers given to the Code Governance Committee in respect of general insurance, and to the Life Code Compliance Committee in respect of life insurance.

The Commission received a statement from the Chairperson of the Code Governance Committee.²²⁵ In that statement, the Chairperson said that

²²³ Transcript, Senior Counsel Assisting, 14 September 2018, 5787–8.

²²⁴ See, eg, Transcript, Senior Counsel Assisting, 13 September 2018, 5655–7.

²²⁵ Exhibit 6.401, Witness statement of Lynelle Briggs, 14 September 2018.

since 1 July 2014, the Committee had determined that there had been breaches of the Code on 33 occasions.²²⁶ Code subscribers had conceded breaches of the Code in the course of an investigation on a further 689 occasions,²²⁷ and had self-reported over 13,000 breaches of the Code.²²⁸ Despite this, the Code Governance Committee had never exercised its powers to impose sanctions in response to those breaches.²²⁹ Nor had the equivalent power been exercised by the Life Code Compliance Committee since its formation on 1 July 2017.²³⁰

The evidence indicated that the power to impose sanctions had not been exercised because the Committees could only impose sanctions where an insurer had failed to *correct* a Code breach.²³¹ Sanctions could not be imposed in response to a *breach* of the Code, in and of itself.

In my view, the sanctions power in the General and Life Insurance Codes of Practice should not be limited in this way.²³² Rather, the FSC and the ICA should amend section 13.10 of the Life Insurance Code of Practice and section 13.11 of the General Insurance Code of Practice 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. When considering whether to impose sanctions following a breach, the Committees should continue to be guided by the matters referred to in section 13.14 of the General Insurance Code of Practice and section 13.13 of the Life Insurance Code of Practice.

²²⁶ Exhibit 6.401, Witness statement of Lynelle Briggs, 14 September 2018, 4 (Question 1(c)).

²²⁷ Exhibit 6.401, Witness statement of Lynelle Briggs, 14 September 2018, 4 (Question 1(f)).

²²⁸ Exhibit 6.401, Witness statement of Lynelle Briggs, 14 September 2018, 7 (Question 1(j)).

²²⁹ Exhibit 6.401, Witness statement of Lynelle Briggs, 14 September 2018, 32 [180].

²³⁰ Exhibit 6.402, Witness statement of Anne Brown, 28 August 2018, 2 [8].

²³¹ In the general insurance context, see Exhibit 6.401, Witness statement of Lynelle Briggs, 14 September 2018, 32 [182]; General Insurance Code of Practice s 13.11. In the life insurance context, see Exhibit 6.402, Witness statement of Anne Brown, 28 August 2018, 1–2 [6]–[8]; Life Insurance Code of Practice s 13.10.

²³² General Insurance Code of Practice s 13.11; Life Insurance Code of Practice s 13.10.

Recommendation 4.9 – Enforceable code provisions

As referred to in Recommendation 1.15, the law should 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 Financial Services Council, 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’.

Recommendation 4.10 – Extension of the sanctions power

The Financial Services Council and the Insurance Council of Australia should amend section 13.10 of the Life Insurance Code of Practice and section 13.11 of the General Insurance Code of Practice 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.

4.6 External dispute resolution

A number of case studies examined in the sixth round of hearings involved problematic dealings between an insurer and the EDR body: previously FOS, now AFCA (the Australian Financial Complaints Authority). These included the CommInsure, TAL and AAI (Hunter Valley Storm) case studies.

Two policy questions, asked after the sixth round of hearings, were whether the duty of utmost good faith in section 13 of the Insurance Contracts Act *does* apply to the way that an insurer interacts with an EDR body, and whether it *should* apply. The Commission received a range of responses. The thrust of many of those responses was that it was appropriate for insurers to be subject to some form of duty when interacting with the EDR

body.²³³ I agree. The issue then becomes what duty and where should the duty be recorded.

I consider it preferable for this duty to sit alongside a pre-existing related duty in section 912A(1)(g) of the Corporations Act. That relevantly provides that an AFSL holder must:

if ... financial services are provided to persons as retail clients:

(i) have a dispute resolution system complying with subsection (2) ...

Subsection (2) of section 912A specifies that an AFSL holder's dispute resolution system must consist of both an IDR procedure that meets certain standards, as well as 'membership of the AFCA scheme'.²³⁴

As they presently stand, sub-sections 912A(1)(g) and (2) mandate the form of AFSL holders' IDR and EDR systems, but they do not impose any conduct-related obligations on AFSL holders when providing or using those systems. I consider this to be an important omission. There is little benefit in mandating the existence of systems if there is no obligation to comply with those systems. As a result, I recommend that section 912A be amended to require that AFSL holders take reasonable steps to co-operate with AFCA in its resolution of particular disputes including, in particular, by making available to AFCA all relevant documents and records relating to the issues in dispute.

This proposal would address issues broader than those that were observed in the CommInsure, TAL and AAI (Hunter Valley storm) case studies, but I do not see any difficulty with this. There is no reason in principle to confine the class of affected entities to insurers (rather than all AFSL holders). The proposal will serve to give statutory force to the promises that AFSL holders have made to the EDR body, and will allow ASIC to take action if those promises are not kept.

²³³ See, eg, AFA, Module 6 Policy Submission, 19; AIST, Module 6 Policy Submission, 20 [30]; ALA, Module 6 Policy Submission, 32 [92]; ASIC, Module 6 Policy Submission, 37–8 [157]–[159]; CALC, Module 6 Policy Submission, 32–3 [121]–[124]; FRLC, Module 6 Policy Submission, 30; Legal Aid NSW, Module 6 Policy Submission, 10; Slater + Gordon Lawyers, Module 6 Policy Submission, 21 [89].

²³⁴ Corporations Act s 912A(2)(c).

Recommendation 4.11 – Co-operation with AFCA

Section 912A of the Corporations Act should be amended to require that AFSL holders take reasonable steps to co-operate 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.

4.7 Accountability

As I explain in the chapter relating to the regulators, I consider that provisions modelled on the **Banking Executive Accountability Regime** (BEAR) should be expanded to all APRA-regulated financial services institutions. I also explain in that chapter why I consider it to be appropriate to adopt a sequential approach to the extended application of these provisions. After these provisions have been applied to the balance of the **authorised deposit-taking institutions**, and to **registrable superannuation entity** (RSE) licensees, they should be applied to the largest insurers and, thereafter, the balance of insurers.

Recommendation 4.12 – Accountability regime

Over time, provisions modelled on the BEAR should be extended to all APRA-regulated insurers, as referred to in Recommendation 6.8.

5 Group life insurance

As I explained in the introduction to this chapter, an important feature of the life insurance market is that life cover, total and permanent disability cover, income protection cover and trauma cover are available not only through individual policies but also through group arrangements.

Most life insurance policies in Australia are held within superannuation funds.²³⁵ In its report, *Superannuation: Assessing Efficiency and Competitiveness*, the Productivity Commission said that about 12 million Australians have one or more forms of life insurance through their superannuation.²³⁶ That may be compared with the individual life insurance market. ASIC Report 498, *Life Insurance Claims, An Industry Review*, said that in 2015, there were 4 million retail policies and 3.9 million direct or non-advised policies.²³⁷ In 2016/2017, Australians paid a total of \$9 billion in group life premiums.²³⁸

Notwithstanding the prevalence of group life policies, consumers' awareness of the content, or even existence, of their policy is relatively low. The Productivity Commission's Draft Report stated that about a quarter of superannuation fund members do not know whether they have a policy.²³⁹

5.1 The structure of group life insurance

Group life insurance involves a policy owner – commonly an employer or superannuation trustee – holding a policy on behalf of a defined group of individuals.

Under an employer group scheme, an employee's life is insured. The employer is the policy owner and can be the agent of the life insured for the purposes of the insurance.²⁴⁰

²³⁵ Peter Kell, 'Insurance in Super: The Regulators – What Do They Think?' (Speech delivered at the Association of Superannuation Funds of Australia Spotlight on Insurance, Sydney, Australia, 27 February 2018).

²³⁶ Productivity Commission, Report 91, *Superannuation: Assessing Efficiency and Competitiveness*, 21 December 2018, 365.

²³⁷ Background Paper No 28, 1–2 [1.3] citing ASIC, Report 498, 12 October 2016, 35.

²³⁸ Productivity Commission, Report 91, *Superannuation: Assessing Efficiency and Competitiveness*, 21 December 2018, 365.

²³⁹ Productivity Commission, Report 91, *Superannuation: Assessing Efficiency and Competitiveness*, 21 December 2018, 365.

²⁴⁰ Background Paper No 28, 2 [2.2]. See also the definition of 'group life contract' in Insurance Contracts Act ss 11(1), 32, on misrepresentation and non-disclosure in that context.

Superannuation fund schemes are structured on the basis that the life insured is a member and beneficiary of the trust fund and the policy owner is the trustee of the fund.²⁴¹

In both schemes, it is the employer or trustee, as the policy owner, and not the life insured, who enters into the contract, is obliged to pay the premium, has standing to claim and is entitled to receive the benefit amounts paid by the life insurer.²⁴²

5.2 MySuper

Section 68AA of the *Superannuation Industry (Supervision) Act 1993* (Cth) (the SIS Act) requires each trustee²⁴³ authorised to offer a **MySuper product** to provide MySuper members with a permanent incapacity benefit and a death benefit by way of life insurance.²⁴⁴ These benefits must be provided unless the member opts out of either or both of the insurances.²⁴⁵ A failure to provide the benefits is a breach of an RSE licence condition.²⁴⁶

Section 68AA was inserted to protect members against the risk of not being able to accumulate a sufficient amount of retirement savings (for themselves or their dependants) as a result of being unable to work because of injury, illness or death.²⁴⁷ Section 68AA was a way of setting minimum levels of default life insurance and total and permanent disability insurance.²⁴⁸

²⁴¹ Background Paper No 28, 2 [2.3]. See also the references to 'superannuation or retirement scheme' in Insurance Contracts Act ss 23, 26, 48A. This description, from *Sutton on Insurance Law*, was cited with approval in *Montclare v Metlife Insurance Ltd* [2015] VSC 306, 18 [61].

²⁴² Background Paper No 28, 2–3 [2.4]; *Erzurumlu v Kellogg Superannuation Pty Ltd* [2013] NSWSC 1115, 22–3 [52]–[55].

²⁴³ Being each trustee of a regulated superannuation fund. See SIS Act s 19 for the definition of 'regulated superannuation fund'.

²⁴⁴ SIS Act s 68AA(1).

²⁴⁵ SIS Act s 68AA(5).

²⁴⁶ SIS Act s 29E(1)(a).

²⁴⁷ Explanatory Memorandum, Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 (Cth) 23 [2.3].

²⁴⁸ Explanatory Memorandum, Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 (Cth) 23 [2.4].

As with all policies of insurance, group life policies are contractual arrangements that hinge, first and foremost, on the terms agreed between the parties. Those terms, and their operation, may also be affected by relevant legislation including the Insurance Contracts Act. But the ordinary operation of the policy as between insurer and insured will turn most significantly on the coverage provided by the terms of the contract, including any key definitions of, and exclusions to, that coverage.

There are particular requirements relevant to the insurance that must be offered to MySuper members under section 68AA of the SIS Act. I describe these below. Importantly, none prescribes any particular forms of key definitions, terms or exclusions.

The first requirement concerns minimum levels of cover for death benefits offered through a MySuper product. The minimum level of coverage varies depending on the member's age:²⁴⁹

- if the person is aged from 20 to 34 years – \$50,000;
- if the person is aged from 35 to 39 years – \$35,000;
- if the person is aged from 40 to 44 years – \$20,000;
- if the person is aged from 45 to 49 years – \$14,000; and
- if the person is aged from 50 to 55 years – \$7,000.

The second requirement concerns the minimum cost of that cover. Both are set by the Superannuation Guarantee (Administration) Regulations 2018 (Cth).²⁵⁰ The minimum premium is \$0.50 per week, or the equivalent, for a person who is under 56 years of age.

The third requirement relates to the conditions for the release of benefits.²⁵¹ These include retirement, death, terminal medical condition and permanent incapacity.²⁵²

²⁴⁹ Superannuation Guarantee (Administration) Regulations 2018 (Cth) reg 14(5).

²⁵⁰ Superannuation Guarantee (Administration) Regulations 2018 (Cth) reg 14(1).
See also *Superannuation Guarantee (Administration) Act 1992* (Cth) s 32C(2)(d).

²⁵¹ Superannuation Industry (Supervision) Regulations 1994 (Cth) reg 4.07D, Sched 1.

²⁵² Superannuation Industry (Supervision) Regulations 1994 (Cth) Sched 1 Items 101–103.

The minimum level of cover, minimum cost of that cover and the prescribed conditions of release comprise the irreducible core minimum of a MySuper group life policy for death insurance. Aside from conditions of release, there are no mandatory or proscribed terms for default group life policies.

5.2.1 Standardising MySuper insurance

Key definitions, terms and exclusion clauses are central to the rights of an insured under a policy of insurance. They are the machinery that, when triggered, will require payment to be made by an insurer to an insured. The amount of cover offered under a policy is evidently an important aspect of cover. But it is only one aspect. Alone, the amount of cover offered says nothing about the insured's rights to claim under the policy, or about the value of one policy compared with other policies.

Insurance contracts can often be difficult for the average consumer to navigate and understand. And subtle differences in definitions, terms and exclusions from one policy to another can make the task of comparing policies particularly challenging.

In many cases, default members will not have made any active choice about the fund they have joined or considered the insurance offered through that product. Often a member will join the default fund chosen by their employer.

Even when a member chooses the fund or product, the choice will almost always be made without advice. It will be for the member alone to form a view about the merits or demerits of the product, and the insurance offered through it. But members are not always able to identify how key terms, definitions and exclusions will affect their coverage under their policy.²⁵³ And whatever consideration a member gives to these issues will be given in the course of considering the broader benefits of a superannuation fund.

²⁵³ See, eg, ASIC, Module 6 Policy Submission, 31 [133].

ASIC Report 591 noted the difficulties that consumers face when comparing definitions in policies such as the definition of total and permanent disability. ASIC considered there was scope for improvement in this regard, including by the use of standardised definitions in policies.²⁵⁴

Because life insurance within MySuper is default insurance, and because the value of a policy turns so heavily on key definitions, terms and exclusions, there is merit in considering the extent to which insurance within MySuper funds can be standardised, or at least standardised in key respects.

The Insurance in Superannuation Voluntary Code of Practice is a step in that direction.²⁵⁵ But it is not a mandatory code. Its effect will not be uniform, and it is not enforceable. To achieve a consistent result, standardisation should be effected by or under the relevant legislation. Only then will it apply across the industry.

Changes to key terms, definitions or exclusions will affect when an insured can claim under the policy. Changes will almost certainly affect the cost of insurance premiums, and will affect how much superannuation the member will have at retirement.²⁵⁶ Hence, the adoption of standardised terms should be carefully considered, and the consequences of change identified, before they are implemented.

I recommend that Treasury, in consultation with industry, determine the practicability, and likely pricing effects, of legislating universal key definitions, terms and exclusions for default MySuper group life policies.

²⁵⁴ ASIC, Report 591, 7 September 2018, 20; see also ASIC, Module 6 Policy Submission, 31 [132].

²⁵⁵ See also ASIC, Module 6 Policy Submission, 32 [134].

²⁵⁶ See Treasury, Module 6 Policy Submission, 13 [67].

That review should also consider:

- **the merits of prescribing higher minimum coverage for life insurance than is currently provided for by the Superannuation Guarantee (Administration) Regulations;**
- **the merits of prescribing minimum coverage for permanent incapacity insurance;**
- **the merits of prescribing maximum coverage for life and/or permanent incapacity insurance; and**
- **the merits of prescribing 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 4.13 – Universal terms review

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.

5.3 Associated entities

5.3.1 Trustee obligations for insurance

Trustees of superannuation funds are currently subject to certain obligations under the SIS Act and the Prudential Standards relevant to insurance.

For example, the trustee of a superannuation fund covenants to do the following things in respect of insurance offered through the fund:²⁵⁷

²⁵⁷ SIS Act s 52(7).

- to formulate, review regularly and give effect to an insurance strategy for the benefit of beneficiaries of the fund. This strategy addresses the kinds and levels of insurance to be offered or acquired on behalf of beneficiaries, as well as the basis for the decision to offer or acquire the insurance and the method by which the insurer is to be determined;²⁵⁸
- to consider the costs to all beneficiaries of offering or acquiring insurance of a particular kind or at a particular level;²⁵⁹
- to offer or acquire insurance of a particular kind or at a particular level only if the cost of the insurance does not inappropriately erode beneficiaries' retirement income;²⁶⁰ and
- to do everything that is reasonable to pursue an insurance claim for the benefit of a beneficiary, if that claim has a reasonable prospect of success.²⁶¹

The RSE licensee remains bound by its obligations to promote the financial interests of members holding MySuper products,²⁶² and its general covenants to perform its duties and exercise its powers in the best interests of the beneficiaries,²⁶³ and to act fairly in dealing with beneficiaries within each class of membership,²⁶⁴ including MySuper.

²⁵⁸ SIS Act s 52(7)(a).

²⁵⁹ SIS Act s 52(7)(b).

²⁶⁰ SIS Act s 52(7)(c).

²⁶¹ SIS Act s 52(7)(d).

²⁶² SIS Act s 29VN(a).

²⁶³ SIS Act s 52(2)(d).

²⁶⁴ SIS Act s 52(2)(e).

APRA has issued Prudential Standard SPS 250: Insurance in Superannuation (SPS 250), which has the force of law.²⁶⁵

SPS 250 imposes various requirements on superannuation trustees. These include to have: an ‘insurance management framework’;²⁶⁶ an ‘insurance strategy’;²⁶⁷ and a process for monitoring and selecting the insurance provided.²⁶⁸

SPS 250 also imposes requirements on trustees about the selection and monitoring of insurers. It provides that:

22. An RSE licensee must:

- (a) develop and implement a selection process for choosing an insurer that includes, at a minimum, consideration of the prospective insurer’s terms of cover and exclusions, claims philosophy, the reasonableness of the premiums to be charged and terms of any delegation to any other person of functions associated with making available insured benefits;
- (b) undertake a due diligence review of the selected insurer; and
- (c) be able to demonstrate to APRA the appropriateness of the selection process and the due diligence review and how it is applied.

23. An RSE licensee must be able to satisfy itself, and demonstrate to APRA, that the engagement of an insurer is conducted at arm’s length and is in the best interests of beneficiaries.

²⁶⁵ A breach of a Prudential Standard is a breach of the ‘RSE licensee law’: see par (aa) of the definition of ‘RSE licensee law’ in s 10(1) of the SIS Act. Any breach of the RSE licensee law results in a breach of the conditions of the RSE licensee’s licence (s 29E(1) (a) of the SIS Act). APRA may direct an RSE licensee to comply with a condition of its licence where it has reasonable grounds to believe that the RSE licensee has breached that condition (s 29EB of the SIS Act). APRA may cancel an RSE licensee’s licence where it fails to comply with a direction (s 29G of the SIS Act) and that failure gives rise to an offence (s 29JB of the SIS Act).

²⁶⁶ APRA, Prudential Standard SPS 250, 15 November 2012, [8]–[16].

²⁶⁷ APRA, Prudential Standard SPS 250, 15 November 2012, [17].

²⁶⁸ APRA, Prudential Standard SPS 250, 15 November 2012, [22]–[24].

24. An RSE licensee must ensure it has sufficient and appropriate resources to manage and monitor its relationship with an insurer at all times. At a minimum, the monitoring must include:

- (a) maintaining regular contact with the insurer at an appropriate frequency and level of seniority; and
- (b) a process for regular monitoring of performance under the insurance arrangement, including reporting to senior management against service levels.

5.3.2 Increased requirements for related insurers

Engaging a related entity as insurer presents particular issues.

The AMP case study in the sixth round of hearings provided an example of an RSE licensee that engaged another entity within the AMP Group (AMP Life) as the group life insurer of many of its funds. AMP Life also acted as the administrator of all of AMP Super's funds, and some of NM Super's funds.²⁶⁹

One of AMP Life's responsibilities as administrator of the AMP trustees' funds was to undertake 'assessments of potential insurers', recommend replacement insurance arrangements and assist the trustees to 'negotiate the terms and appointment with the preferred insurer' and to ensure compliance with SPS 250.²⁷⁰

When asked about the suitability of AMP Life undertaking tasks connected with the selection of the group life insurer, Mr Paul Sainsbury (a senior executive within AMP) said that there was sufficient separation of roles within AMP Life to satisfy the requirements of SPS 250.²⁷¹ Whether or not this is right, it highlights that, where an entity that is required to act in the interests (or best interests) of another elects to engage a related entity to provide services at the expense of those to whom the duty is owed, questions of conflict immediately arise.

²⁶⁹ Transcript, Paul Sainsbury, 17 September 2018, 5861.

²⁷⁰ Exhibit 6.233, Witness statement of Paul Sainsbury, 10 September 2018, 17 [67].

²⁷¹ Transcript, Paul Sainsbury, 17 September 2018, 5863.

I have set out elsewhere in this Report my concerns about the conflicts that arise where related parties are engaged. Those concerns have equal force in the context of group life insurance. Entities that elect to integrate their businesses do so, overwhelmingly, for their own reasons. The entity's motivation will usually be to increase market share, to increase revenue, to increase profit, to place commercial pressure on its competitors, or some combination of those factors. That is not to deny that benefits may ultimately flow to consumers from the integrated arrangement. But because the motivation for the integration is, ordinarily, a self-interested one, the congruence of the arrangement with the duty to act in the interests of the other must be closely examined.

The need for assurance of the appropriateness of the arrangements is all the stronger in circumstances where, as with the introduction of MySuper and the requirements for default superannuation, a policy decision has been made that is, by design, protective of the interests of members.

Entities in the position of conflict described above can reasonably, and should, be subjected to a higher degree of regulatory scrutiny. As the number and nature of conflicts increases, so too should the intensity of regulatory supervision.

In the context of group life insurance, RSE licensees who engage related parties as insurers should be required to demonstrate to APRA how they are meeting the expectations of SPS 250. In particular, RSE licensees that engage related parties as insurers should be required to demonstrate that the engagement is at arm's length and is in the best interests of beneficiaries. And because conflicts can arise not only from legal structure but also from contractual arrangements, the same obligation should apply to any RSE licensee that has a contract, arrangement or understanding with a life insurer by which the life insurer is afforded a priority or privilege in connection with the provision of group life insurance to the RSE licensee. I recommend that RSE licensees in the position I have described be required to 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.

At a minimum, that certification should be obtained before any policy of insurance is entered into and each time any policy is renewed. But because the terms of group life policies are often very long, certification should otherwise be required every two years.

The requirement for independent certification will reinforce to RSE licensees the paramountcy of member's interests and give members comfort that the arrangements are appropriate.

The independent report should also be provided to APRA by the author of the report at the same time as it is provided to the RSE licensee. The contemporaneous provision of the report will allow APRA to form a view more quickly on the appropriateness of the arrangement and to take such action as it thinks necessary, including by referring the matter to ASIC so that it can take action to protect the interests of members.

Recommendation 4.14 – Additional scrutiny for related party engagements

APRA should amend Prudential Standard SPS 250 to require RSE licensees that engage a related party to provide group life insurance, or who enter into a contract, arrangement or understanding with a life insurer by which the insurer is given a priority or privilege in connection with the provision of life insurance, 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.

5.4 Statistically appropriate rates

Default arrangements are those arrangements between an employer and a trustee of a superannuation fund under which the employer agrees to direct contributions paid on behalf of those employees – who make no election about where the employer is to pay their contributions – to a default product in the trustee's fund.

Due to the compulsory nature of superannuation in Australia, default arrangements are a significant feature of Australia's superannuation system. When starting a new job, up to two-thirds of members make no election about where their contributions should be paid, and default to their employer's default fund, and about half the accounts in Australia's superannuation system are in MySuper (or default) products.²⁷²

The features of the default product offered through an employer's plan will often be different to the standard default product offered by the trustee. For example, sometimes the default product for the employer is 'tailored', in that features such as investment strategies and insurance policies are suited to the circumstances of the employee members. In respect of insurance, the premium costs charged through the employer plan are usually discounted by insurers, or subsidised by employers.²⁷³

Where members cease employment with the employer, they will cease to be part of the employer plan. On this happening, the member will be transferred from the employer plan to a personal plan and be subject to the terms of the standard default product offered by the trustee. These members are often referred to as 'delinked' members.

ASIC Report 591 observed that, on transferring members from an employer plan to a personal plan within the same superannuation fund, some trustees were automatically classifying members as 'smokers' or 'blue-collar workers' unless they received specific information from the member to the contrary.²⁷⁴ The rates that are charged for members classified in this way are generally at the higher end of the scale of premiums.

Defaulting members to these higher rates does not reflect the likelihood of the member being a smoker or a blue-collar worker. As ASIC noted in Report 591, only around 14.5% of the adult population of Australia are daily smokers, and only around 25% of all workers are engaged in 'blue-collar' work.²⁷⁵

²⁷² Productivity Commission, Report 91, *Superannuation: Assessing Efficiency and Competitiveness*, 21 December 2018, 104.

²⁷³ See ASIC, Report 591, 7 September 2018, 17.

²⁷⁴ See ASIC, Report 591, 7 September 2018, 17.

²⁷⁵ See ASIC, Report 591, 7 September 2018, 17.

In charging members premiums for insurance offered through the fund, trustees are subject to their general covenants under section 52(2) of the SIS Act, including the obligation to act in the member's best interests, and to their insurance related covenants under section 52(7) of the SIS Act, including only to offer or acquire insurance of a particular kind, or at a particular level, if the cost does not inappropriately erode the retirement income of beneficiaries. Both are relevant to the assumptions a trustee may make when charging premiums to a default member.²⁷⁶

Where a trustee complies with its covenants under section 52 of the SIS Act, there is no need for any further protections to be put in place to ensure that the rate being charged to default members, where they have given no indication or information to the trustee about their circumstances, is statistically appropriate. But, as ASIC's work shows, default members are vulnerable. There is, therefore, merit in providing some further protection.

Trustees must be required to make proper arrangements about the premiums that will be charged to default members. That can be achieved by APRA amending SPS 250 to require that any status attributed to default members (such as 'blue-collar', 'smoker', or other status affecting the premium to be charged for insurance) is fair and reasonable. Ordinarily that would require consideration of whether the status attributed is statistically appropriate.

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.

²⁷⁶ See, eg, ASIC, Module 6 Policy Submission, 33 [144].

Conclusion

Insurance, as a means for spreading risk, brings significant benefits for both individuals and for communities.²⁷⁷ But some changes should be made to bring the regulation of insurance into line with that of other financial products, and to balance better the rights and obligations of insurers and insureds.

These objectives require a prohibition on hawking, reforms to the sale of add-on insurance, reforms to the disclosure and misrepresentation regime, the removal of the 'claims handling' and 'funeral expenses policies' legislative carve outs, the application of UCT provisions to insurance contracts, statutory consequences for breaching key provisions of industry codes and close scrutiny of group life insurance arrangements.

²⁷⁷ Background Paper No 14, 7–9 [1.1]–[1.9].

6. Culture, governance and remuneration

Introduction

I said in the first chapter of this Report that there can be no doubt that the primary responsibility for misconduct in the financial services industry lies with the entities concerned and those who managed and controlled those entities: their boards and senior management. Nothing that is said in this Report can be understood as diminishing that responsibility. Everything that is said in this Report is to be understood in the light of that one undeniable fact: it is those who engaged in misconduct who are responsible for what they did and for the consequences that followed.

Because that is so, every **financial services entity**, named in the Commission's reports or not, must look to its culture. Every financial services entity must look again at the way in which it governs itself and manages not only its employees but also the entities and individuals who act as its intermediaries or are seen by consumers as representing or associated in some other way with the entity. In looking at culture and governance, every entity must consider how it manages regulatory, compliance and conduct risks. And it must give close attention to the connections between compensation, incentive and remuneration practices and regulatory, compliance and conduct risks.

Every entity must ask the questions provoked by the Prudential Inquiry into CBA:¹

- Is there adequate oversight and challenge by the board and its gatekeeper committees of emerging non-financial risks?
- Is it clear who is accountable for risks and how they are to be held accountable?

¹ CBA Prudential Inquiry, Final Report, 3.

- Are issues, incidents and risks identified quickly, referred up the management chain, and then managed and resolved urgently? Or is bureaucracy getting in the way?
- Is enough attention being given to compliance? Is it working in practice? Or is it just 'box-ticking'?
- Do compensation, incentive or remuneration practices recognise and penalise poor conduct? How does the remuneration framework apply when there are poor risk outcomes or there are poor customer outcomes? Do senior managers and above feel the sting?

Those questions direct attention to three topics – culture, governance and remuneration. Each of those words can provoke a torrent of clichés. Each can provoke serious debate about definition. But there is no other vocabulary available to discuss issues that lie at the centre of what has happened in Australia's financial services entities and with which this Report must deal.

The culture of an entity can be described as the 'shared values and norms that shape behaviours and mindsets' within the entity.² It has been described as 'what people do when no-one is watching'³ and that description captures what might be called the essentially 'internalised' or 'instinctive' application of shared values and norms. The shared values and norms can be seen as both reflecting and constituting the culture of an entity. It is evident that culture can drive or discourage misconduct.⁴

Governance refers to the entirety of structures and processes by which an entity is run. By shaping *how* the business is run, governance shapes culture. The systems, controls and risk management processes of the

² Cf CBA Prudential Inquiry, Final Report, 81. I deliberately omit reference to a 'system' of shared values and norms if only to emphasise that culture is observed and described, not created apart from, or imposed on, the entity.

³ G30, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, July 2015, 17.

⁴ See generally FSB, Toolkit.

business affect its culture.⁵ But governance is not limited to questions of risk. Nor is it defined only by reference to how the board operates or what matters the board deals with. It embraces not only how, and by whom, decisions are made, but also the values or norms that the processes of governance are intended to effect. Hence, it is rightly said that the ‘tone’ of the entity is, and must be, set at the top. But that tone must also be echoed from the bottom and reinforced at every level of the entity’s management and supervision; it must always ‘sound from above’. And a culture that fosters poor leadership, poor decision-making or poor behaviour will undermine the governance framework of the entity.⁶

Remuneration and incentives, especially variable remuneration programs, tell staff what the entity rewards. Hence, remuneration and incentives tell staff what the entity values. Remuneration both affects and reflects culture. As the Commission’s work has shown, and is now not disputed, poor remuneration and incentive programs can lead, and have led, to poor customer outcomes.

If what has happened in the past is to be avoided in the future, entities have no choice but to grapple with culture, governance and remuneration. All three are related. Culture obviously affects governance but it also affects remuneration (because remuneration will be structured to reward what the entity values). Governance obviously affects culture but governance will not only affect, it will ultimately determine, how remuneration and incentive arrangements are given practical effect. And remuneration and governance inform and reinforce the culture of the entity.

The relationships between culture, governance, remuneration and misconduct have been the subject of increasing attention since the Global Financial Crisis (GFC). Particular attention has been directed to what role prudential supervision may have in the formation and maintenance of sound culture, governance and remuneration practices.

In this chapter, I will consider culture, governance and remuneration separately. I will examine the attention that each has been given since the GFC – both in Australia and overseas – as well as the failings identified

⁵ FSB, Toolkit, 9. See also APRA, Information Paper, Risk Culture, October 2016, 8.

⁶ FSB, Toolkit, 8.

in relation to culture, governance and remuneration and the ways in which those failings can be met.

While I will consider culture, governance and remuneration separately, that separate consideration should not be taken as denying the close connections between all three. Positive steps taken in one area will reinforce positive steps taken in the others. Failings in one area will undermine progress in the others.

1 Remuneration

I begin with remuneration. As I said in the *Interim Report*, ‘the conduct identified and criticised in [that] report was driven by the pursuit of profit – the entity’s revenue and profit, and the individual actor’s profit’.⁷

Of the topics dealt with in this chapter – culture, governance and remuneration – remuneration is the most concrete. It is also the topic that received the most immediate attention in the wake of the GFC. It is, therefore, a convenient place to begin an account of local and international efforts to improve governance, culture and remuneration practices since the GFC.

I start by providing an outline of those efforts. They form an important part of the backdrop for my recommendations in relation to remuneration practices. I will then consider some of the failings that have been identified in relation to the remuneration practices of financial services entities, and the ways in which those failings can be addressed.

1.1 Background

1.1.1 Responses to the GFC

As the report of the Australian Prudential Regulation Authority (APRA) Prudential Inquiry into CBA noted, ‘remuneration practices at financial institutions globally came under a harsh spotlight during the Global Financial

⁷ FSRC, *Interim Report*, vol 1, 302.

Crisis’.⁸ The report said that remuneration practices ‘were exposed as promoting behaviours and outcomes that were inconsistent with sound risk management and the best interests of customers’.⁹

In 2009, in response to this exposure, the Financial Stability Board (FSB),¹⁰ an international body that monitors and makes recommendations about the global financial system, released its Principles for Sound Compensation Practices (the Principles) and accompanying Implementation Standards. As the panel inquiring into CBA recorded, the Principles ‘sought to realign executive remuneration systems with prudent risk management and long-term financial sustainability’.¹¹ They were not explicitly directed to issues about the interests of customers, but instead aimed to ensure that:

- the boards of financial institutions would have adequate oversight of the institution’s compensation arrangements;
- compensation would be adjusted to take account of the risks to which employees exposed the financial institution; and
- there would be effective supervisory oversight of compensation practices.

Although the Principles stated that compensation should be adjusted to account for all types of risk, including difficult to measure risks, they appear to have been understood as being directed to promoting financial soundness and stability, rather than addressing misconduct. Mr Wayne Byres, Chairman of APRA, described the Principles as having been ‘strongly focused on financial soundness’ and accepted that, in this respect, the Principles may have been ‘too narrowly focused’.¹²

⁸ CBA Prudential Inquiry, Final Report, 65.

⁹ CBA Prudential Inquiry, Final Report, 65.

¹⁰ Established in 2009 as the successor to the Financial Stability Forum that had been founded in 1999 by the G7 Finance Ministers and Central Bank Governors as a mechanism (among other things) for developing and implementing strong regulatory, supervisory and other policies in the interest of financial stability. See FSB, *Our History* (2018) FSB <www.fsb.org/about/history/>.

¹¹ CBA Prudential Inquiry, Final Report, 65.

¹² Transcript, Wayne Byres, 29 November 2018, 7397; FSB, Principles, 2.

This narrow focus was reflected in the way that APRA incorporated the Principles into its prudential guidance and prudential standards.¹³

In 2009, APRA issued a Prudential Practice Guide, PPG 511, about remuneration.¹⁴ The guide was directed to all institutions regulated by APRA including **authorised deposit-taking institutions** (ADIs), general insurers and life companies. The guide said that ‘APRA’s remuneration requirements and guidance relate to managing or limiting risk incentives associated with remuneration’.¹⁵ The guide did not identify the kinds of risk, or risk incentives, to which it was directed. In particular, it said nothing about conduct risk, compliance or regulatory risk and nothing about reputational risk.

In 2010, APRA amended its Prudential Standard about governance, CPS 510, to include requirements about remuneration. Among other things, these amendments introduced requirements for ADIs, general insurers and life companies to:

- maintain a documented remuneration policy;
- design performance-based components of remuneration to encourage behaviour that supports:
 - the institution’s long-term financial soundness; and
 - the risk management framework of the institution;
- design performance-based components of remuneration to align remuneration with prudent risk-taking; and
- provide for the board to adjust performance-based components of remuneration downwards, including to zero, if such adjustments are necessary to:
 - protect the financial soundness of the institution; or
 - respond to significant unexpected or unintended consequences.

¹³ Transcript, Wayne Byres, 29 November 2018, 7394–5.

¹⁴ APRA, Prudential Practice Guide PPG 511, 30 November 2009.

¹⁵ APRA, Prudential Practice Guide PPG 511, 30 November 2009, 5 [2].

Like the guide issued in the previous year, the standard did not identify the kinds of risk to which it was directed. But coming, as they did, in the immediate wake of the GFC, it seems probable that the guide and the standard would have been understood by those to whom they were addressed as being directed primarily, even exclusively, to the management of financial risks. Mr Byres accepted that both documents focused on the financial safety and soundness of financial institutions.¹⁶

Although APRA's guide and standards did not deal expressly with the relationship between remuneration arrangements and misconduct, other developments in Australia in the wake of the GFC prompted legislators to consider that issue.

As I have explained in the chapter dealing with financial advice, several **financial product** and financial services providers in Australia collapsed during or after the GFC. In particular, in late 2008 and early 2009, many clients of Storm Financial sustained significant losses.¹⁷ And many clients of Commonwealth Financial Planning Limited, many of whom were nearing retirement or had already retired, lost millions of dollars because they had followed bad financial advice. In response to these and other events, the **Future of Financial Advice (FoFA)** reforms were proposed.

The FoFA reforms, which were enacted in 2012, drew an explicit connection between remuneration and poor customer outcomes. The legislation did that in the provisions made about conflicted remuneration, defined as: benefits (monetary and non-monetary) given to a **financial services licensee**, or a representative of a licensee, who gives financial product advice to persons as retail clients that 'because of the nature of the benefit or the circumstances in which it is given' could reasonably be expected to influence the choice of product recommended or product advice given to the client.¹⁸

¹⁶ Transcript, Wayne Byres, 29 November 2018, 7395–6.

¹⁷ ASIC, Media Release 18-081MR, 22 March 2018.

¹⁸ Corporations Act s 963A.

To the extent to which banks or their subsidiaries participated in the personal financial advice market, these provisions applied directly. But no wider application of the guiding premise of these FoFA amendments (that remuneration affects conduct) to general remuneration arrangements within the banks seems to have been identified or considered by APRA, the Australian Securities and Investments Commission (ASIC), Treasury, or the banks themselves until several years after the FoFA reforms came into effect.

1.1.2 International developments

By 2015, instances of serious misconduct associated with financial institutions in the United States, the United Kingdom and elsewhere had attracted much publicity. For example, in June 2012, Barclays plc, one of the world's largest and most important banks, had admitted that it had manipulated LIBOR (a benchmark rate fundamental to the operation of financial markets and the basis of trillions of dollars of financial transactions).¹⁹ Between 2012 and 2015, other banks admitted their parts in similar conduct.

These and other scandals prompted prudential concerns about effective governance, risk management, controls, and incentive-based compensation in Europe and North America.²⁰ Over \$320 billion in fines and restitution imposed in the United Kingdom, the United States and the European Union were thought to have affected banks' prudential standing and significantly reduced the value of their issued capital.²¹ Banks and regulatory authorities began to consider how to address misconduct.

In 2015, the FSB launched a work plan to reduce the risk of misconduct at financial institutions around the world. The work plan had a number of elements. It looked at:

¹⁹ Clayton S Rose and Aldo Sesia, 'Barclays and the LIBOR Scandal', *Harvard Business School Case 313-075*, January 2013, revised October 2014 <www.hbs.edu/faculty/Pages/item.aspx?num=43888>.

²⁰ FSB, Supplementary Guidance, 3.

²¹ FSB, Supplementary Guidance, 3–4.

- the relationship between governance frameworks and the risk of misconduct, including the ways in which ‘responsibility mapping’ could be used to strengthen the governance of conduct risk in financial institutions;²²
- the relationship between organisational culture and the risk of misconduct, and the work that supervisors can do to form a view about the culture of financial institutions;²³ and
- the relationship between remuneration and misconduct.²⁴

In 2016, as part of its work on the relationship between remuneration and misconduct, the FSB agreed to develop guidance on better practice in applying the Principles to manage the risk of misconduct. In March 2018, the FSB published the product of that work – the ‘Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices’ (the Supplementary Guidance). The Supplementary Guidance was directed specifically to the use of compensation tools to address misconduct. It recognised that:²⁵

Inappropriately structured compensation arrangements can provide individuals with incentives to take imprudent risks ... Costs may be imposed on firms and their customers not only by inappropriate risk-taking but also by misconduct that can result in harm to institutions, and their customers and other stakeholders, and impair trust in the financial system more generally. Compensation tools, along with other measures, can play an important role in addressing misconduct risk by providing both ex ante incentives for good conduct and ex post adjustment mechanisms for appropriate accountability when misconduct occurs.

²² FSB, *Reducing Misconduct Risks in the Financial Sector: Progress Report to G20 Leaders*, 4 July 2017, 1–2.

²³ FSB, *Reducing Misconduct Risks in the Financial Sector: Progress Report to G20 Leaders*, 4 July 2017, 3.

²⁴ FSB, *Reducing Misconduct Risks in the Financial Sector: Progress Report to G20 Leaders*, 4 July 2017, 3–4.

²⁵ FSB, *Supplementary Guidance*, 1.

The Supplementary Guidance did not alter the Principles, or establish additional principles. It explained how the Principles should be applied to address misconduct. The Supplementary Guidance emphasised that the compensation systems of financial services entities should be *designed* to promote ethical behaviour and compliance with laws and standards, and that they should be *implemented* so as to manage the risk of misconduct.²⁶ Among other things, the Supplementary Guidance said that compensation systems should include:²⁷

- ‘ex ante processes that embed non-financial assessment criteria such as the quality of risk management, degree of compliance with laws and regulations and the broader conduct objectives of the firm including the fair treatment of customers, into individual performance management and compensation plans at all levels of the organisation’; and
- ‘mechanisms to adjust variable compensation, including ... through in-year adjustment, and malus or clawback arrangements, which can reduce variable compensation after it is awarded or paid’.

Importantly, the Supplementary Guidance also said that prudential supervisors should ‘monitor and assess the effectiveness of firms’ compensation policies and procedures, including the application of compensation tools in addressing misconduct risk and related misconduct outcomes’.²⁸ That is, the Supplementary Guidance proposed that supervisors, like APRA, should play a central part in monitoring the way that remuneration systems are designed and implemented to address misconduct. FSB is continuing to work in this area. In November 2018, it published ‘Recommendations for National Supervisors: Reporting on the Use of Compensation Tools to Address Potential Misconduct Risk’ (the Recommendations).

1.1.3 Australian developments

While the work of the FSB progressed overseas, further attention was given to the relationship between remuneration and misconduct in Australia.

²⁶ FSB, Supplementary Guidance, 6.

²⁷ FSB, Supplementary Guidance, 6–7.

²⁸ FSB, Supplementary Guidance, 7.

In 2016, the Australian Bankers' Association (ABA) launched its 'Banking Reform Program'. As part of that program, the ABA appointed Mr Stephen Sedgwick AO to conduct an independent review into remuneration practices in retail banking. The review began in July 2016 and Mr Sedgwick provided his final report in April 2017. The report said that:²⁹

[S]ome current [remuneration] practices carry an unacceptable risk of promoting behaviour that is inconsistent with the interests of customers and should be changed. Some of these relate to management practices that may reduce the effectiveness of the bank's risk mitigation strategies. Other practices relate to the way incentives and remuneration are structured. The need for change is true of both direct (ie staff) and some third party channels ...

New approaches to retail bank remuneration are by no means a panacea. But the Issues Paper (issued by Mr Sedgwick in January 2017) has documented instances in retail banking and across the financial services sector more broadly, both in Australia and abroad, in which incentives have at least appeared to drive behaviour that was not in the best interests of customers and, on occasion, scandalously so.

Mr Sedgwick made 21 recommendations. He summarised the effect of the recommendations he made about retail bank staff (as distinct from introducers, referrers, franchisees and **mortgage brokers**) as being that:³⁰

- incentives will no longer be paid to any retail staff based directly or solely on sales performance (see Recommendations 2 and 7);
- eligibility to receive any personal incentive payments will instead be based on an assessment of that individual's contribution across a range of measures, of which sales (if included at all) will not be the dominant component (Recommendations 3, 4, 5 and 6), and the maximum available payments will be scaled back significantly for some roles (Recommendation 8);

²⁹ Sedgwick Review, Report, i.

³⁰ Sedgwick Review, Report, 7.

- retail bank culture will be demonstrably ethically and customer oriented (Recommendation 9);
- a significant investment will be undertaken, as necessary, to ensure that performance is managed consistently with such a philosophy, and supported by proactive steps to develop leadership and management skills at all levels so that management practices match the intent of the recommendations (Recommendations 10,11 and 12); and
- the board and the most senior managers of the bank will show clear and consistent leadership (Recommendations 13 and 14).

Each of the major banks told the Commission that it is committed to implementing the recommendations made by Mr Sedgwick.³¹

In 2017, APRA reviewed remuneration policies and practices across a sample of large financial institutions. One of the purposes of the review, focusing on APRA-regulated institutions, was ‘to gauge how their stated remuneration frameworks and policies were translated into outcomes for senior executives’.³² In April 2018, APRA published an information paper based on the review.

The paper noted that ‘other financial regulators and industry bodies’ had conducted reviews focused on remuneration ‘largely from the perspective of limiting the potential for misconduct’.³³ It went on to say that the link between remuneration and misconduct ‘is also of interest to APRA as a prudential supervisor’ but explained that this was ‘because conduct issues can provide additional insights into an organisation’s attitudes towards risk more generally’.³⁴ Unlike the FSB and other international bodies, however, APRA appears not to have considered dealing with the risk of misconduct

³¹ Transcript, Matthew Comyn, 19 November 2018, 6587; Transcript, Andrew Thorburn, 26 November 2018, 7040; Transcript, Shayne Elliott, 28 November 2018, 7318; Exhibit 7.48, Statement of Brett Tollmann, 6 November 2018, 17–18 [46], 20 [53].

³² CBA Prudential Inquiry, Final Report, 65.

³³ APRA, Information Paper, Remuneration Practices at Large Financial Institutions, April 2018, 6.

³⁴ APRA, Information Paper, Remuneration Practices at Large Financial Institutions, April 2018, 6.

as being an end in itself. Instead, for APRA, understanding an entity's attitude to the risk of misconduct was a means to understanding the entity's attitude to risk more generally.³⁵

In the *Interim Report*, I expressed the view that it would be surprising, and a cause for concern, if APRA's approach to prudential governance of remuneration remained as narrowly focused as its information paper suggested.³⁶ When he gave evidence in the seventh round of hearings, Mr Byres explained that the narrow focus of the information paper reflected the narrow focus of the prudential standards in their current form.³⁷ He acknowledged that the standards need to 'evolve and improve',³⁸ and said that APRA was in the process of changing its prudential standards and guidance to deal expressly with the potential for poorly designed and implemented remuneration systems to increase the risk of misconduct.³⁹

APRA must revise its prudential standards and guidance about remuneration. Mr Byres said that work is already underway at APRA to identify 'what ... good look[s] like',⁴⁰ and that he expects a revised standard will be made available for consultation next year.⁴¹ I encourage APRA to continue that work as expeditiously as possible.

I make some specific recommendations in relation to the content of the revised standards below, but those recommendations should not be taken to exhaust the changes that will be required. In preparing the revised standards and guidance, **APRA must bear steadily in mind that entities can and should use both the design and the implementation of remuneration and incentive systems to reduce the risk of misconduct. Misconduct can have significant consequences for financial soundness and stability. It undermines trust in the financial system.**

³⁵ APRA, Information Paper, Remuneration Practices at Large Financial Institutions, April 2018, 6.

³⁶ FSRC, *Interim Report*, vol 1, 320.

³⁷ Transcript, Wayne Byres, 29 November 2018, 7401.

³⁸ Transcript, Wayne Byres, 29 November 2018, 7401.

³⁹ Transcript, Wayne Byres, 29 November 2018, 7402.

⁴⁰ Transcript, Wayne Byres, 29 November 2018, 7405.

⁴¹ Transcript, Wayne Byres, 29 November 2018, 7405–6.

The use of remuneration systems to reduce the risk of misconduct is a legitimate – and necessary – subject of concern for a prudential regulator. Prudential regulation and supervision of remuneration arrangements must have, as one of its aims, the reduction of misconduct at financial institutions.

1.1.4 Further observations

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.

What I have said about local and international efforts to improve remuneration practices since the GFC shows that, until recently, the regulator with the power to create binding standards in relation to remuneration arrangements for ADIs, insurers and superannuation entities was focused on the potential for remuneration arrangements to affect the financial soundness of those entities. It had not focused, or not focused sufficiently directly, on the potential for remuneration arrangements to affect misconduct and compliance and, as a result, to diminish trust in and the reputation of individual entities and the Australian financial system generally.

In the sections that follow, I consider some of the failings that have been identified in relation to the remuneration practices of financial services entities, and the ways in which those failings can be addressed. In doing so, I will deal with the remuneration of executives separately from the remuneration of front line staff. While there are common features of the remuneration of both, there are important differences.

Like most international work in this area, APRA's prudential standards and guidance are directed to the remuneration of senior employees: the entities' executives.⁴² Accordingly, I begin by considering those employees.

⁴² APRA, Prudential Standard CPS 510, July 2017, [57]. I note that the requirements do encompass the remuneration arrangements for more junior staff, where their collective activities may affect the financial soundness of the institution.

1.2 Executive remuneration

Regulatory and other bodies considering the links between remuneration practices and misconduct have given particular attention to the remuneration of executives because it is the board and senior management of financial services entities who are responsible for, and have the greatest degree of control over, the way that risks – including compliance risk, conduct risk and regulatory risk – are managed within those entities.

To put that in more concrete terms, it is the board and senior management of financial services entities who are responsible for, and have the greatest degree of control over:

- whether the entity has a culture that encourages good customer outcomes and the sound management of risk – a culture in which employees ask, ‘what *should* I do?’ instead of ‘what *can* I do?’, and feel comfortable speaking up when they see that something is not right;
- whether the entity ensures that compliance issues are identified, escalated as required, and addressed promptly and effectively; and
- whether the entity has an open, transparent and constructive relationship with regulators.

When remuneration arrangements are designed or implemented in a way that sees executives rewarded with large bonuses despite their poor management of risks, those remuneration arrangements increase the likelihood that the entity will engage in misconduct, or conduct that falls below what the community expects. By contrast, when remuneration arrangements are designed and implemented in a way that properly takes into account the way that executives have managed risks – including compliance risk, conduct risk and regulatory risk – those remuneration arrangements will decrease the likelihood that the entity will engage in misconduct, or conduct falling below community standards and expectations. As I said earlier, an entity’s remuneration arrangements, especially variable remuneration programs, tell staff what the entity rewards and what the entity values.

I referred above to the way that remuneration arrangements are ‘designed’ and the way that those arrangements are ‘implemented’. Both the evidence before the Commission, and the work of APRA and the FSB, have shown

that problems can arise in each of these areas. A well-designed system can be undermined by poor implementation. Equally, a well-implemented but poorly-designed system is unlikely to achieve good results. And, a poorly-designed system is even less likely to achieve good results however competently it is implemented. The two areas (design and implementation) present different issues, and require separate consideration.

The issues demonstrated by the evidence before the Commission were often more about implementation than design. This is, perhaps, unsurprising, given that the focus of APRA's standards in relation to remuneration has been on the design of remuneration systems, and the focus of APRA's work on remuneration has, until recently, been on monitoring compliance with those standards of design.⁴³

1.2.1 Issues of design

The Commission received a large body of evidence about the design of executive remuneration systems in Australian banks and some other financial services entities. Unsurprisingly, the systems differed from entity to entity, but there were some features common to all the banks that gave evidence in the seventh round of the Commission's hearings.

- First, each system rewarded executives with a combination of fixed remuneration and variable remuneration. The proportion of fixed and variable remuneration varied depending on the role of the particular executive – for example, staff in risk and compliance roles often had a higher proportion of fixed remuneration compared to staff in other roles. The proportion of fixed and variable remuneration varied between entities. Notably, Bendigo and Adelaide Bank had a much higher proportion of fixed remuneration than the other entities,⁴⁴ and Macquarie had a much higher proportion of variable remuneration.⁴⁵
- Second, each system deferred part of the executives' variable remuneration. Notably, Bendigo also deferred part of its executives'

⁴³ Transcript, Wayne Byres, 29 November 2018, 7401–2.

⁴⁴ See generally Exhibit 7.141, Witness statement of Robert Johanson, 7 November 2018.

⁴⁵ See generally Exhibit 7.60, Witness statement of Nicholas Moore, 19 November 2018.

fixed remuneration.⁴⁶ Since 1 July 2018, for large ADIs, the minimum proportion of variable remuneration that must be deferred, and the minimum period of deferral, have been prescribed by the **Banking Executive Accountability Regime (BEAR)**.

- Third, many systems distinguished between short-term variable remuneration and long-term variable remuneration. The key differences between these types of variable remuneration tended to be that:
 - the amount of short-term variable remuneration that was payable depended on criteria assessed over the most recent financial year;
 - the amount of long-term variable remuneration that was payable depended on criteria assessed over several years;
 - while a proportion of short-term variable remuneration was often deferred, all long-term variable remuneration was always deferred; and
 - generally, only the most senior executives were eligible to receive long-term variable remuneration.
- Fourth, each system allowed the board of the entity to adjust executives' variable remuneration to reflect their management of risk. All systems allowed for this to occur through in-year adjustment of short-term variable remuneration, and through forfeiture of deferred remuneration that had not yet vested (referred to as 'malus'). Some systems also allowed for deferred remuneration that had already vested to be clawed back. I will consider how these mechanisms were applied in dealing with issues of implementation.⁴⁷

Those common features help to provide a framework within which to examine issues relating to the design of executive remuneration systems. There are four issues about which I will say something further:

- experimentation in the design of remuneration systems;

⁴⁶ See generally Exhibit 7.141, Witness statement of Robert Johanson, 7 November 2018.

⁴⁷ Exhibit 7.108, Witness statement of Lynda Dean, 2 November 2018, 7–8 [23(c)], 27 [87(f)].

- the proportion of fixed and variable remuneration;
- the design of variable remuneration; and
- the availability of clawback.

Experimentation in the design of remuneration systems

It was apparent from the evidence before the Commission as well as international work in this area – and unsurprising – that no-one has identified an ‘ideal’ or ‘optimal’ system of executive remuneration for financial services entities. Many have identified particular features of executive remuneration systems for those entities that are desirable – perhaps even necessary – to ensure that the remuneration systems of those entities properly reward and encourage good risk management, and contribute to reducing the risk of misconduct. I will say something further about some of those features below. But there being no agreed ‘ideal’ or ‘optimal’ remuneration system, there are limits to what can or should be regulated or prescribed. And it must be recognised and accepted that it may never be possible to identify a single ‘ideal’ or ‘optimal’ system. As the FSB said in its Principles, ‘financial firms differ in goals, activities and culture, as do jobs within a firm’.⁴⁸ One size does not fit all.

This is not necessarily a bad thing. Experience shows that better outcomes – and valuable information – often emerge only through trial and error. Financial services entities must be able (within limits) to try different forms of remuneration and incentive systems.

The qualification – ‘within limits’ – is, of course, critical. But those limits have been identified in the work of the FSB: in its Principles and in its Supplementary Guidance. As the Principles say, ‘[c]ompensation must be adjusted for all types of risk ... Risk adjustments should account for all types of risk, including difficult-to-measure risks such as liquidity risk, reputation risk and cost of capital’.⁴⁹ That is, financial metrics must not determine remuneration. Risk of all kinds, including reputation risk, compliance risk, and conduct risk, must be taken into account in both designing and implementing the remuneration system.

⁴⁸ FSB, Principles, 1.

⁴⁹ FSB, Principles, 2.

Within those limits, different forms of remuneration and incentive systems will be devised and applied. But trying new or different systems will have value only if:

- the systems are genuinely directed to encouraging good risk management and reducing the risk of misconduct; and
- the results of applying the system are reliably identified and, if possible, measured.

I say measured ‘if possible’ not only because the FSB’s Principles acknowledge that some risks are difficult to measure, but also because, in the end, what is being assessed is not just *what* people do but *how* they do it. ‘What’ can be measured; ‘how’ cannot.

APRA has an important part to play.

Mr Byres said that APRA was in the process of updating its prudential standards and guidance in relation to remuneration.⁵⁰ He said that, in doing so, APRA would incorporate lessons learned from the review that led to its information paper on remuneration practices in large financial services entities, as well as the Prudential Inquiry into CBA, and the FSB’s Supplementary Guidance.⁵¹

This work is important. It must be completed as soon as reasonably possible. I make three points about it.

First, the prudential standards should expressly require APRA-regulated institutions to design their remuneration systems to encourage sound management of non-financial risks, and to reduce the risk of misconduct. There may be several ways to do that. At a minimum, it could be added to the existing requirement that performance-based components of remuneration must be designed to encourage behaviour that supports an institution’s long-term financial soundness and risk management framework.⁵²

⁵⁰ Transcript, Wayne Byres, 29 November 2018, 7402.

⁵¹ Transcript, Wayne Byres, 29 November 2018, 7402.

⁵² APRA, Prudential Standard CPS 510, July 2017, [54].

Second, the prudential standards should expressly require the board of a financial 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. While it is currently a requirement for a remuneration committee to assess the effectiveness of the entity's remuneration policy,⁵³ I have seen little evidence to indicate that these assessments provide the board with sufficient information about how the remuneration system is being applied in practice and whether it is having the desired outcomes.

Third, APRA (and, where appropriate, ASIC) should do more to gather information about the way that remuneration systems are being applied in practice, and about whether those systems are actually encouraging sound management of non-financial risks, and reducing the risk of misconduct. I will say more about the approach that APRA has taken with respect to supervision of remuneration arrangements later in this section. For now, it is sufficient to observe that documents like the report of the Prudential Inquiry into CBA, and APRA's information paper on remuneration practices in large financial institutions, have great value in showing entities what good and bad remuneration practices look like. Further work of that kind will be important.

Proportion of fixed and variable remuneration

Effective management of the risk of misconduct does not depend on an entity dividing fixed and variable remuneration in one way rather than another. Here, too, there is no single 'right answer'. But if remuneration is to be divided between fixed and variable, the purposes of allowing variable remuneration must be clearly understood both by those who are to decide what should be paid and those who are to receive the payment.

Is part, or all of the variable remuneration to be paid *unless* there are disqualifying reasons? Or is part or all of it to be paid *only if* certain conditions are met? Effective management of risk, in all its forms, will depend on, among other things, how those questions are answered. In particular, effective management of risk will depend upon the criteria that will be applied in determining variable remuneration.

⁵³ APRA, Prudential Standard CPS 510, July 2017, [68(a)].

Design of variable remuneration

All of the four large banks, and both Macquarie and Bendigo, have remuneration arrangements under which:

- the performance of executives is assessed against a range of measures, including management of risk; and
- the board is able to make adjustments to the variable remuneration of executives to reflect their management of risk.

But each bank gives effect to those principles in different ways in respect of both short-term and long-term variable remuneration. The particular detail of the differences need not be described. But it is important to make some observations about long-term variable remuneration and, in particular, the conditions that determine whether an employee receives this part of the remuneration.

In its information paper on remuneration practices at large financial institutions, APRA observed that:⁵⁴

[F]or the majority of cases, the conditions which allow [long-term variable remuneration] to vest focused wholly on annual investor return measures such as total shareholder return (TSR) and return on equity (RoE). No apparent links to measures of long-term financial soundness or risk-adjusted performance measures (such as metrics relating to risk-adjusted return on capital) were observed.

Mr Byres described the current structure of long-term variable remuneration in Australia as being ‘particularly problematic in this regard’, and ‘out of step with how best practices in remuneration are evolving internationally’.⁵⁵ He considered that there was too much focus on ‘relative total shareholder return’ measures in determining whether long-term variable remuneration should vest, and described that as not being conducive to a broader, more holistic assessment of performance’.⁵⁶ He said that, internationally, APRA

⁵⁴ APRA, Information Paper, Remuneration Practices at Large Financial Institutions, April 2018, 18.

⁵⁵ Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, 109 [448].

⁵⁶ Transcript, Wayne Byres, 29 November 2018, 7403.

was seeing a shift away from financial metrics towards a greater emphasis on non-financial metrics.⁵⁷

In the last few years, some financial services entities in Australia have attempted to give greater weight to non-financial measures in the design of their long-term variable remuneration arrangements. It is instructive to take CBA as an example.

For many years, senior executives at CBA were entitled to participate in a long-term variable remuneration scheme. At the end of the financial year, each executive who was eligible to participate in the scheme would receive a particular number of reward rights. At the end of a four-year 'performance period', a determination would be made about whether those rights would vest. That determination depended on whether particular 'performance hurdles' had been met.⁵⁸ If the reward rights vested, they would be converted to CBA shares.

In the 2016 financial year, there were two performance hurdles:

- The first was a relative total shareholder return hurdle. This hurdle determined whether 75% of the reward rights would vest. It involved comparing CBA's total shareholder return over the four-year performance period with the total shareholder return of the 20 largest ASX-listed companies (excluding resources companies). If CBA was below the 50th percentile, none of the reward rights attributable to this hurdle would vest. If CBA was at or above the 75th percentile, all of the reward rights attributable to this hurdle would vest. In between those two figures, there was a sliding scale that determined how many reward rights would vest.⁵⁹
- The second hurdle was a customer satisfaction hurdle. This hurdle determined whether the other 25% of the reward rights would vest. It involved comparing CBA's performance on a customer satisfaction survey to the performance of other financial services entities.⁶⁰

⁵⁷ Transcript, Wayne Byres, 29 November 2018, 4703.

⁵⁸ Transcript, Catherine Livingstone, 21 November 2018, 6758.

⁵⁹ Transcript, Catherine Livingstone, 21 November 2018, 6758–9; CBA, Annual Report, 2016, 55.

⁶⁰ Transcript, Catherine Livingstone, 21 November 2018, 6759; CBA, Annual Report, 2016, 55.

In its 2016 remuneration report, CBA announced that it planned to make changes to these performance hurdles for the 2017 financial year. In particular, it planned to reduce the share of the reward rights to which the relative total shareholder return hurdle applied from 75% to 50%, and to add a new ‘people and community’ hurdle that would apply to 25% of the reward rights. The people and community hurdle would ‘measur[e] long-term progress in the areas of diversity and inclusion, sustainability and culture’.⁶¹

At CBA’s annual general meeting in 2016, more than 50% of the votes cast on the resolution to adopt the remuneration report were against the adoption of that report.⁶² Ms Catherine Livingstone, now Chair of CBA, attributed that result, in part, to the proposed changes to the structure of CBA’s long-term variable remuneration arrangements.⁶³ The following year, CBA abandoned that proposal, and replaced its customer satisfaction hurdle with two different non-financial measures, each applicable to 12.5% of the reward rights.⁶⁴ That year, more than 92% of the votes cast on the resolution to adopt the remuneration report were in favour of the adoption of that report.⁶⁵

Each year, a listed company must prepare a remuneration report,⁶⁶ and give its shareholders the opportunity at the company’s annual general meeting to vote on a resolution to adopt that report.⁶⁷ If more than 25% of the votes cast on that resolution are against the adoption of that report at two consecutive AGMs, the company must put to the vote a resolution calling for a spill of board positions.⁶⁸ This is referred to as the ‘two strikes’ rule.

⁶¹ Transcript, Catherine Livingstone, 21 November 2018, 6759–60; CBA, Annual Report, 2016, 56.

⁶² Transcript, Catherine Livingstone, 21 November 2018, 6757.

⁶³ Transcript, Catherine Livingstone, 21 November 2018, 6757.

⁶⁴ Transcript, Catherine Livingstone, 21 November 2018, 6764.

⁶⁵ CBA, *Results of 2017 Annual General Meeting* (16 November 2017) CBA <www.commbank.com.au/content/dam/commbank/about-us/shareholders/pdfs/2017-asx/2017-annual-general-meeting-results.pdf>.

⁶⁶ Corporations Act s 300A.

⁶⁷ Corporations Act s 250R.

⁶⁸ Corporations Act ss 250U, 250V.

It is intended to align the interests of the board (in setting the remuneration policy) and managers (via the incentives created by the remuneration policy) with the interests of the shareholders.⁶⁹

Several witnesses were asked whether they considered that the ‘two strikes’ rule was impeding boards from adjusting their remuneration policies to encourage positive outcomes not only for those shareholders looking to realise profit on sale of their shares but also customers and longer-term shareholders.

Ms Livingstone observed that some institutional shareholders appeared not to be using the vote on the remuneration report for its intended purpose. Instead, they used that vote, and the two strikes rule, to register dissatisfaction with other matters, not related to remuneration.⁷⁰ However, she observed that it was possible, with some work, to convince shareholders that ‘appropriate non-financial measures can be included in the long-term variable remuneration plan’.⁷¹

Dr Kenneth Henry, Chair of NAB said that he considered that the ‘two strikes’ rule requires boards to focus too much on financial measures in the design of their remuneration systems, at the expense of measures directed to things like reducing the risk of misconduct or ensuring good outcomes for customers.⁷²

Mr Robert Johanson, the Chair of Bendigo and Adelaide Bank observed that because institutional shareholders are more likely than other shareholders to vote at annual general meetings, they can have a significant influence on the direction of the company.⁷³ However, like Ms Livingstone, he indicated that with work, boards could convince institutional shareholders to support the use of non-financial measures. Fewer than 5% of votes cast on the resolution to adopt Bendigo and Adelaide Bank’s 2018 remuneration report

⁶⁹ See Explanatory Memorandum, Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011 (Cth), [8.30].

⁷⁰ Transcript, Catherine Livingstone, 21 November 2018, 6761–2.

⁷¹ Transcript, Catherine Livingstone, 21 November 2018, 6761.

⁷² Transcript, Kenneth Henry, 27 November 2018, 7184.

⁷³ Transcript, Robert Johanson, 29 November 2018, 7375–6.

were against the adoption of that report, despite the fact that Bendigo increased the weighting given to the non-financial performance measure for its long-term variable remuneration scheme from 30% to 35%.⁷⁴

Given that the ‘two strikes’ rule applies to all listed companies, any question about modifying that rule is beyond my Terms of Reference. Any review of its operation would be for others to undertake.

There remains, however, the point made by Mr Byres – that focusing only, or largely, on a measure of total shareholder return when deciding whether long-term variable remuneration should be paid does not allow consideration of all relevant aspects of the executive’s performance. In particular, I would add, it does not allow consideration of how the executive has managed risk.

APRA has been considering whether, in its prudential standards, it should set limits on the use of financial metrics in connection with long-term variable remuneration.⁷⁵ Consistent with what I have said about the principles that must inform the proper design of variable remuneration arrangements, and with international best practice, I consider that, in its revised prudential standards dealing with remuneration, APRA should set limits on the use of financial metrics in connection with long-term variable remuneration.

Availability of clawback

The final issue can be addressed briefly. Although the remuneration arrangements examined by the Commission generally allowed for the board to take the decision to forfeit part or all of the *unvested* portion of deferred remuneration, they very rarely provided for remuneration that had *vested* to be clawed back.

⁷⁴ Transcript, Robert Johanson, 29 November 2018, 7376–7.

⁷⁵ Transcript, Wayne Byres, 29 November 2018, 7403–5.

In many of the case studies considered by the Commission, the relevant misconduct was revealed only after some or all of the accountable executives had left, and their deferred remuneration had vested.

This was a particular issue in relation to fees for no service conduct, where the full scale of the issue only became apparent many years after the introduction of ongoing fee arrangements.⁷⁶ Where entities lacked arrangements to claw back remuneration from those accountable executives, there was no step that they could take.

This could have been avoided if entities had made provision to claw back remuneration that had vested. I can see no reason why every financial services entity should not have such arrangements. Doing so would be consistent with the FSB's Supplementary Guidance. And it would be consistent with the report of the Prudential Inquiry into CBA:⁷⁷

Clawback is not a feature of remuneration frameworks in financial institutions in Australia but this tool, were it designed to be readily exercised, would help to drive behaviours that avoid unsound risk management and strengthen accountability for senior management and other material risk-takers. The FSB Supplementary Guidance sets out eight recommendations, one of which includes clawback as a tool for how remuneration can be used to promote ethical behaviours and good conduct. The Panel believes that as part of adopting these recommendations, clawback could be a particularly effective tool for cases of serious misconduct.

In its revised prudential standards dealing with remuneration, APRA should require all APRA-regulated institutions to provide for the entity to claw back remuneration that has vested, in appropriate circumstances.

In this, as in all other aspects of remuneration, the effectiveness of the provision will depend on how it is applied.

⁷⁶ See, eg, Transcript, Kenneth Henry, 27 November 2018, 7121–2, 7130–2. See also Exhibit 7.80, Witness statement of Andrew Thorburn, 19 November 2018, 58 [201].

⁷⁷ CBA Prudential Inquiry, Final Report, 78–9.

1.2.2 Issues of implementation

Although good design of remuneration arrangements is critical to reducing the risk of misconduct, the issues demonstrated by the evidence before the Commission were often issues of implementation rather than design.

There are three issues connected with implementing remuneration arrangements about which I will say something further:

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

Risk-related adjustments

Several of the problems that can arise in connection with the implementation of risk-related adjustments to remuneration were demonstrated by the evidence about the process by which CBA's board determined the remuneration of the CEO and Group Executives in the 2016 financial year.

CBA released its 2016 remuneration report in August 2016. At that time, both ASIC and APRA had continuing investigations into CBA's life insurance business. CBA was aware of a number of other issues that became public over the course of the following year. These included: the anti-money laundering and counter-terrorism financing (or AML/CTF) issues that resulted in the Australian Transaction Reports and Analysis Centre (AUSTRAC) commencing a civil penalty proceeding; the 'fees for no service' issues; and the mis-selling of credit card insurance.⁷⁸ Further, in late 2015, APRA had expressed concerns to CBA about the effectiveness of its operational risk management framework.⁷⁹ APRA was concerned about a number of persistent significant risk issues that were not being dealt with effectively.⁸⁰

⁷⁸ Transcript, Catherine Livingstone, 21 November 2018, 6745.

⁷⁹ See Exhibit 7.31, 24 December 2015, Letter APRA to Narev Concerning Operational Risk Framework and Attached Report.

⁸⁰ Transcript, Wayne Byres, 29 November 2018, 7409.

Despite those issues, in that financial year, CBA's board rated the CEO and all but one of the Group Executives as having 'fully met' relevant requirements in relation to the management of risk.⁸¹

How did that come about?

The Chief Risk Officer told the board remuneration committee (and thus, the board) that he did not believe there were any risk issues or risk behaviours that would suggest that the short-term variable remuneration of the CEO or any of the Group Executives should be modified in any way.⁸² That opinion was supported by information that Ms Livingstone described in her evidence as 'not sufficient' and 'inadequate'.⁸³

Based on that opinion, the CEO recommended to the remuneration committee that there be no risk-related adjustment to the variable remuneration of any of the Group Executives in the 2016 financial year.⁸⁴ Despite the inadequacy of the information provided by the Chief Risk Officer, and the fact that the issues referred to above were known to the board, the remuneration committee accepted the Chief Risk Officer's recommendation not to modify the short-term variable remuneration of the CEO or any of the Group Executives, subject to one change – it made a 5% reduction to the variable remuneration of one of the Group Executives, to reflect the CommInsure matters.⁸⁵ The board accepted the remuneration committee's recommendation.

Ms Livingstone described the process that led to those remuneration outcomes as 'significantly inadequate',⁸⁶ and said that the outcomes themselves were 'patently inadequate' and 'inappropriate'.⁸⁷ I agree.

⁸¹ Transcript, Catherine Livingstone, 21 November 2018, 6752, 6757.

⁸² Transcript, Catherine Livingstone, 21 November 2018, 6749.

⁸³ Transcript, Catherine Livingstone, 21 November 2018, 6748.

⁸⁴ Transcript, Catherine Livingstone, 21 November 2018, 6752.

⁸⁵ Transcript, Catherine Livingstone, 21 November 2018, 6754.

⁸⁶ Transcript, Catherine Livingstone, 21 November 2018, 6746.

⁸⁷ Transcript, Catherine Livingstone, 21 November 2018, 6754, 6755.

What went wrong?

First, the information made available to the board about the risk management performance of the senior executives was plainly deficient. Among other things, it did not adequately inform the board of the nature or seriousness of issues that had been identified. It did not identify to the board who, among the Group Executives, was accountable for the issues. It made no real assessment of whether those executives had behaved in a way that exemplified the sound management of risks.

It is concerning that the information made available to the board was deficient in those ways. It is more concerning that the board did not seek more detailed information.

In subsequent years, the quality of the information provided to CBA's board about the risk management performance of CBA's executive has improved.⁸⁸

But I cannot say that the problem may not exist in other entities. As recently as April 2018, APRA observed in its information paper on remuneration practices at large financial institutions that its review 'noted instances of poor quality, incomplete or inadequate documentation' about risk management performance being provided to board committees.⁸⁹

All financial services entities, not just the largest, must examine carefully the findings set out in the report of the CBA Prudential Inquiry, and in APRA's information paper. All entities must consider, and keep considering, how they can improve the quality of information provided to boards and their committees in connection with remuneration decisions. And in this regard, as in all other aspects of board governance, 'quantity' of information is *not* the same as 'quality' of information. APRA should consider how it can require and encourage APRA-regulated institutions to improve the quality of that information when it updates its prudential standards and guidance in relation to remuneration.

⁸⁸ See Transcript, Catherine Livingstone, 21 November 2018, 6767–9.

⁸⁹ APRA, Information Paper, Remuneration Practices at Large Financial Institutions, April 2018, 26.

The second point to make about CBA's treatment of remuneration in 2016 is more general. Up to and including 2016, the CBA board appears to have been unwilling to make any significant adjustment to variable remuneration as a result of risk-related matters. Between the 2011 financial year and the 2016 financial year, there were only seven instances, involving five executives where an executive's short-term remuneration was reduced as a result of a risk issue.⁹⁰ With one exception, the reductions were 20% or less.⁹¹ And, in each case, the reason given for the reduction was damage to CBA's reputation.⁹² That is, it appears that, unless and until risk and compliance issues became publicly known, accountability for those issues was not reflected in adjustments to executive remuneration.

Of course, all of that changed at CBA in the 2017 financial year, when the short-term variable remuneration for the CEO and all Group Executives was reduced to zero, following the filing of AUSTRAC's proceeding alleging significant breaches of AML/CTF laws.⁹³ Further, less dramatic reductions were made in the 2018 financial year.⁹⁴

In the 2016 financial year, none of ANZ, NAB or Westpac made significant risk-related adjustments to the remuneration of its senior executives. By contrast, in the 2018 financial year:

- ANZ's board reduced the variable remuneration of four senior executives, including its CEO, for reasons related to risk, compliance or conduct.⁹⁵
- CBA's board reduced the short-term variable remuneration of all of its Group Executives by 20% for reasons relating to the findings of the Prudential Inquiry. CBA's CEO offered to forego all of his short-term variable remuneration for the 2018 financial year, and the board accepted this offer. Further reductions were applied to other senior executives for reasons related to risk compliance or conduct.⁹⁶

⁹⁰ Transcript, Catherine Livingstone, 21 November 2018, 6767.

⁹¹ Transcript, Catherine Livingstone, 21 November 2018, 6767.

⁹² Transcript, Catherine Livingstone, 21 November 2018, 6767–8.

⁹³ CBA, Annual Report, 2017, 67.

⁹⁴ CBA, Annual Report, 2018, 98–100.

⁹⁵ Exhibit 7.120, Witness statement of Shayne Elliott, 22 November 2018, 28–9 [115].

⁹⁶ CBA, Annual Report, 2018, 98.

- NAB's board reduced the variable remuneration of its senior executives by 10% to 75% for reasons related to risk, compliance or conduct.⁹⁷
- Westpac's board reduced the short-term variable remuneration of the CEO, Brian Hartzer, by 15%, and of all other Group Executives (except two) by 10%. It also made further reductions to the variable remuneration of three Group Executives.⁹⁸

It is encouraging to see that boards appear to have grasped the importance of implementing their remuneration policies in a way that encourages the sound management of non-financial risks, and reduces the risk of misconduct. It remains to be seen whether boards continue this practice in the coming years, where issues of remuneration and misconduct are not subject to the same public scrutiny as they have been during the life of this Commission.

Supervision of implementation

One way to ensure that boards continue to implement their remuneration policies in a way that encourages the sound management of non-financial risks, and reduces the risk of misconduct, is to ensure that there is ongoing and effective supervision of the way that boards discharge that responsibility.

In the case of APRA-regulated institutions, that supervision is properly the role of APRA. However, the evidence before the Commission indicated that, in the past, APRA's supervision of remuneration practices has been lacking.

Mr Byres explained that APRA's supervision teams do not normally collect information about the way that the remuneration arrangements of APRA-regulated institutions are applied in practice.⁹⁹ This is despite the fact that as long ago as 2009, the FSB's Principles stated that '[s]upervisory review of compensation practices must be rigorous and sustained and deficiencies must be addressed promptly with supervisory action'.¹⁰⁰ When APRA did collect information about the way that remuneration arrangements were

⁹⁷ NAB, Annual Report, 2018, 39.

⁹⁸ Westpac Group, Annual Report, 2018, 48.

⁹⁹ Transcript, Wayne Byres, 29 November 2018, 7410.

¹⁰⁰ FSB, Principles, 3.

applied in practice – in the context of the review that led to its information paper on remuneration practices at large financial institutions, and in the course of the Prudential Inquiry – it identified serious deficiencies in the way that those arrangements were being implemented. However, both of those reviews occurred in 2017 and 2018. For most of the period that APRA's standards and governance in relation to remuneration have been in force, APRA has not collected detailed information about the way remuneration arrangements have been applied in practice.¹⁰¹

As noted above, in November 2018, the FSB published its 'Recommendations for National Supervisors: Reporting on the Use of Compensation Tools to Address Potential Misconduct Risk'. The Recommendations complement the FSB's Supplementary Guidance by setting out the types of data that can support improved monitoring by supervisory authorities on the use of remuneration arrangements to address the risk of misconduct in financial services entities.¹⁰²

APRA should increase the intensity of its supervision of the way APRA-regulated institutions implement their remuneration frameworks. This will require APRA to collect more information about the way those frameworks are applied in practice, including information of the kind described in the FSB's Recommendations.

I recognise that increasing the intensity of supervision in this area will require additional resources. Mr Byres noted several times in his evidence that APRA's supervisory resources were limited, and that it was necessary for APRA to prioritise particular activities.¹⁰³ Mr Byres explained that the Government had recently provided APRA with additional resources to undertake this sort of work.¹⁰⁴ As the work of FSB shows, supervisory review of compensation practices should be rigorous and sustained. It is an essential part of the prudential supervisor's work and that should be reflected in the way in which APRA is funded.¹⁰⁵

¹⁰¹ Transcript, Wayne Byres, 29 November 2018, 7410.

¹⁰² FSB, *Recommendations for National Supervisors: Reporting on the Use of Compensation Tools to Address Potential Misconduct Risk*, 23 November 2018.

¹⁰³ See Transcript, Wayne Byres, 29 November 2018, 7411.

¹⁰⁴ Transcript, Wayne Byres, 29 November 2018, 7411.

¹⁰⁵ FSB, *Principles*, 3.

In addition to the activities and processes associated with the monitoring of remuneration arrangements, the work of FSB also shows that increased supervision of remuneration practices must be supported, where necessary, with prompt supervisory action.¹⁰⁶

Mr Byres said that since APRA introduced remuneration requirements into its prudential standards in 2010, it had never taken action against an APRA-regulated institution for failing to comply with those requirements.¹⁰⁷

I have already described the course of events about CBA's 2016 determination of variable remuneration for the CEO and senior executives. Mr Byres rightly accepted that APRA could, and should, have done more than it did in response to these events.¹⁰⁸ He said that APRA did not take these steps because it was an area in which APRA did not yet have 'sufficient expertise to really be confident challenging [CBA]'.¹⁰⁹

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. As I have said, this is a necessary part of the prudential supervisor's work.

Disclosure of consequences

The final issue can again be addressed briefly. Should entities disclose more information about risk-related adjustments to executive remuneration?

At the moment, listed companies are required to disclose prescribed information about executive remuneration in their annual reports, including the total amount of variable remuneration received by senior executives. Companies are not required, however, to disclose information about whether risk-related adjustments have been made to the remuneration of senior executives, and therefore are not required either to set out why the board made particular risk-related adjustments to executive remuneration.

¹⁰⁶ FSB, Principles, 3.

¹⁰⁷ Transcript, Wayne Byres, 29 November 2018, 7422.

¹⁰⁸ Transcript, Wayne Byres, 29 November 2018, 7417.

¹⁰⁹ Transcript, Wayne Byres, 29 November 2018, 7418.

When asked about that situation, Ms Livingstone said that ‘there would probably be merit in [disclosing] more detail on an individual basis as to what the risk-adjusted outcomes were’,¹¹⁰ and agreed that that would send a powerful message about the way that CBA responds to misconduct.¹¹¹

Mr Byres described disclosure of this kind of information as a ‘double-edged sword’.¹¹² His chief concern was that public disclosure of that kind might deter boards from making risk-related adjustments, if explaining the reasons for doing so would require the board to disclose risk-related issues that were otherwise known only within the institution.¹¹³

As I have said, **the remuneration arrangements of an entity show what the entity values. If the board reduces the variable remuneration of executives for their poor management of non-financial risks, and tells other staff that the variable remuneration of those who are accountable for particular events or forms of conduct has been reduced, it sends a clear message to all staff about both accountability and what kinds of conduct the board regards as unacceptable. No public disclosure should be required.**

Recommendation 5.1 – Supervision of remuneration – principles, standards and guidance

In conducting prudential supervision of remuneration systems, and revising its prudential standards and guidance about remuneration, APRA should give effect to the principles, standards and guidance set out in the Financial Stability Board’s publications concerning sound compensation principles and practices.

Recommendations 5.2 and 5.3 explain and amplify aspects of this Recommendation.

¹¹⁰ Transcript, Catherine Livingstone, 21 November 2018, 6782.

¹¹¹ Transcript, Catherine Livingstone, 21 November 2018, 6782.

¹¹² Transcript, Wayne Byres, 29 November 2018, 7407.

¹¹³ Transcript, Wayne Byres, 29 November 2018, 7407.

Recommendation 5.2 – Supervision of remuneration – aims

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.

Recommendation 5.3 – Revised prudential standards and guidance

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.

1.3 Front line remuneration

Much of the evidence the Commission obtained about remuneration of front line staff related to the front line or ‘customer-facing’ staff in banks. Much of the discussion below is framed with that context in mind. But what is said applies to any financial services entity that provides products or services to consumers. And, as will become apparent, many of the problems with which

I deal emerged most vividly in connection with the direct sale of life insurance products.¹¹⁴

Like senior executives, front line employees in banks, until recently, have typically been paid fixed and variable remuneration.

Front line variable remuneration has typically been awarded, at least in part, on the basis of financial metrics, which encourage the employee to sell products.

On its face, this is unsurprising. Banks are commercial enterprises. Why not encourage and reward sales? And focusing on sales or profits provides concrete, quantifiable measures of performance. What could be simpler or better?

There is a short and obvious answer. **Focusing only on *what* is to be sold is not enough. *How* the employee does the job is at least as important as *what* the employee does.**

***How as well as what* is important because it is not now, and cannot be, disputed that variable remuneration can pose ‘an unacceptable risk of promoting behaviour that is inconsistent with the interests of customers’.**¹¹⁵ **Yet the focus on *what* continues.**

In an example of this narrow focus, CBA CEO Mr Matthew Comyn described short-term variable remuneration as a way of ‘eliciting discretionary effort’ from front line staff, defining discretionary effort as ‘the difference between what [staff] might have otherwise done ... if they were paid a fixed remuneration, versus if they had at least a proportion of their remuneration’ that was variable.¹¹⁶ Yet, when the expression ‘discretionary effort’ is unpacked, it is evident that it is used as a euphemism for selling the bank’s products.¹¹⁷ And Mr Hartzer also provided some more concrete

¹¹⁴ See, eg, the Select case study from the fourth round of hearings and the ClearView and Freedom case studies from the sixth round of hearings.

¹¹⁵ Sedgwick Review, Report, i; Transcript, Matthew Comyn, 19 November 2018, 6535–6; Transcript, Brian Hartzer, 22 November 2018, 6868, 6872; Transcript, Andrew Thorburn, 26 November 2018, 7043; Transcript, Shayne Elliott, 28 November 2018, 7322.

¹¹⁶ Transcript, Matthew Comyn, 19 November 2018, 6530–1.

¹¹⁷ Transcript, Matthew Comyn, 19 November 2018, 6537.

examples of the activities that Westpac sought to encourage by including financial metrics as part of a variable remuneration balanced scorecard for its staff: contributing to a net growth in deposits, a net growth in the number of customers and a net growth of loan balances.¹¹⁸

Of course, variable remuneration is not the only way to encourage desired behaviour. Banks can provide staff with positive feedback on their performance, encourage them to take pride in their work, encourage them to take satisfaction from assisting customers, give them additional responsibilities and offer them a promotion or a higher base salary.¹¹⁹

Nor is variable remuneration the only way to discourage poor behaviour, or to respond to poor behaviour.¹²⁰ Disapproval of the behaviour of front line staff can be demonstrated in many different ways, including withholding a promotion, removing some of their duties, or taking a range of disciplinary actions.¹²¹

In the end, as Mr Shayne Elliott, CEO of ANZ emphasised, ANZ's 'experience and research [has shown that] the most powerful tool' to influence the conduct of staff is the influence exercised by a staff member's manager.¹²² And that is unsurprising. Good management of staff produces good outcomes for the business and for the customer.

The ends that entities are seeking to achieve through variable remuneration can be achieved through other means. Those other means are to be preferred, if they carry fewer intrinsic risks with them. And, as indicated by the evidence given by Mr Johanson, those other means may be no less effective. Mr Johanson explained that Bendigo had removed all sales-based incentives and commissions for front line staff more than 10 years before.¹²³ Those incentives and commissions had not been prevalent within

¹¹⁸ Transcript, Brian Hartzer, 22 November 2018, 6869.

¹¹⁹ See, eg, Transcript, Matthew Comyn, 19 November 2018, 6532.

¹²⁰ Transcript, Matthew Comyn, 19 November 2018, 6535; Transcript, Shayne Elliott, 28 November 2018, 7322.

¹²¹ Transcript, Matthew Comyn, 19 November 2018, 6535.

¹²² Transcript, Shayne Elliott, 28 November 2018, 7322.

¹²³ Transcript, Robert Johanson, 29 November 2018, 7379.

the bank prior to that time.¹²⁴ When asked whether the lack of sales-based incentives and commissions had affected employees' motivation to serve their customers, Mr Johanson said that it had not: the bank's employees got their satisfaction from 'being trusted' and from customers 'feeling [that] they're doing a good job'.¹²⁵

Ultimately, Mr Comyn said that he was 'open-minded' about removing variable remuneration for CBA's front line staff.¹²⁶

Banks have recently made, and are continuing to make, significant changes to the ways in which they remunerate front line staff.¹²⁷ Many of these changes appear to have been made in response to the recommendations contained in the Sedgwick Report, which I have discussed above.¹²⁸

In my view, full implementation of the Sedgwick recommendations is an important first step towards improving front line remuneration practices. But implementation will only improve these practices if banks implement the Sedgwick recommendations *both in letter and in spirit*. To give just a few examples, as indicated in the Sedgwick Report, banks must give careful attention to the way in which they structure any balanced scorecard that is used to award variable remuneration. Any financial metrics must be capped at 33% or less by 2020, and any non-financial metrics must be genuinely non-financial (Mr Sedgwick gave the example of classifying particular metrics as 'customer' metrics when they were arguably financial in character).¹²⁹ Banks must ensure that, where their remuneration systems allow for discretion, that discretion is exercised

¹²⁴ They had for a period been offered by a wealth business that the bank acquired: Transcript, Robert Johanson, 29 November 2018, 7379.

¹²⁵ Transcript, Robert Johanson, 29 November 2018, 7380.

¹²⁶ Transcript, Matthew Comyn, 19 November 2018, 6556.

¹²⁷ Transcript, Matthew Comyn, 19 November 2018, 6530, 6540; Transcript, Andrew Thorburn, 26 November 2018, 7045; Transcript, Shayne Elliott, 28 November 2018, 7316–20, 7322–3.

¹²⁸ Transcript, Matthew Comyn, 19 November 2018, 6540; Transcript, Brian Hartzer, 22 November 2018, 6868; Transcript, Andrew Thorburn, 26 November 2018, 7040–1, 7044; Transcript, Shayne Elliott, 28 November 2018, 7316.

¹²⁹ Sedgwick Review, Report, 8, note following Recommendation 3; FSRC, *Interim Report*, vol 1, 309–13.

consistently with the recommendations put forward by Mr Sedgwick.¹³⁰ And banks must avoid giving an unduly narrow meaning to particular terms within recommendations that are clearly intended to have some breadth (for example, the concept that banks are to ‘remove variable reward payments and campaign related incentives that are *directly* linked to sales or the achievement of sales targets’).¹³¹

But implementation of the Sedgwick recommendations is only the first step. As I have sought to emphasise above, banks must continue to give frequent and considered thought to how their variable remuneration systems are structured: to whether they are geared not only to *what* employees do but *how* they do it.

The evidence showed that a number of entities have taken, or are taking, these types of steps.

For example, in 2017, CBA removed financial metrics from the scorecard for its tellers.¹³² Mr Comyn said that this decision was made after a ‘lot of work’ considering appropriate remuneration structures, and in the hope that it might improve customer outcomes.¹³³ Since removing these metrics, Mr Comyn had not observed a deterioration in tellers’ performance.¹³⁴ He considered that, if asked, his staff members would consistently say that they preferred an environment without financial metrics, because:¹³⁵

there’s a very strong sense of [the] customer in our customer-facing teams, who actually take a lot of pride in doing a good job for their customers, and having their performance solely evaluated on their advocacy as opposed to an element of financial performance, I would say certainly for many ... if not the majority, [that] would be their preference.

¹³⁰ See, eg, Sedgwick Review, Report, 8, Recommendations 4 and 5 and note following Recommendation 5.

¹³¹ Sedgwick Review, Report, 8, Recommendation 2 (emphasis in original).

¹³² Transcript, Matthew Comyn, 19 November 2018, 6545–6; Exhibit 7.2, Witness statement of Matthew Comyn, 14 November 2018, 70 [253(e)].

¹³³ Transcript, Matthew Comyn, 19 November 2018, 6545.

¹³⁴ Transcript, Matthew Comyn, 19 November 2018, 6545, 6556.

¹³⁵ Transcript, Matthew Comyn, 19 November 2018, 6546.

ANZ has also experimented with its remuneration structures. By early 2017, prior to the publication of the Sedgwick Report, ANZ had conducted what it termed a ‘test and learn trial’ in one of its retail banking districts over 15 months.¹³⁶ During the trial, staff had individual sales targets removed from their incentive plans, and customer-based metrics were added in their place.¹³⁷ Customers reported increased levels of satisfaction with their branch experience, and good levels of staff engagement were recorded.¹³⁸ However, ANZ recorded that overall sales figures declined and that the district ‘performed worse on sales than the average across the entire Australian branch network’.¹³⁹ From this trial, ANZ concluded that there was ‘a role for sales targets and that incentive plans that take into account “whole of role” performance through a balanced scorecard approach are likely to be optimal’.¹⁴⁰

ANZ is now undertaking a broader project that is assessing whether ANZ’s reward structure – including its remuneration, performance management, recognition and benefits system – is properly aligned to ANZ’s purpose, culture and strategic direction.¹⁴¹ The project covers the whole organisation, including front line staff.¹⁴² Mr Elliott emphasised that the project is still being developed, and has not yet been approved,¹⁴³ but he said that ANZ expects to be able to implement any revised model in the financial year beginning 1 October 2019.¹⁴⁴

¹³⁶ Transcript, Shayne Elliott, 28 November 2018, 7317; Exhibit 7.131, February 2017, ANZ Response to Sedgwick Issues Paper, 1 [6.1].

¹³⁷ Transcript, Shayne Elliott, 28 November 2018, 7317; Exhibit 7.131, February 2017, ANZ Response to Sedgwick Issues Paper, 1 [6.1].

¹³⁸ Transcript, Shayne Elliott, 28 November 2018, 7317; Exhibit 7.131, February 2017, ANZ Response to Sedgwick Issues Paper, 1 [6.1].

¹³⁹ Transcript, Shayne Elliott, 28 November 2018, 7317; Exhibit 7.131, February 2017, ANZ Response to Sedgwick Issues Paper, 1 [6.1].

¹⁴⁰ Transcript, Shayne Elliott, 28 November 2018, 7317; Exhibit 7.131, February 2017, ANZ Response to Sedgwick Issues Paper, 2 [6.1].

¹⁴¹ Transcript, Shayne Elliott, 28 November 2018, 7319; Exhibit 7.132, 6 August 2018, Reimagining Reward Slide Pack, 4.

¹⁴² Transcript, Shayne Elliott, 28 November 2018, 7319.

¹⁴³ Transcript, Shayne Elliott, 28 November 2018, 7319.

¹⁴⁴ Transcript, Shayne Elliott, 28 November 2018, 7320.

Three key remuneration changes are being considered as part of ANZ's project.¹⁴⁵ Two are significant for present purposes. The first is changing the staff remuneration mix, so that staff receive an increased proportion of fixed remuneration and a decreased proportion of variable remuneration.¹⁴⁶ Mr Elliott explained that this proposal was in part motivated by a concern that ANZ had 'become too reliant on variable remuneration'.¹⁴⁷

The second is changing the basis for *allocating* variable remuneration: ANZ is considering moving to a system in which at least a portion of variable remuneration is awarded based on a group, rather than individual, financial metric. Mr Elliott explained that ANZ had formed the view that 'too many' of its staff members had individual performance-based variable remuneration as part of their remuneration mix.¹⁴⁸ Mr Elliott suggested that individual performance-based variable remuneration was:¹⁴⁹

flawed in an organisation like [ANZ's] where we require far more collaboration and team work to achieve good outcomes than ... the summation of an individual.

Mr Elliott indicated that he saw value in introducing **variable remuneration that was largely based on group performance for 'a broad range' of staff members** within ANZ, including call centre staff, branch staff, most operational staff, customer complaints staff and technology staff.¹⁵⁰

As part of the project, ANZ has trialled a pilot program in 50 branches, in which staff members no longer have individual financial targets but contribute to collective branch targets.¹⁵¹ The purpose of the program was to test the hypothesis that 'having team financial targets [would] improve

¹⁴⁵ Exhibit 7.132, 6 August 2018, Reimagining Reward Slide Pack, 9.

¹⁴⁶ Exhibit 7.132, 6 August 2018, Reimagining Reward Slide Pack, 9.

¹⁴⁷ Transcript, Shayne Elliott, 28 November 2018, 7320.

¹⁴⁸ Transcript, Shayne Elliott, 28 November 2018, 7320.

¹⁴⁹ Transcript, Shayne Elliott, 28 November 2018, 7320.

¹⁵⁰ Transcript, Shayne Elliott, 28 November 2018, 7321.

¹⁵¹ Transcript, Shayne Elliott, 28 November 2018, 7322; Exhibit 7.133, August 2018, Simplifying Performance Management Pilot CCC Roll Out, 2.

customer experience and banker experience, without adversely impacting business performance'.¹⁵² All other performance metrics remained unchanged.¹⁵³

Mr Elliott described the results of the pilot as 'encouraging'.¹⁵⁴ Among other things, customers appeared to be 'achieving better outcomes' or having a 'better experience', there has been 'no diminution in business performance', and ANZ staff 'say they prefer it'.¹⁵⁵ The feedback received from ANZ staff included that this system seemed to encourage better teamwork, better utilisation of staff members' individual areas of expertise and better education between staff, resulting in a 'more seamless experience' for ANZ's customers.¹⁵⁶ Mr Elliott accepted that 'a large number of positives ... have flowed from this pilot' and that there have not been any 'obvious drawbacks'.¹⁵⁷

There are evident advantages, and no obvious disadvantages, in moving to this type of model. And there may be advantages, and no disadvantages, in moving to other models, such as models that increase the amount of fixed remuneration paid to staff and decrease variable remuneration, or that remove variable remuneration altogether. The point is that this work should continue. Entities must challenge assumptions about how they can and should encourage certain behaviours and discourage others. In the end, good management, at all levels, is the best and most effective way to obtain the best results.

¹⁵² Transcript, Shayne Elliott, 28 November 2018, 7323; Exhibit 7.133, August 2018, Simplifying Performance Management Pilot CCC Roll Out, 2.

¹⁵³ Transcript, Shayne Elliott, 28 November 2018, 7323–4; Exhibit 7.133, August 2018, Simplifying Performance Management Pilot CCC Roll Out, 3.

¹⁵⁴ Transcript, Shayne Elliott, 28 November 2018, 7324.

¹⁵⁵ Transcript, Shayne Elliott, 28 November 2018, 7324; see also Exhibit 7.133, August 2018, Simplifying Performance Management Pilot CCC Roll Out, 2.

¹⁵⁶ Transcript, Shayne Elliott, 28 November 2018, 7325; see also Exhibit 7.133, August 2018, Simplifying Performance Management Pilot CCC Roll Out, 5.

¹⁵⁷ Transcript, Shayne Elliott, 28 November 2018, 7325.

Recommendation 5.4 – Remuneration of front line staff

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 on what staff do, but also how they do it.

Recommendation 5.5 – The Sedgwick Review

Banks should implement fully the recommendations of the Sedgwick Review.

2 Culture

I have said more than once in this chapter that an entity's remuneration and incentive arrangements show what the entity values. Hence, consideration of those arrangements may provide a useful starting point for an examination of the entity's culture. But an entity's remuneration and incentive arrangements are not the same as its culture. Culture is a broader concept that is also influenced by other matters.

As I have said, the culture of an entity can be described as 'the shared values and norms that shape behaviours and mindsets' within the entity.¹⁵⁸ It is 'what people do when no-one is watching'.¹⁵⁹ Culture can drive or discourage misconduct.¹⁶⁰

¹⁵⁸ Cf CBA Prudential Inquiry, Final Report, 81. I deliberately omit reference to a 'system' of shared values and norms if only to emphasise that culture is observed and described, not created apart from, or imposed on, the entity.

¹⁵⁹ G30, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, July 2015, 17.

¹⁶⁰ See generally FSB, Toolkit.

Three general points should be made:

- First, the culture of each entity is unique, and may vary widely within different parts of the entity.
- Second, there is no single ‘best practice’ for creating or maintaining a desirable culture, but one necessary aspect of a desirable culture is adherence to the basic norms of behaviour that I have described elsewhere in this Report:
 - obey the law;
 - do not mislead or deceive;
 - act fairly;
 - provide services that are fit for purpose;
 - deliver services with reasonable care and skill; and
 - when acting for another, act in the best interests of that other.
- Third, culture cannot be prescribed or legislated. Proper governance, a healthy culture, and accountability are desired outcomes, but they cannot be imposed by rules that say, ‘You must ...’ or ‘You may not ...’. ‘Culture is about behaviors. Behaviors in general are not amenable to legislation or regulation. ... Sustainable cultures need to arise from, and be embedded in banks’ [and other entities’] DNA’.¹⁶¹

Although culture cannot be prescribed or legislated, it can be assessed. As the report of the Prudential Inquiry into CBA shows, a careful and detailed assessment of the culture of an entity can be of great value. It can show how issues relating to culture are at the root of misconduct. And if those issues can be identified early, then steps can be taken to address them before the misconduct eventuates.

Culture can – and must – be assessed by financial services entities themselves. As I will explain, that is a requirement of APRA’s prudential standards (at least in relation to ‘risk culture’). It is also common sense.

¹⁶¹ G30, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, July 2015, 55.

Given the potential for aspects of an entity's culture to drive misconduct, an entity must form a view of its own culture, identify problematic aspects of that culture, develop and implement a plan to change them, and then re-assess to determine whether it has succeeded. Each financial services entity has primary responsibility for its own culture.

Of course, there are dangers in leaving questions of culture to financial services entities. Everyone can be blind to their own faults, and the same is true for financial institutions. This will often be so with those institutions that have the most problematic culture. It is these entities that will be unwilling to acknowledge problems and deal with them. Unwillingness of this kind is a feature of organisational culture that is highly likely to allow, even drive, misconduct. There is, therefore, an important role for regulators to supervise culture – that is, to:

- assess the entity's culture;
- identify what is wrong with the culture;
- 'hold up a mirror' to the entity,¹⁶² and educate the entity about its own culture;
- agree what the entity will do to change its culture; and
- supervise the implementation of those steps.

In this section of the chapter, I say something further about the assessment of culture by financial services entities, and by supervisors. I will begin with supervisors, before returning to consider what entities themselves have done, and must do.

2.1 Supervising culture

2.1.1 Responses to the GFC

While prudential supervisors have no doubt formed views about the culture of financial institutions for many years, the idea that the culture of financial institutions was directly linked to financial soundness and stability only appears to have taken hold in the wake of the GFC.

¹⁶² Exhibit 7.152, April 2018, Refocusing Risk Culture Pilot Reviews, 3.

As I have said, immediate responses focused on the potential for poor remuneration practices to undermine financial soundness and stability. But before long, attention turned to the failings of culture that had contributed to the crisis.

This focus on the culture of financial institutions was first (and most clearly) evident in the Netherlands. Mr Byres said that this:¹⁶³

Reflect[ed] the fact that their financial system had essentially imploded [and] their large banks ... all had to be rescued, effectively, by their governments ... [The Dutch] were thinking very hard about how do we avoid getting into this situation again.

Mr Byres said that, in looking for ways to avoid repeating the effects of the financial crisis on Dutch banks, the central bank – De Nederlandsche Bank (DNB) – ‘went quite assertively into the area of culture and risk culture’, and created a team, including organisational psychologists, that would make assessments of culture within financial institutions.¹⁶⁴

Since 2011, the DNB has overseen assessments of behaviour and culture in the institutions within its remit.¹⁶⁵ The DNB’s program is predicated on the idea that ‘[c]ulture and behaviour are essential elements for financial and prudential supervision, since the behaviour and culture of a financial organisation influence its financial and organisational performance’.¹⁶⁶ By 2015, the DNB had conducted 52 assessments of ‘banks, insurance companies, pension funds and trust offices’.¹⁶⁷ Most assessments focused

¹⁶³ Transcript, Wayne Byres, 30 November 2018, 7429.

¹⁶⁴ Transcript, Wayne Byres, 30 November 2018, 7429.

¹⁶⁵ See DNB, *Supervision of Behaviour and Culture: Foundations, Practice and Future Developments*, 2015, 13, 305–6. See also DNB, *The Seven Elements of an Ethical Culture: Strategy and Approach to Behaviour and Culture at Financial Institutions 2010–2014*, November 2009, 4, 8–9.

¹⁶⁶ See DNB, *Supervision of Behaviour and Culture: Foundations, Practice and Future Developments*, 2015, 37.

¹⁶⁷ See DNB, *Supervision of Behaviour and Culture: Foundations, Practice and Future Developments*, 2015, 16–17.

on senior management.¹⁶⁸ According to the DNB, more than half of the boards assessed ‘showed serious problems with regard to their board culture’.¹⁶⁹

Although the DNB appears to have acted first in this area, it was not alone. In November 2012, the FSB published a paper about the need for more intense and effective supervision of systemically important financial institutions.¹⁷⁰ Among other things, the paper recommended that supervisors, like APRA, explore ways to formally assess the risk culture of financial institutions.¹⁷¹

Following on from that recommendation, in April 2014, the FSB published its ‘Guidance on Supervisory Interaction with Financial Institutions on Risk Culture’ (the Guidance).¹⁷² Consistent with the FSB’s focus on financial soundness and stability in the period following the GFC, the Guidance focused specifically on the ‘risk culture’ of financial institutions, rather than their organisational culture more generally. The Guidance said that:¹⁷³

Weaknesses in risk culture are often considered a root cause of the global financial crisis, headline risk and compliance events. A financial institution’s risk culture plays an important role in influencing the actions and decisions taken by individuals within the institution and in shaping the institution’s attitude toward its stakeholders, including its supervisors.

¹⁶⁸ See DNB, *Supervision of Behaviour and Culture: Foundations, Practice and Future Developments*, 2015, 19.

¹⁶⁹ See DNB, *Supervision of Behaviour and Culture: Foundations, Practice and Future Developments*, 2015, 19.

¹⁷⁰ FSB, *Increasing the Intensity and Effectiveness of SIFI Supervision: Progress Report to the G20 Ministers and Governors*, 1 November 2012.

¹⁷¹ FSB, *Increasing the Intensity and Effectiveness of SIFI Supervision: Progress Report to the G20 Ministers and Governors*, 1 November 2012, 3.

¹⁷² FSB, *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture: A Framework for Assessing Risk Culture*, 7 April 2014.

¹⁷³ FSB, *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture: A Framework for Assessing Risk Culture*, 7 April 2014, 1.

A sound risk culture consistently supports appropriate risk awareness, behaviours and judgements about risk-taking within a strong risk governance framework. A sound risk culture bolsters effective risk management, promotes sound risk-taking, and ensures that emerging risks or risk-taking activities beyond the institution's risk appetite are recognised, assessed, escalated and addressed in a timely manner.

Like other documents released before the launch of the FSB's work plan in relation to misconduct in 2015, the Guidance did not identify particular risks with which it was concerned. Instead, it was directed to 'risk culture' and 'risk management' generally. Having been framed as part of the FSB's response to the GFC, it is likely that those to whom the Guidance was addressed would have understood it as referring principally to financial risks – that is, those risks with the most obvious and immediate potential to affect the financial soundness of the firm.

APRA's work on culture – in particular, risk culture – began at around this time.¹⁷⁴

In 2014, APRA released a draft of CPS 220, a new prudential standard in relation to risk management.¹⁷⁵ That draft prudential standard would have introduced a requirement for the board of an APRA-regulated institution to 'ensure that a sound risk management culture is established and maintained throughout the institution'.¹⁷⁶ Mr Byres said that this proposed requirement met with considerable opposition, particularly from company directors.¹⁷⁷ There was a general concern among directors about the extent to which non-executive directors could 'ensure' anything (without descending into management), and a more specific concern about the extent to which directors could influence the risk culture of an institution.¹⁷⁸

¹⁷⁴ Transcript, Wayne Byres, 29 November 2018, 7393.

¹⁷⁵ Transcript, Wayne Byres, 30 November 2018, 7430.

¹⁷⁶ Transcript, Wayne Byres, 30 November 2018, 7430.

¹⁷⁷ Transcript, Wayne Byres, 30 November 2018, 7430.

¹⁷⁸ Transcript, Wayne Byres, 30 November 2018, 7430–1.

In response to those concerns, APRA changed the draft.¹⁷⁹ The prudential standard that was ultimately issued in January 2015 required the board of an APRA-regulated institution,¹⁸⁰ among other things, to ensure that it:¹⁸¹

- *forms a view* of the risk culture in the institution, and the extent to which that culture supports the ability of the institution to operate consistently within its risk appetite;
- identifies any desirable changes to the risk culture; and
- ensures the institution takes steps to address those changes.

Risk culture is a narrower concept than organisational culture. An entity's risk culture is one aspect of its culture. Risk culture depends on the organisational norms and behaviours that determine how risks are identified, understood, discussed and acted on.¹⁸² Although the relevant risks are described in CPS 220 as the material risks facing the institution –being ‘those that could have a material impact, both financial and non-financial, on the institution or on the interests of depositors [or] policyholders’¹⁸³ – it appears that the emphasis at the time CPS 220 was issued was on financial risks.¹⁸⁴

Another important development in Australia at this time was the establishment of a Governance, Culture and Remuneration (GCR) team within APRA.¹⁸⁵ Mr Byres explained that the creation of this team reflected a number of considerations:¹⁸⁶

- that risk culture was a nebulous concept, and that APRA needed to develop a more systematic approach to examining and assessing how boards were approaching their new obligations;

¹⁷⁹ Transcript, Wayne Byres, 30 November 2018, 7431.

¹⁸⁰ Defined for the purposes of this prudential standard as not including an RSE licensee. APRA's Prudential Standard SPS 220 applies to RSE licensees.

¹⁸¹ APRA, Prudential Standard CPS 220, April 2018, cl 9(b) (emphasis added).

¹⁸² APRA, Information Paper, Risk Culture, October 2016, 7–8.

¹⁸³ APRA, Prudential Standard CPS 220, April 2018, 5–6 [20].

¹⁸⁴ See APRA, Prudential Standard CPS 220, April 2018, 7 [26].

¹⁸⁵ Transcript, Wayne Byres, 29 November 2018, 7398.

¹⁸⁶ Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, 94 [375].

- that APRA's supervisors were not well equipped to tackle a new area of interest without additional specialist support;
- that supervising risk culture was, internationally, at an embryonic stage, and that stronger connections with peer agencies were needed to draw on international experience; and
- that APRA lacked a central core of expertise in remuneration (and, to a lesser extent, governance), and that the three issues were inextricably linked.

2.1.2 Linking culture and conduct

In the first half of 2015, international bodies began to draw more explicit links not only between risk culture and financial soundness, but also between organisational culture and misconduct.

As I have said, the FSB launched its work plan on measures to address the risk of misconduct in May 2015. Part of that work plan concerned the relationship between organisational culture and the risk of misconduct, and the work that supervisors could do to form a view about the culture of financial institutions.¹⁸⁷

In July 2015, the Group of Thirty (G30) published 'Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform'.¹⁸⁸ The report said that, because '[b]anking is, in 2015, at a low point in terms of customer trust, reputation, and economic returns':¹⁸⁹

¹⁸⁷ See FSB, *Reducing Misconduct Risks in the Financial Sector: Progress Report to G20 Leaders*, 4 July 2017, 2–3.

¹⁸⁸ G30, the Consultative Group on International Economic and Monetary Affairs Inc, is an international body of leading financiers and academics that aims to deepen understanding of international economic and financial issues, and to explore the international repercussions of decisions taken in the public and private sectors. See <www.group30.org>.

¹⁸⁹ G30, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, July 2015, 11.

[t]here must be a sustained focus on conduct and culture by banks and the banking industry, boards, and management. Firms and their leaderships need to make major improvements in the culture within the banking industry and within individual firms.

The report insisted that prudential supervisors should have an important monitoring function, saying that ‘conduct-related prevention, using a range of informal and formal supervisory tools, backed up by robust enforcement, can produce a better outcome for society.’¹⁹⁰ The report also emphasised that:¹⁹¹

Supervisors should look on cultural questions as root cause analysis and intervene when they see demonstrably serious problems as opposed to making culture a generalized additional supervisory add-on.

Despite the emphasis on the relationship between conduct and culture in the G30’s paper, until very recently, there has only been limited *overt* attention given in Australia, by entities or by regulators, to issues about conduct and culture. Particular events of misconduct have been dealt with when they came to light, but regulators gave little or no public attention to what general responses should be made either to events that were then coming to light in Australia or to what had happened in other jurisdictions.

That proposition is perhaps best illustrated by considering the work of APRA’s GCR team following its establishment in 2015.

One of the first major pieces of work that team completed was a review of how APRA-regulated institutions were complying with the requirement for the board to form a view of the institution’s risk culture.¹⁹² That review resulted in an information paper entitled ‘Risk Culture’, which APRA published in October 2016.¹⁹³

¹⁹⁰ G30, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, July 2015, 15.

¹⁹¹ G30, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, July 2015, 64.

¹⁹² Transcript, Wayne Byres, 30 November 2018, 7435.

¹⁹³ Transcript, Wayne Byres, 30 November 2018, 7435.

For the most part, the information paper focused on risk culture as it related to the management of financial risk. The examples APRA gave in the information paper of poor risk culture were the failure of HIH Insurance in 2001; increased risk-taking in the life insurance industry, particularly with respect to **group life insurance**; and what it called the sacrificing of sound market practices for the origination of residential mortgage loans in favour of preserving market share and growth.¹⁹⁴

Towards the end of the information paper, APRA indicated that it intended to 'refine and sharpen its approach to assessing risk culture' through a program of pilot risk culture reviews.¹⁹⁵ Mr Byres explained that 'what we were flagging [there] was that instead of [risk culture] being a part-time or adjunct or add-on to some other primary activity, that we would actually try and do some reviews where the primary purpose was to assess culture or risk culture'.¹⁹⁶

The first of those reviews commenced in July 2017, and was completed in November 2017.¹⁹⁷ APRA made an independent assessment of the relevant entity's culture, through work including surveys, interviews, document reviews, focus groups and observations.¹⁹⁸ A second review had been planned to commence in October 2017, but was overtaken by the announcement of APRA's Prudential Inquiry into CBA.¹⁹⁹

APRA's Prudential Inquiry into CBA marked a watershed in APRA's approach to issues of governance, culture and remuneration.

Mr Byres said that, from 2016, the APRA supervision team responsible for CBA had identified 'a raft of issues that [the team was] pursuing' with CBA.²⁰⁰ He acknowledged that APRA's ordinary supervisory activity

¹⁹⁴ APRA, Information Paper, Risk Culture, October 2016, 4.

¹⁹⁵ APRA, Information Paper, Risk Culture, October 2016, 24.

¹⁹⁶ Transcript, Wayne Byres, 30 November 2018, 7436.

¹⁹⁷ Transcript, Wayne Byres, 30 November 2018, 7436.

¹⁹⁸ Transcript, Wayne Byres, 30 November 2018, 7436.

¹⁹⁹ Transcript, Wayne Byres, 30 November 2018, 7436–7.

²⁰⁰ Transcript, Wayne Byres, 29 November 2018, 7420.

had not been fully effective at addressing these issues, or bringing about cultural change at CBA.²⁰¹

On 3 August 2017, AUSTRAC instituted proceedings against CBA alleging failures to comply with AML/CTF laws.²⁰² On 28 August 2017, APRA appointed a panel to conduct an inquiry into CBA. The panel's terms of reference were 'to examine the frameworks and practices in relation to governance, culture and accountability within the CBA group' so as to identify, assess and consider certain identified matters and recommend (in effect) what initiatives or remedial actions (over and above those then being undertaken by CBA) needed to be undertaken.²⁰³

For the first time, APRA took public steps to examine a regulated institution's 'frameworks and practices in relation to governance, culture and accountability'.²⁰⁴ And one of the particular matters the panel was required to examine was whether CBA's remuneration frameworks, or their implementation, were conflicting with 'sound risk management and compliance outcomes'.²⁰⁵

The panel made its report in April 2018. In that report, the panel made 35 recommendations, in relation to: the board and senior leadership; risk management and compliance; issue identification and escalation; financial objectives and prioritisation; accountability; remuneration; culture and leadership; and remediation initiatives.²⁰⁶ CBA has agreed to implement all of the recommendations.²⁰⁷

But the value of the Inquiry goes beyond its application to CBA. The report provides a very valuable, publicly available account of the ways in which

²⁰¹ Transcript, Wayne Byres, 30 November 2018, 7438; Exhibit 7.150, Undated, Reflections Following Prudential Inquiry by James Douglas, 4.

²⁰² *Chief Executive Officer of AUSTRAC v CBA*, FCA, NSD1305 of 2017, Statement of Agreed Facts and Admissions <www.austrac.gov.au/sites/default/files/statement-agreed-facts-admissions-3june2018.pdf>.

²⁰³ CBA Prudential Inquiry, Final Report, 105.

²⁰⁴ CBA Prudential Inquiry, Final Report, 105.

²⁰⁵ CBA Prudential Inquiry, Final Report, 105.

²⁰⁶ CBA Prudential Inquiry, Final Report, 102–4.

²⁰⁷ See Enforceable Undertaking, APRA and CBA, 30 April 2018 <www.apra.gov.au/sites/default/files/20180430-CBA-EU-Executed.pdf>.

failings of culture, governance and remuneration can act as drivers of misconduct. And it explains how those problems can be addressed.

Recognising the broader value of the Inquiry, APRA required each of the major banks (and many other large APRA-regulated institutions) to complete a self-assessment of the entity against the matters identified in the Prudential Inquiry report. Some made that assessment without external assistance; others engaged one or more consultants. The final versions of those self-assessments were provided to APRA at the end of November 2018.

2.1.3 The way forward

Despite recognising the value of analysing organisational culture as the Prudential Inquiry and the first of the pilot risk culture reviews did,²⁰⁸ the evidence indicated that APRA was not planning to undertake further work of that kind. Instead, it was planning to refocus its risk culture review program. Rather than making independent assessments of the culture of financial services entities, APRA would seek to assess the way that the boards of financial institutions form a view of the risk culture of those institutions.²⁰⁹

On its face, this refocusing of the risk culture review program represents a retreat to the approach adopted by APRA in connection with its information paper on risk culture. If that is right, I consider that the direction in which APRA is headed is not desirable.

As both the FSB and the G30 have made clear, there is an important role for supervisors in assessing the culture of financial services entities. I agree with the view of the G30 that '[s]upervisors should look on cultural questions as root cause analysis and intervene when they see demonstrably serious problems as opposed to making culture a generalized supervisory add-on'.²¹⁰ I also agree with the view of the G30 that:²¹¹

²⁰⁸ Transcript, Wayne Byres, 30 November 2018, 7438.

²⁰⁹ Transcript, Wayne Byres, 30 November 2018, 7437.

²¹⁰ G30, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, July 2015, 64.

²¹¹ G30, *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform*, July 2015, 64.

It is essential that there be enough supervision resources, and with the right skill sets/seniority and expert support if needed, to engage constructively with banks on these issues. The main objective should be early problem identification and bank-led corrective action. Conduct and values should be part of mainstream supervisory processes as opposed to a separate add-on.

In April 2018, the FSB released ‘Strengthening Governance Frameworks to Mitigate Misconduct Risks: A Toolkit for Firms and Supervisors’. Among other things, the Toolkit states that supervisors should:²¹²

- build a supervisory programme focused on culture to mitigate the risk of misconduct;
- use a risk-based approach to prioritise for review the firms or groups of firms that display significant cultural drivers of misconduct;
- use a broad range of information and techniques to assess the cultural drivers of misconduct; and
- engage firms’ leadership with respect to observations on culture and misconduct.

In its November 2018 Recommendations for National Supervisors, FSB made recommendations ‘intended to support supervisors in their dialogue with firms, and to foster the development of better practice’.²¹³

Each of the steps and recommendations proposed by FSB should inform APRA’s supervision of the culture of APRA-regulated institutions.

I recognise that increasing the intensity of supervision in this area will require additional resources. As I noted earlier, Mr Byres explained that APRA’s supervisory resources were limited, and that it was necessary for APRA to prioritise particular activities.²¹⁴

²¹² FSB, Toolkit, 5.

²¹³ FSB, *Recommendations for National Supervisors: Reporting on the Use of Compensation Tools to Address Potential Misconduct Risk*, 23 November 2018, 4

²¹⁴ See Transcript, Wayne Byres, 29 November 2018, 7411.

But, the work of the FSB, G30 and international practice more generally shows that this work is essential to the proper prudential supervision of banks and, in my view, other large APRA-regulated institutions. Because it is an essential part of prudential supervision, APRA must have the resources to do it.

2.2 Changing culture

As I have said, each financial services entity is responsible for its own culture. Each must form a view of its culture, identify problems, develop and implement a plan to deal with them, and then determine whether the changes it has made have been effective.

Doing this will take time and effort. How much time and how much effort are shown by what ANZ has been doing.

Mr Elliott said that, during 2016, ANZ's internal audit team designed a cultural assessment tool, focused on organisational culture.²¹⁵ The tool measures four key 'levers' that are thought to affect ANZ's culture and the way that people within ANZ work:²¹⁶

- leadership (tone from the top);
- middle management (tone from the middle);
- risk environment; and
- transparency ('speak up' culture).

The internal audit team makes its assessments in four steps. First, it engages with 'business leadership' to clarify the assessment process and determine its scope, and to seek input on the questions that it will ask.²¹⁷ Second, it conducts an online survey of the relevant employees,

²¹⁵ Transcript, Shayne Elliott, 29 November 2018, 7344.

²¹⁶ Transcript, Shayne Elliott, 29 November 2018, 7345; Exhibit 7.136, 4 October 2017, Internal Audit Culture Assessment Board Presentation, 6, Appendix 1.

²¹⁷ Transcript, Shayne Elliott, 29 November 2018, 7345; Exhibit 7.136, 4 October 2017, Internal Audit Culture Assessment Board Presentation, 7, Appendix 1.

with a target response rate of 60%.²¹⁸ The team then undertakes a statistical analysis of the data returned.²¹⁹ Third, it conducts focus groups and individual interviews to clarify what are the cultural strengths and challenges, and it undertakes associated root cause analysis.²²⁰ Fourth, it engages with the business about the outcomes of the survey.²²¹ ‘Engagement with the business’ has a number of different aspects, including:²²²

- presenting an executive summary to the leadership team;
- the leadership team developing an action plan over a three-month period, with oversight from the internal audit team; and
- continuing engagement with management to discuss the effectiveness of the agreed actions, with further formal re-assessments undertaken as needed.

By 30 June 2018, ANZ’s internal audit team had conducted more than 30 culture assessment reviews, covering more than 21,000 of ANZ’s employees.²²³ Sixteen of those assessments were completed in ANZ’s 2018 financial year.²²⁴ ANZ has begun re-assessing certain business units so that it can evaluate how the culture of those units has changed over time.²²⁵ Mr Elliott explained the need for re-assessment by saying that

²¹⁸ Transcript, Shayne Elliott, 29 November 2018, 7345; Exhibit 7.136, 4 October 2017, Internal Audit Culture Assessment Board Presentation, 7, Appendix 1.

²¹⁹ Transcript, Shayne Elliott, 29 November 2018, 7345; Exhibit 7.136, 4 October 2017, Internal Audit Culture Assessment Board Presentation, 7, Appendix 1.

²²⁰ Transcript, Shayne Elliott, 29 November 2018, 7345; Exhibit 7.136, 4 October 2017, Internal Audit Culture Assessment Board Presentation, 7, Appendix 1.

²²¹ Transcript, Shayne Elliott, 29 November 2018, 7345; Exhibit 7.136, 4 October 2017, Internal Audit Culture Assessment Board Presentation, 7, Appendix 1.

²²² Transcript, Shayne Elliott, 29 November 2018, 7345; Exhibit 7.136, 4 October 2017, Internal Audit Culture Assessment Board Presentation, 7, Appendix 1.

²²³ Transcript, Shayne Elliott, 29 November 2018, 7346.

²²⁴ Transcript, Shayne Elliott, 29 November 2018, 7346.

²²⁵ Transcript, Shayne Elliott, 29 November 2018, 7346.

sampling needs to be done ‘on a regular basis so that you can see change. Otherwise ... it’s all very interesting, but [without] see[ing] any actual outcome, it’s largely pointless’.²²⁶

When asked how the results of these audits were received by the relevant business units, Mr Elliott said:²²⁷

[W]hen this first idea came up, I have to admit I was a little sceptical about doing a cultural audit, how exactly would that work, what exactly would they ask, how reliable would the data be, because we already do a lot of surveys. So we piloted it ... And the feedback from the team, the recipients, a very senior person at the bank ... was that this [feedback] was enormously valuable information, and it gave them the ability to not only get this feedback, but do something about it.

Mr Elliott said that this work had played a part in changing ‘the culture and the conversation at the most senior level of the bank’ and he said that his team, the Board and the Human Resources Committee all cared about, and are giving consistent consideration to, the results of the culture audits.²²⁸

In addition to these area-based culture reviews, ANZ also undertakes much larger-scale culture reviews. Every year or two years, ANZ conducts entity-wide ‘My Voice’ surveys.²²⁹ The 2018 survey received more than 15,000 responses.²³⁰ Mr Elliott described the findings of these surveys as ‘an incredibly valuable piece of data’, because, he said, they tell ANZ what its staff ‘really think’ about the business.²³¹

In its most recent report on banking culture, the G30 identified what it said were some of the ‘key lessons ... repeatedly raised in the interviews by financial sector leaders as they reflected on the lessons learned and the future of banking culture’.²³²

²²⁶ Transcript, Shayne Elliott, 29 November 2018, 7348–9.

²²⁷ Transcript, Shayne Elliott, 29 November 2018, 7348.

²²⁸ Transcript, Shayne Elliott, 29 November 2018, 7349.

²²⁹ Transcript, Shayne Elliott, 29 November 2018, 7350.

²³⁰ Transcript, Shayne Elliott, 29 November 2018, 7350.

²³¹ Transcript, Shayne Elliott, 29 November 2018, 7351.

²³² G30, *Banking Conduct and Culture: A Permanent Mindset Change*, November 2018, xii–xiii.

- ‘Managing culture is not a one-off event, but a continuous and ongoing effort that must be integrated into day-to-day business operations.’
- ‘Leadership always matters, and banks must embed conduct and culture messages and expectations from the top down, through middle management down to the teller in their organization. There is increasing awareness that tone from above is as important as tone from the top, and this requires a shift in how managers at all levels of the organization are trained, promoted and supported.’
- ‘While cultural norms and beliefs cannot be explicitly measured, the behaviours and outcomes that culture drives can and should be measured’.

The G30 also observed that the decade since the GFC had been a decade of ‘slow progress and uneven results’ for banking culture.²³³

It cannot be doubted that reform of organisational culture is difficult. Dr Henry said that it could take 10 years to embed the culture that NAB was striving to achieve.²³⁴ Mr Elliott was more optimistic. He said that with an ‘obsessive focus by management to say that [culture] is really important [and] to lead by example’, cultural shifts could begin to be seen within two or three years.²³⁵

As I have said, every financial services entity, named in the Commission’s reports or not, must look to its culture. Given the conduct and events described in the Commission’s reports, some entities must change their culture and their governance. That will require continuing effort ‘integrated into day-to-day business operations’. It will require leadership from within the entities and continued attention by boards, senior executives and others within the entities as well as consideration and attention by APRA as prudential regulator.

²³³ G30, *Banking Conduct and Culture: A Permanent Mindset Change*, November 2018, xii–xiii.

²³⁴ Transcript, Kenneth Henry, 26 November 2018, 7115.

²³⁵ Transcript, Shayne Elliott, 29 November 2018, 7354.

Recommendation 5.6 – Changing culture and governance

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; and
- determine whether the changes it has made have been effective.

What entities must do can be stated in the form of a recommendation expressed only at a level of generality that some may too easily say 'does not apply to us'. But it does. It applies to every financial services entity, named or not named in the work of the Commission. And 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.

What the Recommendation requires is much more than an exercise in 'box-ticking'. Its proper application demands intellectual drive, honesty and rigour. It demands thought, work and action informed by what has happened in the past, why it happened and what steps are now proposed to prevent its recurrence. Above all, it demands recognition that the primary responsibility for misconduct in the financial services industry lies with the entities concerned and with those who manage and control them: their boards and senior management.

The Recommendation, although it is expressed generally, can and should be seen as both reflecting and building upon all the other recommendations that I make. As I have explained in the introduction to this Report, all of the recommendations are informed by underlying principles that reflect basic norms of conduct and seek to answer four key questions. That is why, in the Introduction, I set out the recommendations not only in the order in which they appear in this Report but also in a way that drew out connections between them. 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.

Recommendation 5.7 – Supervision of culture and governance

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.

3 Governance

Coming now to the third of the principal themes of this chapter, as I said earlier, governance refers to all of the structures and processes by which an entity is run. It embraces not only by whom, and how, decisions are made, but also the values or norms to which the processes of governance are intended to give effect. Notions of accountability lie at the heart of governance. Who is to be held accountable for what is done or not done? How are those who are accountable held to account?

In 2006, in response to major corporate collapses, both in Australia (HIH Insurance) and overseas (Enron, Worldcom), APRA published prudential standards about governance.²³⁶ The increased regulation of corporate governance in response to those collapses:²³⁷

sought to ensure that companies [would] operate in a way that is transparent and open and that minimises the risk of loss to stakeholders from mismanagement, fraud and conflicts of interest, as well as other factors that may motivate directors and managers of companies to operate in a manner that is detrimental to the interests of stakeholders.

Failings of corporate governance received less direct attention in the wake of the GFC than did failings in compensation practices and organisational culture (in particular, attitudes to risk). The GFC was seen as having been precipitated by compensation practices and problems of culture that contributed to the poor management of financial risks.

More recently, however, issues of governance have again received explicit attention.

²³⁶ Prudential Standards APS 510, GPS 510 and LPS 510 were all introduced in May 2006 and took effect from 1 October 2006. Prudential Standard CPS 510 was introduced in 2011, consolidating the three earlier Prudential Standards.

²³⁷ Explanatory Statement, Banking (Prudential Standard) Determination No 2 of 2006 (Cth); Explanatory Statement, Insurance (Prudential Standard) Determination No 5 of 2006 (Cth).

In particular, the Prudential Inquiry into CBA highlighted the ways in which governance failings at CBA contributed to the reputational damage it had suffered. The panel concluded that:²³⁸

- there was inadequate oversight and challenge by the CBA Board and its gatekeeper committees of emerging non-financial risks;
- it was unclear who in CBA was accountable for risks, and how they were to be held accountable;
- issues, incidents and risks were not identified quickly, and were not managed and resolved with sufficient urgency; and
- not enough attention was being given to compliance.

The introduction of the BEAR for large ADIs in July 2018 has intensified the attention given to accountability.

Connections between failings in governance and the occurrence of misconduct can be examined under three headings: the role of the board, the entity's priorities and accountability.

The evidence before the Commission showed that too often, boards did not get the right information about emerging non-financial risks; did not do enough to seek further or better information where what they had was clearly deficient; and did not do enough with the information they had to oversee and challenge management's approach to these risks.

The evidence also showed that too often, financial services entities put the pursuit of profit above all else and, in particular, above the interests of their customers, and above compliance with the law. When financial services entities did have regard to risks, they gave priority to financial risks, leaving their frameworks for the management of non-financial risks underdeveloped.

The evidence further showed that too often, it was unclear who within a financial services entity was accountable for what. Without clear lines of accountability, consequences were not applied, and outstanding issues were left unresolved.

²³⁸ CBA Prudential Inquiry, Final Report, 3.

3.1 The role of the board

Boards cannot operate properly without having the right information. And boards do not operate effectively if they do not challenge management.

Two instances examined in evidence can be used to explain and justify those propositions. Both show the importance of a board getting the right information and using it effectively.

3.1.1 CBA and AML/CTF

CBA's internal audit department identified issues with CBA's compliance with AML/CTF laws in 2013, 2015 and 2016.²³⁹ In each of those years, internal audits gave the issues a 'red' rating – the most serious rating available.²⁴⁰

In 2016, although the 'red' rating was reported to the board's audit committee, the audit report on which that rating was based was not provided to the committee.²⁴¹ Ms Livingstone said that during her time on the audit committee, she could not recall anybody asking for a copy of that audit report, or any other audit report.²⁴²

The minutes of the meeting at which the 'red' rating was reported to the audit committee did not record the committee members challenging management's assurances that the matter was being dealt with.²⁴³ Ms Livingstone said that at the board meeting in October 2016, she had challenged management about the AML/CTF issues.²⁴⁴ The minutes of the meeting make no reference to an exchange of that kind.²⁴⁵ Ms Livingstone said that at the meeting, she did not receive satisfactory answers to her questions, stating:²⁴⁶

²³⁹ Transcript, Catherine Livingstone, 20 November 2018, 6697.

²⁴⁰ Transcript, Catherine Livingstone, 20 November 2018, 6697.

²⁴¹ Transcript, Catherine Livingstone, 20 November 2018, 6702.

²⁴² Transcript, Catherine Livingstone, 20 November 2018, 6702.

²⁴³ Transcript, Catherine Livingstone, 20 November 2018, 6707–8.

²⁴⁴ Transcript, Catherine Livingstone, 21 November 2018, 6727–8.

²⁴⁵ Transcript, Catherine Livingstone, 21 November 2018, 6730.

²⁴⁶ Transcript, Catherine Livingstone, 21 November 2018, 6727–8.

My judgment as a director at that time was further questioning of that detail would serve little purpose at that time, because it would simply elicit further unsatisfactory answers. What was clear to me was that neither management nor internal audit could articulate the problem that they were trying to solve, let alone identify the root cause of that problem. And, unfortunately, that judgment was borne out by subsequent events.

I cannot say whether other directors held a similar view.

What is clear is that when the audit committee was informed in December 2016 of the third 'red' rated audit report for AML/CTF issues, it did not do enough. The committee did not ask to see a copy of the audit report. It did not challenge, or at least adequately challenge, management about why three audit reports for the same issue over four years had all been rated 'red', or about management's assurances that the matter was being dealt with. When asked what the committee did to hold management to account for the failings and require management to fix those failings, Ms Livingstone said:²⁴⁷

the discussion ... would have been ... how long is it going to take and what's happening, but I think, as is clear from what has happened, those matters were being addressed over time. It was taking too long. And there were always responses, 'Yes, we're doing this, yes, we're spending that money'. So these responses were taken as assurance that the issue was being addressed, but I absolutely accept that ... that was an inadequate conclusion on the part of the audit committee and the board.

Ms Livingstone accepted that she and her colleagues on the audit committee did not give sufficient attention to the significant non-financial risks associated with CBA's failings in relation to AML/CTF. And she accepted that she did not do enough to hold management to account to ensure that the AML/CTF problems were fixed in a timely manner.²⁴⁸

3.1.2 NAB and adviser service fees

The second example concerned NAB, and its conduct in relation to the charging of adviser service fees to members of superannuation funds.

²⁴⁷ Transcript, Catherine Livingstone, 20 November 2018, 6708.

²⁴⁸ Transcript, Catherine Livingstone, 20 November 2018, 6709.

The relevant subsidiaries of NAB began charging superannuation fund members adviser service fees in 2008 or 2009.²⁴⁹ In about the middle of 2014, NAB's subsidiaries began to identify issues with the charging of those fees.²⁵⁰ Although one of NAB's subsidiaries reported a significant breach in relation to those issues to ASIC and APRA in December 2014,²⁵¹ the issues were not brought to the attention of NAB's board until August 2015.²⁵²

When the issues were reported to the board, the information that was provided about them was inadequate. Not enough was done to make it clear that the issues were not new, but were being reported to the board for the first time.²⁵³ Not enough was done to convey to the board the seriousness of the issues, and the fact that ASIC was already engaged in relation to those issues.²⁵⁴ And not enough was done to make clear to the board the potential consequences of the issues for the business.²⁵⁵

Negotiations between NAB and ASIC in relation to the adviser service fees issues dragged on for years. NAB made many proposals to ASIC about how it would investigate the issues and compensate members, and ASIC rejected those proposals – describing them more than once as not being 'customer centric'.²⁵⁶ While these negotiations dragged on, NAB was not remediating its customers.

NAB's board did not do enough to impress upon management the importance of getting the issue resolved, and making an appropriate proposal to ASIC. This was most evident when, in April 2018 – more than three years after issues about adviser service fees were first reported to ASIC – NAB made a proposal to ASIC, a proposal that NAB CEO Mr Andrew Thorburn accepted, with the benefit of hindsight, should not have

²⁴⁹ Transcript, Kenneth Henry, 27 November 2018, 7121.

²⁵⁰ Transcript, Kenneth Henry, 27 November 2018, 7121.

²⁵¹ Transcript, Kenneth Henry, 27 November 2018, 7121.

²⁵² Transcript, Kenneth Henry, 27 November 2018, 7127.

²⁵³ Transcript, Kenneth Henry, 27 November 2018, 7128.

²⁵⁴ Transcript, Kenneth Henry, 27 November 2018, 7129.

²⁵⁵ Transcript, Kenneth Henry, 27 November 2018, 7131–2.

²⁵⁶ See Transcript, Kenneth Henry, 27 November 2018, 7160.

been made.²⁵⁷ The proposal prompted a blunt response from ASIC in May 2018:²⁵⁸

The proposed resolution set out in your letter fails to adequately reflect any insight into the seriousness of the suspected misconduct, which took place over an extended period of time and affects a substantial number of customers.

...

For a significant period of time, NAB has suggested various remediation methodologies that ASIC has consistently rejected as unacceptable, and the latest proposal retreats even further from what we would expect NAB to consider to be in the interests of its customers.

Dr Henry said that when he read what ASIC wrote, he was ‘appalled’.²⁵⁹ But, despite that reaction, it still took NAB until September 2018 to agree a position with ASIC about the remediation of some of its customers. Even as late as November 2018 (when NAB’s Chair and CEO were to give evidence to the Commission) NAB had not agreed with ASIC what NAB would do in relation to the customers of its aligned licensees.²⁶⁰

It is plainly not the role of the board to review every piece of correspondence that goes out the door. But it is the role of the board to be aware of significant matters arising within the business, and to set the strategic direction of the business in relation to those matters. When management is acting in a way that is delaying the remediation of customers, and damaging the bank’s relationship with regulators, it is appropriate for the board to intervene and say, ‘Enough is enough. Fix this, and fix it now’.

Dr Henry would go no further than saying that he wished NAB’s board had stepped in sooner.²⁶¹ In my view, it is clear that NAB’s board should have acted sooner to impress on management the importance of resolving this

²⁵⁷ Transcript, Andrew Thorburn, 26 November 2018, 7078.

²⁵⁸ Exhibit 5.77, 9 May 2018, Letter from ASIC to Cook and Smith, 1–2.

²⁵⁹ Transcript, Kenneth Henry, 27 November 2018, 7162.

²⁶⁰ Transcript, Kenneth Henry, 27 November 2018, 7165.

²⁶¹ Transcript, Kenneth Henry, 27 November 2018, 7166.

issue quickly, and resolving it in a way that was in the interests of NAB's customers.

3.1.3 What the examples show

Boards must have the right information in order to discharge their functions. In particular, boards must have the right information in order to challenge management on important issues including issues about breaches of law and standards of conduct, and issues that may give rise to poor outcomes for customers. Without the right information a board cannot discharge its functions effectively.

When I refer to boards having the *right* information, I am not referring to boards having *more* information. As I noted earlier, it is the quality, not the quantity, of information that must increase. Often, improving the *quality* of information given to boards will require giving directors *less* material and more information.

I do not pretend to be able to offer any single answer to how boards can ensure that they receive the right information. But boards and management must keep considering how to present information about the right issues, in the right way.

Boards must also use the information that they have to hold management to account. Boards cannot, and must not, involve themselves in the day-to-day management of the corporation. Nothing in this Report should be taken to suggest that they should. The task of the board is overall superintendence of the company, not its day-to-day management. But an integral part of that task is being able and willing to challenge management on key issues, and doing that whenever necessary.

The two examples I have given are both instances where the board did not have the information necessary to challenge management effectively; did not seek out that information; and did not do enough to challenge management about serious issues that had the ability to affect the interests of the banks' customers, the banks' relationships with regulators, and the reputation of the bank more broadly.

3.2 Priorities

Proper governance requires setting priorities. Setting priorities requires choices. Sometimes the choice is between conflicting goals or conflicting courses of action; often the choice is about application of resources, timing or relative importance.

In the present context, two different, but closely related choices are considered:

- first, the choice to pursue profit above all else – in particular, above the interests of customers, and above compliance with the law; and
- second, when financial services entities have had regard to risks, the choice to give priority to financial risks, leaving their frameworks for management of non-financial risks underdeveloped.

3.2.1 The pursuit of profit

As I said in the *Interim Report*, many of the case studies considered in the Commission showed that the financial services entity involved had chosen to give priority to the pursuit of profit over the interests of customers and above compliance with the law.²⁶²

Some have sought to explain this emphasis on the pursuit of profit as reflecting the fact that a financial services entity is ultimately accountable to its shareholders. That proposition requires close examination.

All entities that are incorporated and have a share capital have responsibilities, and are accountable, to their shareholders. It is shareholders who will elect directors and, in the case of publicly listed companies, will vote to adopt, or not adopt, remuneration reports. It is shareholders who will give effect to the ‘two strikes rule’ that may see the entire board spilled.²⁶³

²⁶² To give only one example, see Transcript, Michael Winter, 17 September 2018, 5955.

²⁶³ Corporations Act ss 250U–250Y.

These forms of accountability are, of course, important. But they do not mark the boundaries of the matters that the boards of financial services entities must consider in the course of performing their duties and exercising their powers. That other considerations bear upon those decisions is most evident in the case of the largest financial services entities.

Each of the largest entities is systemically important. The long-term stability and performance of each is important to the proper performance of the national economy. It follows, therefore, that the boards of those entities must have regard to those enduring requirements. And the requirements are neither wholly captured by nor completely reflected in the day-to-day share price of the entity or some measurement of ‘total shareholder return’ over some period. The horizon of these larger entities must lie well beyond the next announcement of results.

This gives rise to a further point about the nature and extent of directors’ duties. Directors must exercise their powers and discharge their duties in good faith in the best interests of the corporation, and for a proper purpose.²⁶⁴ That is, it is the *corporation* that is the focus of their duties. And that demands consideration of more than the financial returns that will be available to shareholders in any particular period. Financial returns to shareholders (or ‘value’ to shareholders) will always be an important consideration but it is not the *only* matter to be considered. The best interests of the corporation cannot be determined by reference *only* to the current or most recent accounting period. They cannot be determined by reference only to the economic advantage of those shareholders on the register at some record date. Nor can they be judged by reference to whatever period *some* of those shareholders think appropriate for determining *their* results.

²⁶⁴ Corporations Act s 181(1). See also the ‘business judgment rule’ in s 180(2), which depends, among other things, on the director or other officer rationally believing that the judgment made ‘is in the best interests of the corporation’.

It is not right to treat the interests of shareholders and customers as opposed. *Some* shareholders may have interests that are opposed to the interests of other shareholders or the interests of customers. But that opposition will almost always be founded in differences between a short term and a longer-term view of prospects and events. Some shareholders may think it right to look only to the short term.

The longer the period of reference, the more likely it is that the interests of shareholders, customers, employees and all associated with any corporation will be seen as converging on the corporation's continued long-term financial advantage. And long-term financial advantage will more likely follow if the entity conducts its business according to proper standards, treats its employees well and seeks to provide financial results to shareholders that, in the long run, are better than other investments of broadly similar risk.

Financial services entities are no different. In the longer term, the interests of all stakeholders associated with the entity converge. And the burden of the evidence from the chief executives of all four large banks was that a bank's best earnings opportunity comes from long-term relationships with its customers. That is why, as Mr Hartzler said: 'banking is an annuity business'.²⁶⁵

Regardless of the period of reference, the best interests of a company cannot be reduced to a binary choice. And financial services entities are no different. Pursuit of the best interests of a financial services entity is a more complicated task than choosing between the interests of shareholders and the interests of customers.

²⁶⁵ Transcript, Brian Hartzler, 22 November 2018, 6863: 'So the way we think about this business is that banking is ultimately an annuity business, the value comes from having long-term relationships with customers, and that, that is – it's best thought of as a service business rather than a product business.'

3.2.2 The importance of non-financial risks

When financial services entities have considered risk and risk management, they have focused on financial risks, rather than non-financial risks.

Mr Comyn said that one of the key things that CBA had learned from the report of the Prudential Inquiry was that there was '[n]ot enough capability in the management of non-financial risk, particularly in operational risk and in ... compliance'.²⁶⁶ He acknowledged that CBA had 'an enormous amount of work to do to improve our management of non-financial risk'.²⁶⁷ Dr Henry also accepted that at NAB there was 'insufficient attention given to the management' of non-financial risks.²⁶⁸

Given the focus on financial soundness and stability in the wake of the GFC, it is not surprising that after 2009, financial services entities placed significant emphasis on the management of financial risk.

This emphasis was also apparent in APRA's prudential standard about risk management, CPS 220, which was released in January 2015. As well as introducing the requirement for boards to 'form a view' of an institution's risk culture, mentioned earlier, CPS 220 requires APRA-regulated institutions²⁶⁹ to take various steps associated with the prudent management of risk, including maintaining a risk management framework and a risk appetite statement.²⁷⁰ Although an entity's risk management framework and risk appetite statement must deal with all material risks, including non-financial risks, the apparent focus of CPS 220 is on financial risks. Of the different types of risk enumerated in CPS 220, only one – operational risk – specifically directs attention to the non-financial risks referred to above.

As discussed earlier in this chapter, from about 2015, the focus internationally shifted to misconduct in financial institutions, and the ways in which the risk of misconduct could be reduced.

²⁶⁶ Transcript, Matthew Comyn, 19 November 2018, 6523. See CBA Prudential Inquiry, Final Report, 6.

²⁶⁷ Transcript, Matthew Comyn, 19 November 2018, 6521.

²⁶⁸ Transcript, Kenneth Henry, 26 November 2018, 7101.

²⁶⁹ Defined for the purposes of CPS 220 as not including an RSE licensee. Prudential Standard SPS 220 applies to RSE licensees.

²⁷⁰ APRA, Prudential Standard CPS 220, July 2017, 3–4 [13].

The types of risk associated with misconduct – compliance risk, conduct risk, regulatory risk, operational risk – are more difficult to measure than most types of financial risk. In the period following the introduction of CPS 220, many financial services entities struggled to develop frameworks for the effective management of these types of risks (and other non-financial risks).

So, for example, in November 2015, APRA conducted a review of CBA's operational risk management framework.²⁷¹ APRA expressed concern that CBA's existing framework was not effectively identifying, escalating and addressing significant operational risks, and required CBA to take steps to improve that framework.²⁷² And, by the time of the Prudential Inquiry in 2017 and 2018, APRA still had concerns about the effectiveness of CBA's systems and processes for the management of operational and compliance risk.

The Prudential Inquiry into CBA recommended that CBA establish a 'non-financial risk committee' at the Group Executive level. One aim of the committee is to 'increase the visibility of operational risk and compliance at senior management and Board level'.²⁷³ CBA has established that committee²⁷⁴ with Mr Comyn saying that:²⁷⁵

All of the participants would say that it's invaluable and, obviously, there was a clear deficiency and gap in the way we operated previously.

Some financial services entities devoted inadequate resources to compliance, and did not give compliance staff a strong enough voice in the business. But this, too, is changing.

One example makes the point sufficiently. Allianz's Chief Risk Officer, Ms Lori Callahan, accepted that in the past, Allianz had not devoted

²⁷¹ Transcript, Catherine Livingstone, 20 November 2018, 6710.

²⁷² Transcript, Catherine Livingstone, 20 November 2018, 6710.

²⁷³ CBA Prudential Inquiry, Final Report, 25–6.

²⁷⁴ Transcript, Matthew Comyn, 20 November 2018, 6667.

²⁷⁵ Transcript, Matthew Comyn, 20 November 2018, 6670.

adequate resources to compliance.²⁷⁶ She noted that Allianz had taken steps to increase the seniority of some risk and compliance roles and she emphasised the importance of risk and compliance staff having sufficient seniority to challenge management.²⁷⁷

Paragraph 43 of CPS 220 requires entities to have ‘a designated compliance function that assists senior management of the institution in effectively managing compliance risks’,²⁷⁸ and provides that the compliance function ‘must be adequately staffed by appropriately trained and competent persons who have sufficient authority to perform their role effectively, and have a reporting line independent from business lines’.²⁷⁹

Mr Byres accepted that the references to compliance and internal audit in the prudential standards were ‘fairly cursory and short’, and that APRA would ‘need to think about how we give them more prominence in our assessment of risk management because it has traditionally been ... [assessed from a] financial soundness perspective’.²⁸⁰ He said that his reflection on the instances of misconduct reported to the Commission in response to the requests for information sent in January 2018 was that ‘compliance and audit functions are not strong enough in organisations’.²⁸¹

Obviously, the prudent management of financial risks by financial services entities is and will always remain important. But financial services entities must now accept that financial risks are not the only risks that matter. The prudent management of non-financial risks is equally important. Financial services entities must give sufficient attention, and devote sufficient resources, to the effective management of non-financial risks. APRA should give consideration to how that requirement can be made more prominent in its prudential standards.

²⁷⁶ Transcript, Lori Callahan, 18 September 2018, 5991. See also Transcript, Lori Callahan, 18 September 2018, 6057.

²⁷⁷ Transcript, Lori Callahan, 18 September 2018, 5989, 6021.

²⁷⁸ APRA, Prudential Standard CPS 220, April 2018, 11 [43].

²⁷⁹ APRA, Prudential Standard CPS 220, April 2018, 11 [43].

²⁸⁰ Transcript, Wayne Byres, 30 November 2018, 7443.

²⁸¹ Transcript, Wayne Byres, 30 November 2018, 7443.

3.3 Accountability

Accountability is centrally important to any consideration of culture, governance and remuneration.

Clear accountability is vital to effective governance. It ensures that issues are resolved, and resolved effectively. It fosters a culture where risks are managed soundly. It lies at the heart of the proper operation of any variable remuneration and incentive system. It is accountability that determines what consequences must follow when things go wrong (and where credit is due when things are done well).

The report of the Prudential Inquiry into CBA observed that:²⁸²

A lack of accountability is a common theme underlying several of the issues observed in this Inquiry. This contributed to: an inability to identify who is accountable when things have gone wrong; inadequate remuneration outcomes for adverse risk and compliance outcomes; weak issue escalation, management and closure; insufficient Executive Committee oversight; and inadequate business unit supervision of functions performed elsewhere in the Group.

When asked to comment on the G30's observation that 'the Australian banking industry is only beginning its long journey to repair its conduct and culture',²⁸³ Mr Byres said:²⁸⁴

[T]he general concept of clarity of accountability, or, more to the point, the problem of diffused responsibility and no clarity of accountability has been at the heart of many problems that have happened. No one had responsibility. No one has actually taken responsibility for issues. Boards have not known how to apply consequences because it's not clear who was responsible for things.

I agree.

²⁸² CBA Prudential Inquiry, Final Report, 59.

²⁸³ G30, *Banking Conduct and Culture: A Permanent Mindset Change*, November 2018, 6.

²⁸⁴ Transcript, 30 November 2018, Wayne Byres, 7443.

3.3.1 The BEAR

The enactment of the Banking Executive Accountability Regime (BEAR) will provide entities and regulators (both APRA and ASIC) with a clearer understanding of the responsibilities that attach to particular offices or positions within banks. It will allow those individuals to be held to account if they fail in performing their obligations.

I have already indicated in the chapter about the banking sector that I consider APRA should determine, under section 37BA(4) of the *Banking Act 1959* (Cth), an additional responsibility of accountable persons within each of the banks subject to the BEAR. That additional responsibility would be for the end-to-end management of product design, delivery, maintenance and, where necessary, remediation. It would then be for each bank to identify the relevant accountable person.

As is also evident from what I have written about the superannuation sector and the regulators, **I consider that provisions of the kind now made by the BEAR should be made in respect of all APRA-regulated institutions.** Given that systems of even greater reach have been implemented in other jurisdictions, there is, in my view, every reason to go down this path, and no satisfactory reason to draw back.

Obviously, **a change of this kind should be introduced only after allowing a sufficient time for both the regulators and the regulated to prepare for its introduction. And it may very well be that the change should be made first in the superannuation sector and then after a further interval, in the insurance sector.** (I say that superannuation sector should be the first chosen because of the particular size and importance of that sector to members and to the economy generally.) Regardless, there is no reason in principle or in practice to confine the reach of accountability provisions of the kind set out in the BEAR to the banking sector.

Obviously, enactment of the BEAR has introduced an additional form of accountability for senior banking executives. But the BEAR is not a substitute for proper processes within entities for identifying who is accountable for risk and how they are to account for it and be held accountable. As the CBA Prudential Inquiry showed, that accountability must include financial risk but must extend to all forms of risk including, in particular, conduct and compliance risk. Under the BEAR,

the Chief Risk Officer of a bank will have certain responsibilities with respect to risk management. That responsibility is, of course, important.

But it cannot be seen as a *complete* or *comprehensive* identification of who within the organisation should be held accountable for risks or as a complete or comprehensive statement of how they are to account and be held accountable.

3.3.2 This Commission

The proceedings of this Commission have brought an additional, and different, form of accountability to bear on the entities whose conduct has been examined. The Commission's examination of conduct that might amount to misconduct and conduct falling short of community standards and expectations has attracted close public attention.

The last oral evidence the Commission received, in the seventh round of public hearings, was given by the chairs of three bank boards, the CEOs of the five largest banks and AMP, and the chairs of APRA and ASIC. Each was asked many questions intended to show how their entities or agencies assessed what had been looked at in the course of the Commission's work.

As would be expected, each of these witnesses gave evidence suggesting that their respective entities or agencies had its own distinctive understanding of, and response to, the events considered in and issues raised by the Commission. Most professed to having learned from what had happened and proffered their ideas about causes and responses. But the nature and extent of their engagement with the issues differed rather more markedly than I had expected. It seemed to me that there remain elements of unwillingness to recognise, and to accept responsibility for, poor conduct of the kinds examined in this inquiry.

Unwillingness to recognise and to accept responsibility for misconduct explains the prolonged and repeated failures by large entities to make breach reports required by the law. That same unwillingness explains the prolonged negotiation with the regulator about what should be done in response to misconduct, whether by compensating affected customers or altering defective practices and processes.

There remains unwillingness, in at least some entities, to recognise and give effect to the obligation to ensure that the relevant services are provided efficiently, honestly and fairly, without first having the regulator agree with what the entity judges to be required in order to meet that standard.²⁸⁵ That is, there remains a reluctance in some entities to form and then to give practical effect to *their* understanding of what is ethical, of what is efficient honest and fair, of what is the 'right' thing to do.²⁸⁶ Instead, the entity contents itself with statements of purpose, vision or values, too often expressed in terms that say little or nothing about those basic standards that underpin both the concept of misconduct and the community's standards and expectations.

These observations do not apply to all entities. It was apparent from the evidence that some entities recognise now the need to respond to *what* has happened by confronting *why* it happened and then seeking to prevent recurrence. And it was also apparent that they recognise that the task is not easy.

CBA has been compelled by the Prudential Inquiry to confront why it has had 'a succession of conduct and compliance issues' and has not met the community's 'high expectations' for it as an institution.²⁸⁷ As a result of that Inquiry, CBA gave an **enforceable undertaking** (EU) that obliged it to undertake a remedial action plan responding to each of the recommendations in the Inquiry's report. An independent reviewer must report to APRA every three months until all items on the remediation action plan have been completed. The reports must explain the status of compliance with the EU and the items on the remediation action plan that CBA considers are nearing completion.²⁸⁸

I was persuaded that Mr Comyn, CEO of CBA, is well aware of the size and nature of the tasks that lie ahead of CBA.

²⁸⁵ Transcript, Kenneth Henry, 27 November 2018, 7134.

²⁸⁶ Transcript, Andrew Thorburn, 26 November 2018, 7091–2.

²⁸⁷ CBA Prudential Inquiry, Final Report, 3.

²⁸⁸ Enforceable Undertaking, APRA and CBA, 30 April 2018, cls 12–13.

None of the other large banks have been confronted so directly with why each has had its own conduct and compliance issues.

I have little doubt that Mr Elliott, CEO of ANZ, is also well aware of the size and nature of the tasks that lie ahead of ANZ.

Westpac stands apart from the other three major banks by seeking to maintain at least some aspects of its wealth business. The challenges for Westpac may therefore differ from those facing the other major banks. And while I do not doubt Mr Hartzler, CEO of Westpac, when he says that Westpac has sought to ‘reset’ its relationship with ASIC,²⁸⁹ only time will tell whether that proves to be right.

NAB also stands apart from the other three major banks. Having heard from both the CEO, Mr Thorburn, and the Chair, Dr Henry, I am not as confident as I would wish to be that the lessons of the past have been learned. More particularly, I was not persuaded that NAB is willing to accept the necessary responsibility for deciding, for itself, what is the right thing to do, and then having its staff act accordingly. I thought it telling that Dr Henry seemed unwilling to accept any criticism of how the board had dealt with some issues. I thought it telling that Mr Thorburn treated all issues of fees for no service as nothing more than carelessness combined with system deficiencies when the total amount to be repaid by NAB and NULIS on this account is likely to be more than \$100 million.²⁹⁰ I thought it telling that in the very week that NAB’s CEO and Chair were to give evidence before the Commission, one of its staff should be emailing bankers urging them to sell at least five mortgages each before Christmas. Overall, my fear – that there may be a wide gap between the public face NAB seeks to show and what it does in practice – remains.

²⁸⁹ Transcript, Brian Hartzler, 22 November 2018, 6878.

²⁹⁰ See ASIC, Media Release 18-229MR, 7 August 2018.

Conclusion

Failings of organisational culture, governance arrangements and remuneration systems lie at the heart of much of the misconduct examined in this Commission. Improvements in the culture of financial services entities, their governance arrangements and their remuneration systems should reduce the risk of misconduct in future. Culture, governance and remuneration march together. Improvements in one area will reinforce improvements in others; inaction in one area will undermine progress in others. Making improvements in each area is the responsibility of financial services entities. But regulators also have an important role to play in the supervision of culture, governance and remuneration. In the past, that supervision has focused on financial soundness and stability. But, as events here and overseas show, that is too narrow. Supervision must extend beyond financial risks to non-financial risks, and that requires attention to culture, governance and remuneration.

7. Regulators

Introduction

I said in the *Interim Report* that almost all of the conduct identified and criticised in that Report contravened existing norms of conduct and that the most serious conduct broke existing laws.¹ Notwithstanding that, the law was too often not enforced at all, or not enforced effectively.²

In its response to the *Interim Report*, the Australian Securities and Investments Commission (ASIC) accepted that its enforcement approach must change.³ The Australian Prudential Regulation Authority (APRA)'s response to the *Interim Report* emphasised that its core role is 'proactive *ex ante* supervision ... rather than *ex post* enforcement'.⁴ It also said that recent developments, including the work of the Royal Commission, had caused it to review its approach to enforcement.⁵

This chapter considers the regulatory model currently in place, the remit given to APRA and ASIC under that model, and the powers currently available to APRA and ASIC. The overarching question is: to what extent, if any, should the model, the remits, or the powers be changed?

Consideration of the question must proceed from an understanding of the current regulatory framework and its history.

¹ FSRC, *Interim Report*, vol 1, 267.

² FSRC, *Interim Report*, vol 1, 269–70.

³ ASIC, Interim Report Submission, 5 [24]–[25], 9–10 [43]–[45].

⁴ APRA, Interim Report Submission, 8 [44].

⁵ APRA, Interim Report Submission, 9 [46]–[48].

1 History

1.1 Twin peaks

Australia's financial regulatory system is often said to be a 'twin peaks' model. Two principles inform its structure:

- Prudential regulation is (largely) separated from conduct regulation and is the province of APRA; and
- Conduct regulation of the financial services industry is separated from conduct regulation of other parts of trade and commerce and is (largely) the province of ASIC.

The twin peaks model originated in the Wallis Inquiry.

1.2 The Wallis Inquiry

The Wallis Inquiry into the Australian financial system was conducted between 1996 and 1997.

It proposed a new prudential regulator that would combine existing prudential regulation undertaken by several government agencies into one.⁶ That regulator became APRA.

The Inquiry proposed a new market-conduct and consumer-protection regulator for financial services.⁷ That regulator became ASIC. It was to have comprehensive responsibilities for regulation of market integrity, consumer protection and corporations law. The consumer protection aspect of that regulator's remit was directed principally towards disclosure.⁸ ASIC's regulation of consumer protection in the financial services industry was

⁶ Wallis Inquiry, Final Report, 18 March 1997, 42 Recommendation 31; see also 20.

⁷ Wallis Inquiry, Final Report, 18 March 1997, 32 Recommendations 1 and 2; see also 17.

⁸ Wallis Inquiry, Final Report, 18 March 1997, 246–52. See also Recommendation 41 at page 46 in respect of superannuation: 'Regulation to ensure the compliance of superannuation funds, other than excluded funds, with retirement income requirements should be undertaken by [the entity that became APRA] in conjunction with prudential regulation. Disclosure regulation should be undertaken by [the entity that became ASIC]'.

to include all types of businesses offering banking and deposit products, insurance products and superannuation, as well as investment products and advisory services.⁹

The Inquiry recommended that the two regulators be operationally autonomous,¹⁰ but work closely together, where appropriate.¹¹ It proposed separating prudential regulation from market conduct and consumer protection regulation, leaving the Reserve Bank of Australia (RBA) responsible for monetary policy and the payments system. It proposed establishing the Council of Financial Regulators (the CFR), chaired by the Governor of the RBA, to act as a co-ordinating forum, to discuss developments in the financial system and to co-ordinate responses to any areas of concern. The CFR was to have (and now has) no formal mandate or powers separate from those held by its members.

1.3 The Cooper Review

The Cooper Review into Australia's superannuation system, also known as the Super System Review, was undertaken between 2009 and 2010. The focus of the Review was on promoting efficiencies and improving outcomes for members in the superannuation system. One of its recommendations resulted in the creation of **MySuper**.

The Review considered that there were gaps in APRA's mandate.¹² Those gaps were said to be the result of the piecemeal way in which APRA's role as the prudential regulator had developed over time.¹³ It recommended that a new role be given to APRA that was more focused on member outcomes, and proposed that APRA would oversee and promote the overall efficiency and transparency of the superannuation system, to the ultimate benefit of members.¹⁴ The Review expected APRA's role to extend from routine fund reviews to matters such as trustees' approaches to meeting their new

⁹ Wallis Inquiry, Final Report, 18 March 1997, 248 fn 5.

¹⁰ Wallis Inquiry, Final Report, 18 March 1997, 67–8 Recommendation 103.

¹¹ Wallis Inquiry, Final Report, 18 March 1997, 22.

¹² Cooper Review, Final Report, 30 June 2010, 309.

¹³ Cooper Review, Final Report, 30 June 2010, 309.

¹⁴ Cooper Review, Final Report, 30 June 2010, 310 Recommendation 10.1.

duties, but not to extend to intervening in the trustee's decisions.¹⁵

The Review thought that APRA would need to have a broader range of regulatory functions to regulate member outcomes, and that this might call for new skills, resources and perspectives.¹⁶

The Review also said that there should be closer co-operation between APRA and ASIC, and recommended that the Government should explore how they could work more closely together in discharging their superannuation mandates.¹⁷

Following the recommendations of the Cooper Review, the *Superannuation Industry (Supervision) Act 1993* (Cth) (the SIS Act) was amended in 2012 to give APRA power to determine prudential standards for superannuation under section 34C; to expand the duties of trustees under section 52; to apply duties to directors of trustees under sections 52A; and to impose additional obligations on trustees, and directors of trustees, under sections 29VN and 29VO of the SIS Act, respectively.¹⁸ ASIC's remit and powers under the SIS Act were unchanged.

1.4 The Murray Inquiry

The Murray Inquiry undertook a review of Australia's financial system between 2013 and 2014.

The Inquiry said that, while it did not recommend 'major changes to the overall regulatory system', it believed that action should be taken in five areas to improve the current arrangements 'and ensure regulatory settings remain fit for purpose in the years ahead'.¹⁹

The five recommendations were to:

- improve the regulator accountability framework;²⁰

¹⁵ Cooper Review, Final Report, 30 June 2010, 309–10.

¹⁶ Cooper Review, Final Report, 30 June 2010, 311.

¹⁷ Cooper Review, Final Report, 30 June 2010, 315–6 Recommendation 10.5.

¹⁸ See *Superannuation Legislation (Trustee Obligations and Prudential Standards) Act 2012* (Cth).

¹⁹ Murray Inquiry, Final Report, November 2014, 235.

²⁰ Murray Inquiry, Final Report, November 2014, 235.

- improve the effectiveness of our regulators;²¹
- strengthen ASIC;²²
- rebalance the regulatory focus towards competition;²³ and
- improve the process of implementing new financial regulations.²⁴

The Inquiry said that its first recommendation, to improve the regulator accountability framework, was made because ‘Australia needs a better mechanism to allow Government to assess the performance of financial regulators’.²⁵ To that end, the Inquiry recommended establishing a new Financial Regulator Assessment Board ‘to undertake annual ex post reviews of overall regulator performance against their mandates’.²⁶

The recommendation to establish a new assessment board was not taken up by Government.²⁷ The Government Response to the Murray Inquiry made three points. First, it said that the requirements of the *Public Governance, Performance and Accountability Act 2013* (Cth) and the Government’s Regulator Performance Framework provided ‘avenues to strengthen regulator accountability [as did] other existing mechanisms such as Parliamentary hearings’.²⁸ Second, it said that it proposed to reconstitute the Financial Sector Advisory Council ‘with refreshed Terms of Reference to include providing advice on the performance of the financial regulators’.²⁹ And third, it said that Government supported providing regulators with clearer guidance in Statements of Expectations and that a proposal had

²¹ Murray Inquiry, Final Report, November 2014, 235.

²² Murray Inquiry, Final Report, November 2014, 236.

²³ Murray Inquiry, Final Report, November 2014, 237.

²⁴ Murray Inquiry, Final Report, November 2014, 237.

²⁵ Murray Inquiry, Final Report, November 2014, 235.

²⁶ Murray Inquiry, Final Report, November 2014, 235.

²⁷ Australian Government, *Improving Australia’s Financial System: Government Response to the Financial System Inquiry*, 2015, 23.

²⁸ Australian Government, *Improving Australia’s Financial System: Government Response to the Financial System Inquiry*, 2015, 23.

²⁹ Australian Government, *Improving Australia’s Financial System: Government Response to the Financial System Inquiry*, 2015, 23.

been made to update the regulators' Statements of Expectations in the first half of 2016.³⁰

The Financial Services Advisory Council was reconstituted and, among other things, given the task of providing 'advice to the Government on the performance of the financial system regulators'.³¹ In 2018, the work of the Council was suspended pending the completion of this Commission's work.³²

1.5 ASIC Capability Review

When the Government responded to the Murray Inquiry, it had already announced, in June 2015, a review to consider the capabilities of ASIC. The panel appointed to conduct that review provided its report to Government in December 2015. The panel recommended changing the governance of ASIC 'to achieve a clear separation of the non-executive (governance) and executive line management roles'.³³ ASIC Commissioners would form a full-time non-executive internal board of the Commission, and operational decision-making and execution of operational matters would be delegated to the senior executive level, reporting directly to a new Head of Office of ASIC.³⁴

Against the background of these recommendations about governance, the panel endorsed the Government's position not to proceed with the Murray Inquiry recommendation to establish a Financial Regulator Assessment Board, not seeing the need for 'another regulator to regulate the regulators'.³⁵

ASIC did not adopt the governance model the panel had proposed but did 'adopt new initiatives to support [ASIC's] role and focus on strategy

³⁰ Australian Government, *Improving Australia's Financial System: Government Response to the Financial System Inquiry*, 2015, 23.

³¹ Productivity Commission, Report 89, 29 June 2018, 533.

³² Productivity Commission, Report 89, 29 June 2018, 533.

³³ ASIC Capability Review, Report, 14.

³⁴ ASIC Capability Review, Report, 14.

³⁵ ASIC Capability Review, Report, 17.

and accountability'.³⁶ ASIC identified three initiatives: enhanced management information and performance reporting; a review of the mandate, membership, effectiveness and role of committees; and a review of Commissioners' engagement with stakeholders.³⁷

1.6 ASIC Enforcement Review

On 19 October 2016, the Minister for Revenue and Financial Services appointed a Taskforce to conduct a review of ASIC's enforcement regime (the Enforcement Review).

The Terms of Reference required the Taskforce to examine relevant Commonwealth legislation to determine the adequacy of, among other things: the civil and criminal penalties for serious contraventions relating to the financial system; existing penalties for serious contraventions; enforcement-related licensing powers; ASIC's power to ban company officers; ASIC's information gathering powers; and the frameworks for notifying ASIC of breaches of law.³⁸ The Taskforce was required to identify any gaps in ASIC's powers and make recommendations to the Government to address gaps or deficiencies it identified in a way that would allow more effective enforcement of the regulatory regime.³⁹

The Taskforce issued its report in December 2017. It made 50 recommendations.⁴⁰ The recommendations included reforming section 912D of the *Corporations Act 2001* (Cth) (the Corporations Act) (about reporting significant breaches, or likely breaches, of certain provisions); strengthening ASIC's licensing and banning powers; increasing penalties for contraventions; and giving ASIC a new directions power.⁴¹

³⁶ Exhibit 7.63, Witness statement of James Shipton, 7 November 2018, Exhibit JS-7 [ASIC.0800.0016.0905 at .0001–.0002].

³⁷ Exhibit 7.63, Witness statement of James Shipton, 7 November 2018, Exhibit JS-7 [ASIC.0800.0016.0905 at .0002].

³⁸ ASIC Enforcement Review, Report, ix.

³⁹ ASIC Enforcement Review, Report, ix.

⁴⁰ ASIC Enforcement Review, Report, xiv–xviii.

⁴¹ ASIC Enforcement Review, Report, xiv–xviii.

On 16 April 2018, the Government published its response to the Taskforce's final recommendations, in which it agreed, or agreed in principle, to all 50 recommendations. Implementation of some of the recommendations was deferred pending the work of this Royal Commission. I deal separately with those recommendations in the chapter about other important steps.

When implemented, the recommendations of the Enforcement Review will provide ASIC with considerable new or enhanced powers and will lead to significant increases to the maximum penalties that may be imposed for breaches of financial services laws.

1.7 Productivity Commission Competition Report

The Murray Inquiry had recommended that 'Government should provide more clarity around its expectations of regulators' and that 'regulators should develop better performance indicators'.⁴² In its report on competition in the Australian financial system, the Productivity Commission emphasised the importance it attached to both Government statements of expectations and regulators' statements of intent. The Productivity Commission urged the swift publication of updated statements of expectations written in clear language,⁴³ and recommended that regulators publish their statements of intent within three months of receiving the statement of expectations. It recommended further, that regulators provide in their annual reports 'information on the actions they have taken in line with their statements of intent and outcomes on performance measures'.⁴⁴

One other recommendation made by the Productivity Commission should be noted. It recommended that the Australian Competition and Consumer Commission (the ACCC) be made a permanent member of the CFR and that it 'be given a mandate by the Australian Government to champion competition in the financial system, including in decisions taken by regulators that have or may have the outcome of restricting competition'.⁴⁵

⁴² Murray Inquiry, Final Report, November 2014, 235.

⁴³ Productivity Commission, Report 89, 29 June 2018, 535 Recommendation 18.1.

⁴⁴ Productivity Commission, Report 89, 29 June 2018, 535 Recommendation 18.1.

⁴⁵ Productivity Commission, Report 89, 29 June 2018, 556 Recommendation 19.1.

This goes to matters beyond this Commission's Terms of Reference and I offer no comment on it.

These matters of history explain how and why we have come to the present regulatory arrangements.

Further consideration of whether to modify those arrangements may usefully begin by recognising the size of ASIC's remit as conduct regulator.

2 ASIC's remit

2.1 Size of the existing remit

ASIC's remit is very large. It has increased greatly since ASIC was first established.

As I noted in the *Interim Report*,⁴⁶ ASIC now administers 11 pieces of legislation and their associated regulations.⁴⁷ The legislation itself has grown longer and more complex. The length of the Corporations Act, for example, has increased by 178% since 1981.⁴⁸ In preparing Background Papers for its hearings, this Commission found that an introductory overview of the law governing consumer credit in Australia required 86 pages of explanation; financial advice and sale of **financial products** required 114; and small business lending law that did not overlap with that governing consumer lending, required 41 pages to explain.

ASIC's remit in respect of consumer protection has evident parallels with the ACCC's remit in respect of consumer protection in other sectors of the economy. Consumer protection provisions administered by ASIC are often expressed in terms that are not materially different from how those administered by the ACCC are expressed.⁴⁹

⁴⁶ FSRC, *Interim Report*, vol 1, 294–5.

⁴⁷ See also ASIC Capability Review, Report, 133.

⁴⁸ ASIC Capability Review, Report, 134.

⁴⁹ See, eg, the unfair contract terms discussed in the *Interim Report*: FSRC, *Interim Report*, vol 1, 281–5.

The ACCC has chief responsibility for competition questions in the Australian economy. Competition in parts of the Australian financial services industry is not always strong and has not prevented the misconduct considered by this Commission.

All of these are matters that might suggest there would be some advantages to be gained by detaching some aspects of ASIC's remit and requiring the ACCC to take responsibility for their administration. And the force of those arguments would not be lessened if, as ASIC urges, it were to take on a larger role with respect to conduct regulation of **registrable superannuation entities** (RSEs) than it now has.

All this being so, why not alter ASIC's remit? Why not modify the twin peaks model?

2.2 Change the remit?

Altering ASIC's remit would mark a sharp departure from the twin peaks model. I am not persuaded that the two principles underpinning the twin peaks model of financial regulation should now be abandoned or should be given substantially different effect by dividing ASIC's regulatory role.

Detaching significant parts of ASIC's remit and transferring them to another agency would disrupt the processes of responding to what has happened in the Australian financial services industry, and has now been brought into the public gaze by the Commission's work. I think the costs of that disruption outweigh the possible benefits.

There is force in Treasury's submission that there are some functions 'that are core to the conduct regulator under the twin peaks model – and that should be kept together'.⁵⁰ The functions Treasury identified as 'core' were: 'administering the necessary licensing regimes for financial services; preventing consumer detriment from inappropriate products and contracts; enabling consumers' access to redress via dispute resolution and compensation; and enforcing the relevant law'.⁵¹

⁵⁰ Treasury, Interim Report Submission, 37 [184].

⁵¹ Treasury, Interim Report Submission, 37 [184].

Further, as Treasury submitted, shifting responsibilities between agencies does not diminish the size of the tasks that have to be performed. Hence, what Treasury called ‘the overall resource demand’ is largely unchanged.⁵² And any shift in responsibilities will necessarily have transitional costs of the kind Treasury mentioned (likely loss of experienced staff coupled with the costs of accommodating the new responsibilities in the new agency) accompanied by some measure of regulatory uncertainty.⁵³

Importantly, I have no doubt that Treasury was right to say that ‘the impact of the breadth of remit on a regulator is largely a function of its leadership and resourcing (including staffing)’.⁵⁴ As Treasury said ‘[w]ith strong leadership and adequate resources (including staff), a broad remit is not a problem’.⁵⁵ But one of the chief challenges for leadership of a regulatory agency is fostering a proper culture. And as I sought to make plain in the *Interim Report*, the criticisms I made of ASIC were about the ways in which it responded to reports of misconduct, ways that might be seen as reflecting the prevailing culture of the agency.

In my view the enforcement culture of ASIC, not the size of ASIC’s remit, should be the focus of change.

Recommendation 6.1 – Retain twin peaks

The ‘twin peaks’ model of financial regulation should be retained.

⁵² Treasury, Interim Report Submission, 38 [188].

⁵³ Treasury, Interim Report Submission, 38 [189].

⁵⁴ Treasury, Interim Report Submission, 38 [188].

⁵⁵ Treasury, Interim Report Submission, 38 [188].

3 Changing ASIC's enforcement culture

3.1 Why change?

In the *Interim Report*, I said that '[w]hen deciding what to do in response to misconduct, ASIC's starting point appears to have been: How can this be resolved by agreement?'⁵⁶ I said also that '[t]his cannot be the starting point for a conduct regulator'.⁵⁷ I remain of those views.

ASIC is charged with enforcing financial services laws on behalf of the community. One of ASIC's objectives is to 'take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth'.⁵⁸ The community is entitled to expect, and does expect, that financial services entities will comply with those laws.

Financial services entities are not ASIC's 'clients'. ASIC does not perform its functions as a service to those entities. And it is well-established that 'an unconditional preference for negotiated compliance renders an agency susceptible to capture' by those whom it is bound to regulate.⁵⁹ As one leading American scholar has written, 'corporate behavior moves quickly to take advantage of any perceived softening. Social norms act less upon complex organizations than upon individuals'.⁶⁰

All of these considerations show that improving compliance with financial services laws cannot be achieved by focusing only on negotiation and persuasion. Compliance with the law is not a matter of choice. The law is, in that sense, coercive and its coercive character can be neither hidden nor ignored. Negotiation and persuasion, without enforcement, all too readily

⁵⁶ FSRC, *Interim Report*, vol 1, 277.

⁵⁷ FSRC, *Interim Report*, vol 1, 277.

⁵⁸ ASIC Act s 1(2)(g).

⁵⁹ Malcolm K Sparrow, *The Regulatory Craft: Controlling Risks, Solving Problems, and Managing Compliance* (Brookings Institution Press, 2000) 63 (footnote omitted).

⁶⁰ Malcolm K Sparrow, *The Regulatory Craft: Controlling Risks, Solving Problems, and Managing Compliance* (Brookings Institution Press, 2000) 63.

leads to the perception that compliance is voluntary. It is not. All financial services entities must obey the law, not just those who are willing to do so. And all financial services entities must comply with all the laws that apply to them, not just with those bits of the law that they find to be commercially acceptable.

In the *Interim Report* I said that there were already signs that ASIC may be seeking to alter its approach to enforcement, but that there were five reasons for caution.⁶¹

First was the size of ASIC's remit. The reforms I have proposed, particularly regarding the **Banking Executive Accountability Regime** (BEAR) and enforcement of breaches of the SIS Act, will further enlarge that remit. ASIC will require deft management, a stable and appropriate level of funding and effective oversight to discharge its duties. But, as I have sought to explain, the size of ASIC's remit is not an insurmountable obstacle to effective enforcement.

My second reason for caution was what seemed to me to be a deeply entrenched culture of negotiating outcomes rather than insisting upon public denunciation of, and punishment for, wrongdoing. Third, I referred to remediation of consumers being important but not the only consideration relevant to the regulator. Fourth, I said that there seemed to be no recognition of the fact that the amount outlaid to remedy a default may be much less than the advantage an entity has gained from the default. Fifth, I said that there appeared to be no effective mechanism for keeping ASIC's enforcement policies and practices congruent with the needs of the economy more generally.

ASIC said in its written response to the *Interim Report* that it accepts that it needs to make changes.⁶² More particularly, ASIC said that it accepts 'that it must alter its enforcement priorities and practices within the financial sector – and particularly for larger financial institutions – so as to be more agile in initiating and prosecuting court action, and in many instances even commencing with it'.⁶³ It said that it 'recognises that its enforcement priorities

⁶¹ FSRC, *Interim Report*, vol 1, 293–4.

⁶² ASIC, *Interim Report Submission*, 2 [7].

⁶³ ASIC, *Interim Report Submission*, 5 [25].

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'.⁶⁴ ASIC said that it now accepts that, when considering enforcement measures, it should start with the question '[W]hy not litigate?'.⁶⁵

Consideration of the way ahead begins, then, from the accepted premise that change is needed. What is that change? How is it to be made and then maintained?

3.2 What change?

As I said in the *Interim Report*, legislation allowing criminal or civil punishment of conduct proceeds from the premise that engaging in the conduct is harmful to society. In financial services legislation, the premise is more likely to be that the conduct will be harmful to the economy generally. Hence, the ways in which ASIC (or APRA) enforce these laws will affect the overall health of the economy.⁶⁶

It is as well to repeat some basic points made in the *Interim Report*.

The first point relates to negotiated outcomes. Of course there can and will be some cases of contravention of the law in which the outcome is negotiated between contravener and regulator. Sometimes the negotiations will be completed before proceedings are commenced; sometimes not. Often, institution of proceedings should be, and will be, a step the parties recognise will be taken. But whether or not proceedings are on foot or anticipated, there can be no satisfactory negotiated outcome if ASIC has not *first* decided what *it* wants from the negotiation (as distinct from what it thinks the entity is prepared to give).⁶⁷

The second point is about remediation. The regulator is not called on to choose between remediation and enforcement. Remediation for consumers

⁶⁴ ASIC, *Interim Report Submission*, 9 [41]. See also, Exhibit 7.159, 6 January 2019, Summary of Review of ASIC's Enforcement Policies.

⁶⁵ ASIC, *Interim Report Submission*, 9 [45] (footnote omitted).

⁶⁶ FSRC, *Interim Report*, vol 1, 296.

⁶⁷ FSRC, *Interim Report*, vol 1, 295–6.

is one important goal. It is not the *only* goal to be pursued. Often, enforcement will induce an entity to set about remedying the consequences of its default, or committing to doing so, before the penalty is fixed.⁶⁸

The third concerns the size of remedies relative to profits. Financial services entities will often have profited from their contraventions of the law. The regulator *must* do whatever can be done to ensure that breach of the law is not profitable.⁶⁹

In the end, the critical question whenever ASIC is considering any contravention of the law must be the question ASIC now accepts must be asked: ‘Why not litigate?’. And, much more often than not, ASIC will ask and answer that question in circumstances where the entity has provided a breach notification. That is, ASIC will have to ask and answer ‘why not litigate’ in circumstances where the entity itself has reported that its conduct may have breached a relevant provision of the financial services law. ASIC will approach litigation knowing that the first document to be tendered in evidence will show what the *entity* has said it has done or may have done in contravention of the law.

Answering the question ‘why not litigate’ calls for skill and judgment. Especially will that be so when it appears that the issue is systemic (as with, for example, the issues about add-on credit and loan insurance products). As Mr James Shipton, Chair of ASIC, pointed out in his evidence, add-on insurance was an industry-wide issue affecting many thousands of consumers.⁷⁰

Issues of that kind will often present in a form such that the way ahead seems anything but clear because they appear to present ‘an overwhelming amount of work’.⁷¹ But from first contact with the matter, whether that is a breach report or a complaint, **the regulator must approach the work ahead with a clear view of what kinds of outcome are being considered. And unless and until it is plain that the public interest**

⁶⁸ FSRC, *Interim Report*, vol 1, 296.

⁶⁹ FSRC, *Interim Report*, vol 1, 296.

⁷⁰ Transcript, James Shipton, 23 November 2018, 6952.

⁷¹ Transcript, James Shipton, 23 November 2018, 6952.

requires that there be no litigation, all forms of regulatory enforcement must remain under active consideration.

When I say that all forms of regulatory outcome must remain under active consideration, **what will be required will be consideration of what forms of regulatory response will be appropriate for the *kind of conduct in issue*.** So, for example, in the case of add-on insurance, the possible responses would require identification and examination against what appeared to be the essential character of the conduct that is in issue: the selling to consumers of insurance on which they could not claim. As investigation proceeds, the conduct will be better understood and its essential character will be more accurately and easily described. Possible responses will become more detailed and more refined. But at every stage along the way, the regulator is working towards one or more identified end-points. Those end-points may require re-definition from time to time. But the work will remain focused. And if the work is focused, that which is apparently an overwhelming mass is rendered intelligible and manageable.

3.3 Radical change?

For the first 90 years of Federation, civil penalty provisions were rarely found in the Commonwealth statute book.⁷² In 1989, the Senate Standing Committee on Legal and Constitutional Affairs (the Cooney Committee) inquired into directors' duties.⁷³ The Cooney Committee recommended the enactment of civil penalty provisions for breaches of directors' duties. That recommendation was legislated in 1992.⁷⁴ Since then, there has been a significant increase in the number of civil penalty provisions in the various financial services statutes.

⁷² See ALRC, Report 95, December 2002, 87 [2.108].

⁷³ Commonwealth, *Company Director's Duties: Senate Standing Committee on Legal and Constitutional Affairs*, Parl Paper No 395 (1989).

⁷⁴ The civil penalty regime was introduced into the *Corporations Act 1989* (Cth) by the *Corporate Law Reform Act 1992* (Cth), with effect from 1 February 1993. See also Vicky Comino, 'The Challenge of Corporate Law Enforcement in Australia' (2009) *Australian Journal of Corporate Law*, 233, 234–5; Treasury, *Australian Securities and Investments Commission Enforcement Review Report*, 18 December 2017, 72.

In 2002, civil penalty provisions relating to financial services were first inserted into the Corporations Act by the *Financial Services Reform Act 2001* (Cth).⁷⁵ That Act extended the civil penalty regime to apply to offences relating to all market misconduct.⁷⁶ By 2015, there were 50 civil penalty provisions in the Corporations Act.⁷⁷ By November 2018, there were 72.⁷⁸

If the recommendations of the ASIC Enforcement Review are implemented,⁷⁹ there will be 37 new civil penalty provisions in the Corporations Act, and 11 new civil penalty provisions across the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act), the Credit Code and the *Insurance Contracts Act 1984* (Cth) (the Insurance Contracts Act).⁸⁰ ASIC is, or will be, responsible for enforcing those provisions.⁸¹

⁷⁵ See, eg, Michelle Welsh, 'Enforcing Contraventions of the Continuous Disclosure Provisions: Civil or Administrative Penalties' (2007) 25 *Corporate and Securities Law Journal* 315, 318.

⁷⁶ For example, provisions concerning insider trading, continuous disclosure obligations, market manipulation, false trading and market rigging and dissemination of information about an illegal transaction. See, eg, Vicky Comino, 'Civil or Criminal Penalties for Corporate Misconduct: Which Way Ahead?' (2006) 34(6) *Australian Business Law Review* 428, 432–3 fn 37; Michelle Welsh, 'Enforcing Contraventions of the Continuous Disclosure Provisions: Civil or Administrative Penalties' (2007) 25 *Corporate and Securities Law Journal* 315, 318 fn 10.

⁷⁷ See Jasper Hedges et al, 'An Empirical Analysis of Public Enforcement of Directors' Duties in Australia: Preliminary Findings' (Working Paper No 3, Melbourne Law School, 31 December 2015), 9.

⁷⁸ See Corporations Act s 1317E. This number includes each subsection that is a civil penalty provision.

⁷⁹ The Bill that proposes to amend these Acts to insert the civil penalty provisions was passed in the House of Representatives on 29 November 2018, and read for the second time in the Senate on 3 December 2018.

⁸⁰ See Explanatory Memorandum, Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 (Cth), 43–6.

⁸¹ As to the ASIC Act, see the unconscionable conduct and consumer protection provisions in Pt 2, Div 2, Sub-div G. As to the Credit Act, see the civil penalty regime in Pt 4.1. As to the Credit Code, see s 111. See generally, also, Treasury, *ASIC Enforcement Review: Positions Paper 7 – Strengthening Penalties for Corporate and Financial Sector Misconduct*, 2017, 37.

As civil penalty provisions have proliferated, and been more regularly litigated, a body of law has developed. Though the courts must apply civil procedure rules to civil penalty proceedings,⁸² proceedings for a civil penalty have both civil and criminal characteristics.⁸³ Because of that, the common law privilege against self-incrimination,⁸⁴ and the privilege against exposure to a penalty,⁸⁵ extend to natural person defendants to civil penalty proceedings. The penal nature of the proceeding also means that satisfaction that an issue has been proved ought not to be reached by ‘inexact proofs, indefinite testimony, or indirect inferences’.⁸⁶

The growth in the number of civil penalty provisions, in the law relating to the specific provisions, and in the related procedural law, coupled with ASIC’s ineffective enforcement culture, have caused me to consider whether radical change is required. I have already ruled out transferring part of ASIC’s remit to the ACCC. Another option would be to establish a specialist *civil* enforcement agency, just as the Commonwealth and all of the states and territories have specialist agencies to prosecute criminal breaches.

The creation of a specialist civil enforcement agency would preserve all of ASIC’s regulatory tools, save for the right to litigate in respect of civil penalty provisions. ASIC would be required to prepare a brief of materials to the new agency if a particular evidentiary threshold was reached. It would then be for the enforcement agency to make any decision about whether to commence proceedings. In other words, ASIC would act as the investigators, but not make the decision to commence civil penalty proceedings.

⁸² See, eg, Corporations Act s 1317L; *Rich v ASIC* (2004) 220 CLR 129, 143–4 [27].

⁸³ See *Chief Executive Officer of Customs v Labrador Liquor Wholesale Pty Ltd* (2003) 216 CLR 161, 198–9 [114]. It is now understood that civil penalties punish, but do not provide any form of retribution or rehabilitation: *Commonwealth v Director, Fair Work Building Industry Inspectorate* (2015) 258 CLR 482, 506 [55]. See also ALRC, Report 95, December 2002, 72–3 [2.45]–[2.50].

⁸⁴ *The Daniels Corporation International Pty Ltd v ACCC* (2002) 213 CLR 543, 559 [31].

⁸⁵ *The Daniels Corporation International Pty Ltd v ACCC* (2002) 213 CLR 543, 553–4 [13]; *Rich v ASIC* (2004) 220 CLR 129, 141 [23].

⁸⁶ *Briginshaw v Briginshaw* (1938) 60 CLR 336, 362.

There would be some benefits in such an arrangement. A specialised litigation agency would have to develop core skills in what is an increasingly specialised area of the law. This arrangement would repose responsibility for determining whether public interest considerations required action or no action in a professional body that would become skilled in making those judgments.

At the same time, the twin peaks model would be preserved. ASIC would retain its licensing authority and the power to take action under a licence. It would remain the entity in regular contact with the regulated population. And the risk of industry capture affecting litigation decisions would be removed, by placing that decision in an independent agency.

Notwithstanding the prospect of those benefits, I do not recommend such a radical change. It may be that the removal of a regulatory tool as important as civil penalty litigation would have other effects for ASIC's work.⁸⁷ Those effects would need to be properly understood before taking such a large step. But, more importantly, ASIC has acknowledged that its enforcement culture must change.⁸⁸ It should be given time to demonstrate that changes can be made and to demonstrate that, once made, the changes are durable.

Although I do not now recommend the establishment of a specialist civil enforcement agency, ASIC's progress in reforming its enforcement function should be closely monitored. If, over the coming years, it becomes apparent that ASIC is not sufficiently enforcing the laws within its remit, or if the size of its remit comes at the expense of its litigation capability, further consideration should be given to developing a specialist agency of the type I have described.

It is important, then, for me to say something further about the conduct of regulatory litigation.

⁸⁷ Civil penalties were intended to be a feature of an enforcement regime that provided ASIC with gradations of sanctions, based on 'strategic regulation theory' and the enforcement pyramid model. See ALRC, Report 95, December 2002, 76 [2.60]–[2.61]; see also Anne Rees, 'Civil Penalties: Emphasising the Adjective or the Noun' (2006) 34 *Australian Business Law Review* 139, 140; Vicky Comino, 'James Hardie and the Problems of the Australian Civil Penalties Regime' (2014) 37(1) *University of New South Wales Law Journal* 195, 202.

⁸⁸ Transcript, James Shipton, 22 November 2018, 6930; Transcript, James Shipton, 23 November 2018, 6991.

3.4 Litigation

Litigation (of any sort) must never be undertaken without a clear understanding of what the initiating party seeks to achieve. For a regulator alleging contravention of law, that means identifying what conduct it alleges, what law it alleges the defendant has contravened by that conduct, and how the alleged conduct amounted to a contravention. That is, at its most basic, the regulator:

- must know what case it seeks to make;
- must be able to prove the necessary facts; and then
- must be able to show how what was done breached the law.

Often, a regulator must choose how best to frame the case. Often the information available may reveal more than one, and often many, different contraventions of different provisions. What is the provision that best captures the true nature and character of what was done in breach of the law? Confronted with a mass of material, often relating to events that have occurred over a long period, what are the critical facts? How will those facts be proved?

Litigation takes time. It costs money and often great effort. There is always some uncertainty. What is to be made of time, cost and uncertainty? All three considerations will always be there. Why not avoid them? If a compromise can be reached without those risks, why not take it?

The answer lies in recognising that **litigation of the kind now under consideration is the exercise of public power for public purposes. It is litigation by a public authority to enforce the law. A private plaintiff can always choose not to pursue, to abandon or to compromise that plaintiff's private rights. A private plaintiff may take any of these steps for any reason or no reason. But altogether different considerations arise in connection with the public enforcement of the law.**

Breach of the law carries consequences. Parliament, not the regulators, sets the law and the consequences. There are cases where there is good public reason not to seek those consequences. Prosecution policies have always recognised that there may be good *public* reasons not to pursue a particular case. **But the starting point for consideration is,**

and must always be, that the law is to be obeyed and enforced. The rule of law requires no less. And, adequate deterrence of misconduct depends upon visible public denunciation and punishment.

The regulatory pyramid, to which so much reference has been made in evidence and submissions, reflects two very practical observations: not all contraventions of law are of equal significance; and regulators do not have unlimited time or resources. But it is wholly consistent with the analyses that are expressed by the metaphor of the regulatory pyramid, that serious breaches of law by large entities call for the highest level of regulatory response. And that is what has been missing. Too often serious breaches of law by large entities have yielded nothing more than a few infringement notices,⁸⁹ an **enforceable undertaking** (EU) not to offend again (with or without an immaterial ‘public benefit payment’)⁹⁰ or some agreed form of media release.⁹¹

I remain of the view that breaches of the offence and civil penalty provisions of the financial services laws are not to be dismissed as ‘*just* a breach of *those* laws’ as if the laws governing the conduct of financial services entities are some less important form of law. The financial services laws regulate the conduct of central actors in the Australian economy. Their enforcement should be governed by the same principles that inform enforcement of the general law.⁹²

A regulator may go to court only if there is a proper basis for doing so. If ASIC has a reasonable prospect of proving contravention of the law, the starting point for its consideration of what to do must be that the consequences of contravention should be determined by a court. As I said in the *Interim Report*, this neither departs from the model litigant requirements set out in Appendix B to the Legal Services Directions 2017 nor precludes negotiation about resolving those proceedings.⁹³

⁸⁹ Transcript, Gary Dransfield, 20 September 2018, 6321.

⁹⁰ ASIC, Media Release 18-092MR, 6 April 2018; ASIC, Media Release 18-102MR, 13 April 2018; ASIC, Media Release 18-206MR, 6 July 2018.

⁹¹ Transcript, Gregory Martin, 11 September 2018, 5399.

⁹² FSRC, *Interim Report*, vol 1, 278.

⁹³ FSRC, *Interim Report*, vol 1, 278.

Nor is it the case that a regulator is only permitted to commence proceedings when there are reasonable prospects of success. Paragraph 4.7 of the Legal Services Directions provides that an agency is not to start civil proceedings unless the agency has received written legal advice that there are reasonable grounds for starting proceedings. However, the requirement for 'reasonable grounds' directs attention to other factors, interests and considerations than just prospects of success. And so, there may be reasonable grounds for commencing a civil penalty proceeding where the issue raised is systemic or will assist to clarify the law, notwithstanding that the prospects of success may be uncertain.

Central to all of the observations I have made about litigation is the need for a regulator to decide what it seeks to achieve. Starting litigation, especially litigation to enforce the law, is not an end in itself. It is never more than a step towards some other end. What is that end? When starting enforcement proceedings the intended end must always be to demonstrate the alleged contravention and have the court impose a proper penalty.

The history of what has become known as the fees for no service issue demonstrates, in the clearest possible way, the need for visible public denunciation and punishment in deterring misconduct. So much appears from the following chronology:

- ASIC announced, in April 2015, that it was investigating 'multiple instances' of fees being charged for ongoing advice that had not been provided.⁹⁴
- ASIC published its report on the matter in October 2016.⁹⁵
- In April 2018, a few days before the Commission was first to take evidence about the issues, ASIC accepted EUs from ANZ and CBA (in respect of two of CBA's advice licensees).⁹⁶

⁹⁴ Exhibit 2.1, Witness statement of Peter Kell, 12 April 2018, Exhibit PK-2 [ASIC.0902.0001.0941].

⁹⁵ ASIC, Report 499, 27 October 2016.

⁹⁶ FSRC, *Interim Report*, vol 1, 124; Enforceable Undertaking, ASIC and ANZ, 29 March 2018, 5 [3.1]; ASIC, Media Release 18-092MR, 6 April 2018; Enforceable Undertaking, ASIC and CFPL and BWFA, 9 April 2018, 9 [3.5.5]; ASIC, Media Release 18-102MR, 13 April 2018.

- In August 2018, the Commission took further evidence on the issues in connection with superannuation.
- In September 2018, ASIC began civil penalty proceedings against MLC Nominees Pty Ltd and NULIS Nominees (Australia) Ltd alleging contraventions of several statutory provisions in connection with the charging of certain advice fees.⁹⁷

Despite ASIC's investigation, the evidence led in the Commission showed that some entities may have continued to charge fees for which no service was provided until the matters were examined publicly by the Commission.⁹⁸ And no less importantly, the evidence of protracted negotiations between ASIC and entities about how entities would frame their remediation programs showed their unwillingness to accept that what they had done was wrong. Maintaining that kind of attitude would have been all the harder had a court decided the issue.

The time and cost of litigation can be measured when it ends. But the decision not to litigate also has time and cost implications. Not litigating does not guarantee faster resolution. Nor does it reduce the overall cost to the community if it means that the opportunity to deter further misconduct by litigation that denounces and punishes the original misconduct is not taken.

What then is to be made of the time, cost and risks of litigation?

Time and cost will be much affected by the precision of the case that is sought to be made. But beyond that, time and cost are inevitable features of litigation.

Risk is a different matter. Risk of failing on the facts is an ever-present danger in almost every form of litigation. So much turns on how the evidence is finally presented in court and perceived by the tribunal of fact. But proper preparation of litigation reduces litigation risk.

⁹⁷ *ASIC v MLC Nominees Pty Ltd & Anor* FCA, NSD1654/2018.

⁹⁸ See the chapter about financial advice. See also, eg, Transcript, Linda Elkins, 15 August 2018, 4962–3.

Proper preparation requires careful and dispassionate assessment of the questions posed earlier: What conduct is alleged to contravene what law in what respect? And then the relevant questions become: What are the critical facts? How will they be proved? In at least some past cases, there may be grounds to think that insufficient attention was given to these basic questions. If that is right, the solution lies in more precise case formulation and preparation. It does not provide any reason for responding to misconduct by asking ‘How can this be resolved by agreement?’. The relevant question in such a case must always be ‘Why not litigate?’.

3.5 Infringement notices

Infringement notices, or penalty notices, are notices authorised by statute that set out the particulars of an alleged contravention and a penalty for that contravention.⁹⁹ The recipient of a notice from a Commonwealth regulator may elect to pay the amount stated in the notice. By doing that, the breaches alleged in the notice will be resolved and the issuing authority will be barred from taking further legal action. Alternatively, the recipient may elect not to pay, leaving the regulator to decide whether to commence proceedings in the ordinary way.¹⁰⁰ The usefulness of infringement notices in punishing contraventions is limited.

Historically, infringement notices were applied to minor criminal offences, and did not extend to non-criminal contraventions.¹⁰¹ The policy rationale for this is that infringement notices expedite the collection of monetary penalties arising from minor offences, and avoid court time and resources from being unduly burdened by minor matters.¹⁰² In essence, infringement notices were designed to provide a system for punishment of an offence proportionate to the seriousness of the conduct.¹⁰³

⁹⁹ ALRC, Report 95, December 2002, 426 [12.4].

¹⁰⁰ ALRC, Report 95, December 2002, 426 [12.4].

¹⁰¹ ALRC, Report 95, December 2002, 426–7 [12.5].

¹⁰² ALRC, Report 95, December 2002, 426–7 [12.5]–[12.8].

¹⁰³ ALRC, Report 95, December 2002, 427 [12.8].

Over time, the types of provisions for which an infringement notice can issue have expanded. The ASIC Enforcement Review Taskforce explained in its December 2017 report that ASIC's powers in respect of infringement notices first started to widen in 2004, when it was given a power to issue an infringement notice for alleged breaches of continuous disclosure obligations.¹⁰⁴ ASIC now has powers to issue infringement notices for certain unconscionable conduct and consumer protection provisions of the *Australian Securities and Investments Commission Act 2001* (the ASIC Act), for strict liability offences and certain civil penalty provisions under the NCCP Act, and for breaches of market integrity rules, derivative transaction rules and derivative trade repository rules under the Corporations Act.¹⁰⁵

The ASIC Enforcement Review Taskforce recommended that further provisions be made infringement notice provisions.¹⁰⁶ The Bill currently before the Senate that implements the Taskforce's recommendations will, if enacted, have the effect that all strict liability and absolute liability offences in the Corporations Act, and certain civil penalty provisions in the Corporations Act and Insurance Contracts Act, will be subject to an infringement notice regime.¹⁰⁷

The availability of infringement notices for non-criminal provisions is relatively new and the range of conduct in respect of which they may be issued has expanded quickly. The Taskforce's recommendations will increase the number of provisions within the infringement notice regime.

The use of infringement notices for types of contraventions that involve matters of judgment has been criticised.¹⁰⁸ In particular, the Australian Law Reform Commission (ALRC) criticised the proposal to introduce an infringement notice regime for contraventions of continuous disclosure provisions, and the Law Council of Australia has described the use of infringement notices for substantive contraventions as 'lazy

¹⁰⁴ Treasury, *ASIC Enforcement Review Taskforce Report*, 18 December 2017, 80.

¹⁰⁵ Treasury, *ASIC Enforcement Review Taskforce Report*, 18 December 2017, 80–1.

¹⁰⁶ Treasury, *ASIC Enforcement Review Taskforce Report*, 18 December 2017, 81.

¹⁰⁷ Explanatory Memorandum, Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 (Cth), 12.

¹⁰⁸ ASIC Taskforce Review, Report, 81.

regulation' that does not 'provide guidance to the community as to what conduct should be proscribed or not'.¹⁰⁹ Those criticisms were not accepted by the Enforcement Review.¹¹⁰

Further attention should be given to those criticisms. It cannot be doubted that infringement notices serve as a practical regulatory tool for dealing with non-compliance with some provisions. But I doubt that expanding the infringement notices regime can be shown to have served the public well.

Infringement notices give the regulator a course of action (reportable as an 'enforcement action') that is unlikely to have any real deterrent (or punitive) effect. That was amply borne out by the evidence of Mr Gary Dransfield of AAI in the sixth round of hearings.¹¹¹

Mr Dransfield's evidence was that AAI paid the sum of the four infringement notices issued by ASIC that alleged that representations made about a particular policy were misleading and deceptive, despite maintaining throughout ASIC's investigation that it did not believe the advertising was misleading or deceptive. In Mr Dransfield's words, AAI paid the infringement notices because it 'felt that it was appropriate [to] meet the requirements of [the] regulator'.¹¹² The sum of the infringement notices AAI paid – \$43,200 – represented 0.01% of the total amount it received in premiums from the policies for the relevant year – \$426 million.¹¹³ When asked whether the reputational effects that flowed from the infringement notice caused AAI to want to defend the allegations put against it, Mr Dransfield's evidence was that, generally, the view was taken that 'we should pay the penalty [and] move on'.¹¹⁴

¹⁰⁹ ASIC Taskforce Review, Report, 81.

¹¹⁰ See ASIC Taskforce Review, Report, 81–3 Recommendation 44.

¹¹¹ Transcript, Gary Dransfield, 20 September 2018, 6305–23, particularly at 6321–2.

¹¹² Transcript, Gary Dransfield, 20 September 2018, 6321.

¹¹³ Transcript, Gary Dransfield, 20 September 2018, 6321–2.

¹¹⁴ Transcript, Gary Dransfield, 20 September 2018, 6322.

That is, AAI saw paying the infringement notices as a way of bringing an issue to an end. And no doubt payment of the infringement notices did bring the issue to an end. But with what effect? Issuing the infringement notices may have been ‘convenient and expeditious’ but it achieved neither punishment nor deterrence.

Infringement notices are a useful way to deal with lax administrative conduct such as failure to file a return on time. But their use beyond purely regulatory matters will rarely be appropriate. And if the provision involves contestable matters of judgment – for example, an alleged breach of the prohibition on false and misleading conduct or the duty of utmost good faith – the issue of an infringement notice will rarely, if ever, be an appropriate regulatory response.

One risk of the use of infringement notices for a broader range of conduct risks is that it can encourage financial services entities to treat the consequential penalties as a cost of doing business, which is not compatible with the intent to deter further misconduct. That risk is heightened if the recipient of the notice is a large financial institution.

Ultimately, the use of infringement notices is dependent on the enforcement culture of the regulator. An enforcement culture that is properly focused upon effective enforcement of the law will recognise that infringement notices can play only a minor role in that task and, ordinarily, that role will be limited to penalising administrative failings.

I recommend that ASIC’s enforcement policy in respect of infringement notices be redrawn to reflect that:

- infringement notices should principally be used in respect of administrative failings by entities;
- the use of infringement notices for provisions that require an evaluative judgment will rarely, if ever, be appropriate; and
- beyond purely administrative failings, infringement notices will rarely be the appropriate enforcement tool where the infringing party is a large corporation.

3.6 Enforceable undertakings

ASIC rightly describes an enforceable undertaking (EU) as a form of administrative settlement that ASIC may accept as an alternative to civil court action or certain other administrative actions.¹¹⁵ ASIC may accept EUs given by a person, or a responsible entity of a managed investment scheme, in connection with a matter for which ASIC has a function or power under the ASIC Act or related legislation.¹¹⁶

In Regulatory Guide 100, ASIC sets out its approach to accepting EUs. The approach has two component parts. It is necessary to say something about each.

The first is that ASIC will not consider an EU unless it has reason to believe there has been a contravention of relevant legislation and it has commenced an investigation or surveillance of the conduct it believes gives rise to the suspected contravention.¹¹⁷

These are important conditions. They are important because they identify the essential foundations for ASIC's acceptance of an EU.

The second part of ASIC's stated approach is that it will only use EUs where they result in a 'more effective regulatory outcome'.¹¹⁸ ASIC says it will generally consider accepting an EU only where:¹¹⁹

- it has weighed up the nature of the alleged breach and the effectiveness of the regulatory outcome offered by the EU compared with outcomes offered by other available enforcement remedies; and
- it believes an EU is the most effective and appropriate regulatory outcome given the significance of the issues to the market and the community, the nature and seriousness of the alleged breach and the compliance history of the entity.

¹¹⁵ ASIC, Regulatory Guide 100, February 2015, 5–7.

¹¹⁶ See ASIC Act ss 93AA, 93A.

¹¹⁷ ASIC, Regulatory Guide 100, February 2015, 8 [100.17].

¹¹⁸ ASIC, Regulatory Guide 100, February 2015, 9 [100.24]–[100.25].

¹¹⁹ ASIC, Regulatory Guide 100, February 2015, 9 [100.20].

ASIC says it considers an EU to be an effective regulatory outcome if it does all or any of the following:¹²⁰

- promotes the integrity of, and public confidence in, Australia's financial markets and corporate governance;
- specifically deters the person from future instances of the conduct that gave rise to the undertaking;
- promotes general deterrence by making the business community aware of the conduct and the consequences arising from engaging in that conduct;
- provides an ongoing benefit by way of an improved compliance program.

In the *Interim Report*, I observed that entities often only acknowledge ASIC's 'concerns' when they accept EUs, rather than acknowledge or accept their breach of specific provisions.¹²¹ That is, the facts agreed to in the EU often are not sufficient to establish a breach of the provisions said to have been breached.

EUs are a negotiated outcome between ASIC and the regulated entity. They can be used only if the entity agrees to give the undertaking. It may be assumed that the entity's decision to agree to give the undertaking will be influenced by its willingness to acknowledge ASIC's 'concerns', the strength of the evidence available to support ASIC's concerns, and the availability and nature of other remedies for ASIC to pursue.¹²²

Should the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 (Cth) be enacted, ASIC will be given disgorgement remedies in civil proceedings and a directions power, which extends to ordering remediation. In these circumstances, it will be more difficult to show that an EU will result in a more effective regulatory outcome than could be achieved by other means. It would follow that ASIC's use of EUs may be expected to be less frequent.

¹²⁰ ASIC, Regulatory Guide 100, February 2015, 9 [100.25].

¹²¹ FSRC, *Interim Report*, vol 1, 271.

¹²² See the discussion in the ASIC Taskforce Review, Report, 100.

The flexibility of EUs has undoubted appeal. But that appeal cannot be allowed to distract attention from the fact that EUs ordinarily are given in circumstances where the regulator has formed a view that the law has been breached. That is, they are used in aid of enforcement of the law.

As I have said above, and as ASIC has accepted, the first question to be asked when misconduct has been identified is ‘why not litigate?’. One answer to that question is that a better regulatory outcome can be achieved by the use of an EU. But that view cannot be formed without having first given proper consideration to questions of deterrence, both general and specific. A regulatory response to a breach of law that does not deter, generally and specifically, will rarely be a more effective regulatory outcome.

When an entity fails to acknowledge that it has done wrong the risk is that it considers the promises made in the EU as no more than the cost of doing business or the cost of placating the regulator. And the absence of a judicial determination means that none of the regulator, the entity concerned, or the market more generally, can be sure if the conduct was wrongful. All of those factors will ordinarily point firmly away from accepting an EU.

If, despite all of these considerations, an EU can still be said to be a more effective regulatory outcome, ASIC should adopt a policy that it will generally not agree to an EU in respect of a civil penalty provision without the entity acknowledging that it has breached one or more specific legislative provisions.

3.7 Making the change in ASIC’s enforcement culture

3.7.1 Internal review

ASIC’s first step, which it had taken at the time it made its submissions in response to the *Interim Report*, has been to undertake an Internal Enforcement Review focusing particularly on ‘policies, processes and decision-making procedures’ relevant to ‘whether or not to enforce the law using criminal and civil proceedings or other options’ and ‘the effectiveness and timeliness of the conduct of litigation and of enforcement outcomes’.¹²³

¹²³ ASIC, Interim Report Submission, 6 [27].

Policies, processes and procedures are important to the proper operation of an organisation like ASIC. There can be no basis for criticising ASIC reviewing its policies, processes and procedures about enforcement. But only time and experience will tell whether altering statements of policies, processes and procedures is effective in achieving their more fundamental purposes.

Time and experience will be necessary because ASIC's statements of enforcement policies, and its processes and procedures as they stood at the time of the events described in the course of the Commission, were not unorthodox. They were statements entirely consistent with the enforcement pyramid model of sanctions of escalating severity.¹²⁴ And ASIC's stated policies about enforcement did not preclude it from taking much stronger steps than it did. This is why I have said that the question is one of culture rather than of needing to reformulate policies, processes and procedures. Any resulting restatement of policies, processes or procedures will be important only to the extent that it changes *what* ASIC does, as distinct from *how* it is done.

A related point concerns the structure of the enforcement function as compared with other units within ASIC. Because enforcement is concerned with deciding whether and what legal action is to be taken against an entity, it must, so far as possible, be independent of, and free from continuing relationships with, that entity.

As noted earlier, the risk of regulatory capture is well acknowledged.¹²⁵ One means of avoiding regulatory capture affecting enforcement decisions is to have the enforcement arm of ASIC separated from day-to-day dealings with the entities it regulates to the greatest possible extent.

Enforcement staff will have to meet with regulated entities to discuss enforcement decisions. So, for example, enforcement staff will have to negotiate about litigation that is on foot. But those meetings should be conducted through the parties' legal representatives and with appropriate formality. Enforcement staff should not be responsible for the general

¹²⁴ ASIC, Interim Report Submission, 4–5 [18]–[23].

¹²⁵ See, eg, James Kwak, 'Cultural Capital and the Financial Crisis' in Daniel Carpenter and David Moss (eds), *Preventing Regulatory Capture* (Cambridge, 2014) 71–98.

relationship between the regulator and the regulated entity.¹²⁶

Their involvement with an entity should be matter-specific.

Within the regulator, enforcement officers must be relied upon for clear and objective advice and action. Those responsible for continuing supervision of an entity may give too much weight to past good conduct, or may – even subconsciously – explain away conduct that would otherwise raise a red flag.

In short, enforcement is radically different from most other functions within a regulator and, to the maximum extent practicable, should be divorced from those other functions. ASIC's Enforcement Review report recommends the establishment of an Office of Enforcement.¹²⁷ At a general level – I say nothing as to the proposed role of Commissioners in that office – functional separation of enforcement is consistent with what I have said about the radical difference between enforcement and other regulatory functions.

3.7.2 Altering the management structure

Beyond the essential structure established by the ASIC Act, it is for ASIC to decide what organisational structure will best help it fulfil its remit.

I note the recent changes made in ASIC's management structure by the creation of a group of executive directors (immediately below the Commissioners), who are to manage particular parts of ASIC's activities. I note also that every one of these positions was filled from the existing ranks of senior team leaders without any opportunity for others within or without ASIC to apply for the positions.

One of the chief objectives of the change is said to be to allow Commissioners to deal better with higher-level strategic issues.¹²⁸ However, introducing a new level of management must not be permitted to prevent the proper application of the principles I have set out above under the heading 'Litigation' when deciding whether, and what form of, enforcement action will

¹²⁶ Exhibit 7.157, 20 June 2018, Meeting Invitation Re 'AMP Executive Group & ASIC (Reset)'.

¹²⁷ Exhibit 7.159, 6 January 2019, Summary of Review of ASIC's Enforcement Policies.

¹²⁸ Exhibit 7.6.3, Witness statement of James Shipton, 7 November 2018, 4 [19].

be taken. The longer and more attenuated the chain of responsibility, the harder it is to challenge the views that are expressed along the way. And unless the decision relates to a simple and quasi-administrative requirement (which will either be met or not met), the judgments that are made along the way to making some recommendation about future action may not be explained in ways that give the final decision-maker a real sense of why the recommendation is as it is. No less importantly, the final decision-maker is all too often in a position where he or she cannot be held properly accountable for the decision that is made.

One significant challenge for ASIC's new administrative structure is likely to be the proper determination of enforcement decisions. If ASIC's new management structure operates as intended, it can be expected that many matters of significance will be determined by staff rather than Commissioners. That will require strong operational controls and clear lines of accountability.

But even under the new structure, inevitably some decisions will be reserved to the Commission, or a subset of it. The authors of ASIC's internal Enforcement Review consider that it is in the best interests of the Australian community that enforcement of the Corporations and Consumer Credit legislation be made the principal responsibility of a recognised sub-committee of the Commission comprised of the Deputy Chair and two Commissioners.¹²⁹ Close attention will need to be given to both the process by which matters are elevated to the Commissioners (either the proposed sub-committee or the Commissioners as a whole), and the quality of the information presented to the Commissioners. Both may have significant consequences for ASIC's enforcement work. Those observations remain true irrespective of whether an Office of Enforcement is established.

It is for the Commissioners to satisfy themselves that ASIC's processes are designed in a way that assists them to arrive at the correct decisions. I will say no more about that issue, or about ASIC's internal structure.

¹²⁹ Exhibit 7.159, 6 January 2019, Summary of Review of ASIC's Enforcement Policies.

Recommendation 6.2 – ASIC’s approach to enforcement

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.

4 APRA’s remit

APRA is the prudential ‘peak’ of the twin peaks model established following the recommendation of the Wallis Inquiry.¹³⁰

APRA is responsible for administering a wide range of legislation,¹³¹ most relevantly the *Banking Act 1959* (Cth) (the Banking Act), the *Life Insurance Act 1995* (Cth) (the Life Insurance Act), the *Insurance Act 1973* (Cth) (the Insurance Act)¹³² and the SIS Act.¹³³ Under each Act, APRA is responsible for (among other things):

¹³⁰ See Wallis Inquiry, Final Report, 17–24.

¹³¹ See, eg, the legislation listed in the definition of ‘prudential regulation framework law’ in APRA Act s 3(1).

¹³² APRA shares administration of the Life Insurance Act with ASIC: see Life Insurance Act s 7.

¹³³ APRA shares administration of the SIS Act with ASIC and the Commissioner of Taxation: see SIS Act ss 3(1), 6.

- the licensing,¹³⁴ authorisation¹³⁵ or registration¹³⁶ of the relevant entity subject to the Act;
- the suspension,¹³⁷ removal,¹³⁸ disqualification,¹³⁹ revocation¹⁴⁰ or cancellation¹⁴¹ of that licence (and persons within an entity) issued under the Act;
- giving directions where it believes an entity has failed to comply with the Act;¹⁴²
- conducting investigations where it believes there is a breach of the Act;¹⁴³
- determining prudential standards for conduct relating to prudential matters.¹⁴⁴

APRA's administration of all of these matters takes a prudential focus. That focus reflects the foundational promises made by institutions to customers. **Authorised deposit-taking institutions** (ADIs) and insurers promise depositors and insureds that they will be paid what they are due when the occasion (and the contract) demands it. APRA's regulatory focus is on ensuring ADIs and insurers do not fail and can therefore meet those promises.

By contrast with the promise of ADIs and insurers, the promise of the superannuation trustee is to manage the member's account in a particular way, in accordance with the covenants provided under

¹³⁴ SIS Act s 29D.

¹³⁵ Banking Act s 9; Insurance Act s 12(1).

¹³⁶ Life Insurance Act s 21.

¹³⁷ SIS Act s 133.

¹³⁸ Banking Act s 23; Insurance Act s 27.

¹³⁹ Banking Act s 21; Insurance Act s 25A; Life Insurance Act s 245A; SIS Act s 126H.

¹⁴⁰ Insurance Act s 15; Life Insurance Act s 26.

¹⁴¹ SIS Act s 29G.

¹⁴² Banking Act s 11CA; Insurance Act s 104; Life Insurance Act s 230B; SIS Act s 29EB.

¹⁴³ Banking Act s 61; Insurance Act s 52; Life Insurance Act s 137; SIS Act s 263.

¹⁴⁴ Banking Act s 11AF; Insurance Act s 32; Life Insurance Act s 230A; SIS Act s 34C.

the SIS Act. No particular outcome is promised.¹⁴⁵ Instead, the trustee promises (covenants) to exercise powers and perform its duties in the best interests of beneficiaries.

5 Co-regulation by APRA and ASIC

The original conception of APRA from the Wallis Inquiry has shaped how it perceives its role, how it performs its functions and how it exercises its powers. Mr Wayne Byres, APRA's Chair, put the matter plainly:

[W]e don't see ourselves as sometimes a prudential regulator and sometimes a conduct regulator. Our Act, our mandate, our name, the statement of expectations – everything that we have says we are a prudential regulator, but we do have these other things that take us into the conduct territory. But if we're going to be judged as to what we are, we're a prudential regulator.¹⁴⁶

In the course of the Commission's work, questions have arisen about the scope of APRA's remit and APRA's ability and willingness to exercise its powers. These questions have been raised in circumstances where misconduct has been observed in institutions regulated by APRA and at a time where it is increasingly acknowledged, both domestically and internationally,¹⁴⁷ that the conduct and governance of an institution are relevant to the prudential supervision of that institution.¹⁴⁸

The Commission's task, directed heavily as it is by the Terms of Reference to misconduct, did not involve an examination of all of APRA's work. Instead the examination of APRA focused largely on two issues: the supervision of the superannuation system and of the BEAR. I deal with each below.

¹⁴⁵ Except by defined benefit superannuation funds, and they are a small and diminishing number of funds.

¹⁴⁶ Transcript, Wayne Byres, 30 November 2018, 7449–50.

¹⁴⁷ See, eg, FSB, *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture: A Framework for Assessing Risk Culture*, 7 April 2014 <www.fsb.org/wp-content/uploads/140407.pdf>.

¹⁴⁸ I discuss those developments further in the chapter on culture, governance and remuneration.

5.1 Conduct regulation and superannuation

5.1.1 The current division

Responsibility for administration of the SIS Act is divided between APRA, ASIC and the Commissioner of Taxation. In general terms, ASIC's role under the SIS Act is limited to matters of disclosure. For example, ASIC has general administration of the covenants imposed on Registrable Superannuation Entity (RSE) licensees under section 52 of the SIS Act, but only to the extent that it relates to, in general terms, any disclosures made by the RSE licensee to members.¹⁴⁹ The Commissioner of Taxation is responsible for those parts of the SIS Act that concern self-managed superannuation funds and revenue matters more generally. It falls to APRA to administer the balance of the Act.

The trustee's covenants set out in the SIS Act have been generally described in the chapter dealing with superannuation. I will not repeat that summary here. For present purposes, it is important to note that many of the Act's covenants both protect the interests of individual members and serve a prudential purpose.

In a document published in 2018, APRA and ASIC set out their respective responsibilities in superannuation. They said that:¹⁵⁰

Five years after the introduction of the Superannuation Guarantee in 1992, the Wallis Inquiry (1997) made some fundamental recommendations which influenced the way superannuation was regulated. Key recommendations included the establishment of APRA as the prudential regulator and ASIC as the regulator for market conduct and disclosure. *The regulation of the superannuation system involves an adjustment to the twin peaks model* whereby APRA has general oversight of best interest obligations derived from trust law. The model reflects risks arising from the compulsory and market-linked nature of superannuation.

The last two sentences of this paragraph reflect the different nature of the financial promise an RSE licensee makes to members of the

¹⁴⁹ See SIS Act ss 6(1)(d) and (2).

¹⁵⁰ Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, Exhibit WB-1-45 [APRA.0075.0001.0306 at .0306] (emphasis added; footnotes omitted).

fund and the risks inherent in that promise. As I noted above, and in the chapter on superannuation, the promise of the superannuation trustee is to manage the member's account in a particular way, in accordance with the covenants provided under the SIS Act. That differs markedly from the promises made to consumers by ADIs and insurers. Unlike ADIs and insurers, an RSE licensee promises no particular outcome.¹⁵¹ Instead, the trustee promises (it covenants) to exercise powers and perform its duties in the best interests of beneficiaries. The SIS Act therefore requires the regulator with administration of the Act (in this case, APRA) to have regard not only to the *viability* of each fund but also to the *conduct* of trustees.

5.1.2 Enlarging ASIC's role

Allocating responsibilities between prudential and conduct regulation is not always assisted by using the word 'conduct' to describe the type of activity requiring a regulator's attention. Conduct often has both prudential and non-prudential connotations. In its prudential sense, conduct is most directly concerned with the institution in question being administered with appropriate integrity, prudence and professional skill and with action by the institution that, alone or in aggregate, could present a threat to the survival of the institution or the stability of the market. In each case, the focus is on the health of the institution and its ability to meet the promises it has made, and the health of the broader market. In its more common, non-prudential sense, 'conduct' is concerned with consumer protection and market conduct rules. Its essential focus is on the rights and interests of consumers in the context of their participation in the financial services industry.

APRA and ASIC have acknowledged that each has a responsibility for conduct issues concerning RSE licensees. ASIC has a responsibility because RSE licensees are also **Australian financial services licence (AFSL)** holders. However, the current arrangements for the administration of the SIS Act mean that where an RSE licensee's conduct gives rise to harm to a member (other than in respect of disclosure) and is a breach of one or more of the covenants under section 52(2), the prospect of regulatory action is slight. APRA, as the prudential regulator, does not naturally administer those covenants with consumer protection in mind. ASIC, the conduct regulator, has a role limited to disclosure.

¹⁵¹ Save for, as noted above, defined benefit superannuation funds.

The Productivity Commission said, in its report on superannuation, that ‘APRA and ASIC’s respective roles need to be more clearly delineated and better aligned with their distinct “regulatory DNA”’.¹⁵²

It might be thought, therefore, that there is a need for a separate regulator for the superannuation sector altogether. For reasons I explain in the chapter on superannuation, I do not consider that is necessary.

The Productivity Commission proposed that ‘APRA should be distinctly focused on prudential health – ensuring high standards of system and fund performance. And ASIC should focus on the behaviour of the system – the conduct of trustees, advisers and the appropriateness of products (including for particular target markets)’.¹⁵³

I agree. In my opinion, the twin peaks should be preserved and reinforced in superannuation. For this reason, I recommend that APRA’s remit in respect of the SIS Act be shared with ASIC in a way that aligns with their traditional roles and strengths. As APRA submitted, an appropriate allocation of responsibility would be as follows:

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 ...

As the conduct and disclosure regulator, ASIC’s role in superannuation primarily concerns the relationship between RSE licensees and individual consumers.¹⁵⁴

I have reached this conclusion for three broad reasons.

¹⁵² Productivity Commission, Report 91, *Superannuation: Assessing Efficiency and Competitiveness*, 21 December 2018, 459

¹⁵³ Productivity Commission, Report 91, *Superannuation: Assessing Efficiency and Competitiveness*, 21 December 2018, 459.

¹⁵⁴ APRA, Module 5 Policy Submission, 8 [15]–[16].

First, **providing ASIC with the power to protect the interests of members would provide some consistency across the two legislative regimes that apply to RSE licensees.** An RSE licensee holds an AFSL and in holding that licence is subject to the obligations under section 912A of the Corporations Act. Those obligations have some general similarity with obligations imposed under section 52 (and section 52A) of the SIS Act. They are also similar to the obligations imposed on RSE licensees who are authorised to offer a MySuper product under section 29VN(a) (and section 29VO) of the SIS Act. It is evident that the same conduct may give rise to breaches of all of these provisions.

The second reason relates to practical matters. **APRA's skills are geared to prudential regulation.** Its capabilities in respect of enforcement are less developed, and are currently the subject of an internal review.¹⁵⁵ Its enforcement culture is similarly under-developed. Seldom, if ever, has it brought proceedings of the kind it instituted in December 2018 against persons and entities associated with IOOF.

Conversely, **enforcement is a fundamental aspect of ASIC's work.** In enforcing the SIS Act, ASIC would face issues not dissimilar to those it currently faces in enforcing other legislation. For example, the covenants of RSE licensees and their directors under the SIS Act are akin to the duties that ASIC already enforces in respect of responsible entities of managed investment schemes and their officers under the Corporations Act.¹⁵⁶

The third reason for wanting to embed the twin peaks model into superannuation is informed by APRA's approach to its core tasks. APRA is predisposed to methods of regulation that rely on 'supervisory suasion'¹⁵⁷ conducted 'behind closed doors', rather than to public deterrence.¹⁵⁸ The prudential regulator may wonder whether public denunciation of an entity might disturb the stability of an entity or the system. But, as I have said, deterrence of misconduct depends upon visible public denunciation and punishment. ASIC's core work is consistent with that objective. APRA's is not.

¹⁵⁵ Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, 81–3 [325]–[334].

¹⁵⁶ Corporations Act ss 601FC, 601FD; SIS Act ss 52, 52A.

¹⁵⁷ Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, 86 [341].

¹⁵⁸ Transcript, Wayne Byres, 30 November 2018, 7451–2.

Because of the nature of its core tasks, APRA is more alive and attentive to threats to the stability and safety of an entity or the financial system as a whole than it is to consumer outcomes. As the Wallis Inquiry noted, where an agency is charged with both consumer protection and prudential regulation, consumer protection tends to become subservient to the prudential objectives.¹⁵⁹ When asked if the ability to commence proceedings for breaches of the SIS Act was in tension with APRA's regulatory approach, Mr Byres answered:

To some extent, yes. There are obvious tensions there. And if we were – if we were taking lots and lots of enforcement action, I would probably have to conclude we were a poor prudential supervisor because ideally we should be trying to head these things off.¹⁶⁰

Recommendation 6.3 – General principles for co-regulation

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.

¹⁵⁹ Wallis Inquiry, Final Report, 18 March 1997, 244.

¹⁶⁰ Transcript, Wayne Byres, 30 November 2018, 7478.

5.1.3 Giving effect to co-regulation

It is necessary then to say something about which provisions ASIC should have the ability to enforce, and how this should be achieved.

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. They are provisions that have members' interests and outcomes as their touchstone. At a minimum, this will include sections 52, 52A, 29VN and 29VO, but I do not intend that to be an exhaustive list. That expansion of ASIC's functions and powers will also increase the range of circumstances in which it can cause proceedings to be commenced in the name of beneficiaries to recover loss or damage resulting from a breach of the Act.¹⁶¹ ASIC is the more appropriate litigant for those proceedings for the reasons I have given.

To be clear, the provisions should not exclude APRA from exercising the same powers. Any decision by APRA to litigate in respect of a provision that is also actionable at the suit of ASIC will be motivated by different concerns. But APRA should retain the ability to have recourse to the provisions in order to achieve the prudential objectives they can serve.

It is also necessary to say something about some responsibilities and powers that APRA should retain, particularly under the SIS Act. Section 6 of the SIS Act sets out the divisions of administrative responsibilities under the Act. In large part these should not change. 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. This includes any powers to apply to the court to disqualify a person (section 126H of the SIS Act) and remove that person from being a director of a trustee (section 133); the power to accept an EU (section 262A) and to conduct an investigation under section 263(1), where it appears to APRA that there has been a contravention of the Act. It also includes any power to issue directions that

¹⁶¹ SIS Act s 298.

APRA presently has or is to be given.¹⁶² I consider the directions power to be a useful complement to APRA's supervisory toolkit because it can be used to bring pressure to bear on an unco-operative trustee. APRA has itself expressed support for having a broader directions power, which will reflect the scope of directions powers it has for other industries it regulates.¹⁶³

Recommendation 6.4 – ASIC as conduct regulator

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.

Recommendation 6.5 – APRA to retain functions

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.

5.2 The BEAR

Another overlap between conduct matters and prudential matters arises from the Banking Executive Accountability Regime (BEAR). It will be recalled that the regime came into effect for large ADIs on 1 July 2018

¹⁶² The amendments proposed by the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2017 would give APRA the power to give directions where it has 'prudential concerns' in certain circumstances: see Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2017, 56 [6.12]. Under the proposed provisions, APRA would be able to issue a direction if it has reason to believe that the direction is necessary 'in the interests of beneficiaries' or where the failure to issue a direction 'would materially prejudice the interests or reasonable expectations of those beneficiaries': see Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2017, 59 [6.29].

¹⁶³ Helen Rowell, 'Opening Statement' (Speech delivered at the House of Representatives Standing Committee on Economics, Canberra, 10 October 2017) <www.apra.gov.au/media-centre/speeches/opening-statement-house-economics-committee-october-2017>.

and contains accountability obligations for both ADIs and ‘accountable persons’, as well as other obligations such as those associated with deferred remuneration. ADIs are required to conduct their business with honesty and integrity, and with due skill, care and diligence.¹⁶⁴ Accountable persons have a similar obligation in the way they conduct the responsibilities of their position.¹⁶⁵ But the BEAR also requires ADIs to take reasonable steps to prevent matters from arising that would adversely affect the ADI’s prudential standing or prudential reputation.¹⁶⁶ An equivalent obligation applies to the way accountable persons conduct their responsibilities.¹⁶⁷

The BEAR, therefore, has both a conduct and prudential outlook. So much is clear from the second reading speech, which emphasised that when community expectations are not met, appropriate consequences should follow for those accountable.¹⁶⁸ This is one reason ASIC should have a role to play in regulating and commencing proceedings in respect of the accountability obligations. Another is that the key accountability obligations reflect the obligations of AFSL holders under section 912A of the Corporations Act. As a practical matter, ASIC must be able to deal with both breaches together.

There should therefore be co-regulation or joint administration of the BEAR by ASIC and APRA. ASIC should be charged with overseeing those parts of Divisions 1, 2 and 3 that concern consumer protection and market conduct matters, and APRA should be charged with the prudential aspects of Part IIAA. That would mean that ASIC would be responsible for bringing any civil penalty proceeding against a contravention of Divisions 1, 2 or 3 to the extent that it related to conduct matters. And APRA would be responsible for bringing any civil penalty proceeding for a contravention of Part IIAA under section 37G to the extent it concerned prudential matters. It would be prudent to enable both ASIC and APRA to seek disqualification of accountable persons if they are satisfied that an accountable person has

¹⁶⁴ Banking Act s 37C(a).

¹⁶⁵ Banking Act s 37CA(a).

¹⁶⁶ Banking Act s 37C(c).

¹⁶⁷ Banking Act s 37C(c).

¹⁶⁸ Commonwealth, *Parliamentary Debates*, House of Representatives, 19 October 2017, 11270 (Scott Morrison, Treasurer).

breached his or her accountability obligations, although I would expect that the power would ordinarily be exercised by APRA.¹⁶⁹

Subject to what follows, I do not otherwise consider there to be a need for the obligations in the BEAR to be expanded, although consequential changes may be necessary in light of what I have said above. For example, sections 37C and 37CA should be amended to make clear that both ADIs and accountable persons must deal with ASIC in an open, constructive and co-operative way, as well as with APRA. And practical amendments should be made to provisions such as sections 37K and 37G(1) so that joint administration can be carried out.

Lastly, provisions modelled on the BEAR should be extended to all APRA-regulated financial services institutions. After medium and small ADIs have complied with the BEAR in accordance with the current timetable, the largest RSE licensees should also be required to comply with like provisions. Thereafter, the provisions should be applied to the balance of RSE licensees. After that, they should apply to the largest insurers and, thereafter, the balance of insurers.

These changes cannot and should not be made at once. They must be made sequentially and they will take time. There would be evident advantage in giving notice to all concerned of the general timetable that is proposed but implementation will depend upon how the changes play out and satisfaction that the changes made are proving effective.

Recommendation 6.6 – Joint administration of the BEAR

ASIC and APRA should jointly administer the BEAR. ASIC should be charged with overseeing those parts of Divisions 1, 2 and 3 of Part IIAA of the Banking Act that concern consumer protection and market conduct matters. APRA should be charged with overseeing the prudential aspects of Part IIAA.

¹⁶⁹ Banking Act s 37J.

Recommendation 6.7 – Statutory amendments

The obligations in sections 37C and 37CA of the Banking Act should be amended to make clear that an ADI and accountable person must deal with APRA and ASIC (as the case may be) in an open, constructive and co-operative way. Practical amendments should be made to provisions such as sections 37K and 37G(1) so as to facilitate joint administration.

Recommendation 6.8 – Extending the BEAR

Over time, provisions modelled on the BEAR should be extended to all APRA-regulated financial services institutions. APRA and ASIC should jointly administer those new provisions.

6 Regulatory co-ordination and information sharing

What I have said above about the utility in having ASIC as the principal conduct regulator (including in respect of superannuation) and the need for ASIC and APRA to co-regulate the BEAR, means that the two regulators will have to work more closely than ever across a range of entities and subject matters. Failures to share information, co-ordinate approaches and act with a consistent purpose will result in duplication of effort or, worse, regulatory failings.

6.1 History

There are events in the history of ASIC and APRA's relationship that show the harm that can come from a lack of co-ordination.

In April 2003, the Report of the HIH Royal Commission was published, providing early insight into the relationship between ASIC and APRA. The HIH Commission found failings in the joint relationship. These included deficiencies in information exchange on APRA's part, which

meant that ASIC was less well-informed of issues concerning HIH than it should have been.¹⁷⁰

Commissioner Owen said:¹⁷¹

The evidence indicated there were difficulties in the relationship between ASIC and APRA. Those arose principally from the fact that the two organisations took on overlapping and unclearly delineated roles from June 1998 in relation to financial service providers ... The differences in regulatory approach extended ... to information exchange between the two agencies, which was the subject of regular debate in the ASIC–APRA coordinating committee. [An ASIC employee] said that although there were legislative restrictions on such exchange, APRA was ‘conservative’ in its interpretation of those restrictions.

The Commission concluded that sensible co-ordination of relevant activities and exchange of information of possible interest to the other was required.¹⁷² In particular, the Commission recommended that communications and exchanges should be undertaken in a systematic way (through both formal and informal means) and based on clear protocols.¹⁷³

6.2 The need for change

Formalised co-ordination and co-operation between the regulators can no longer be an aspiration. It must become a reality. Co-ordination and co-operation will facilitate quicker detection of misconduct and allow for more timely enforcement action. Co-ordination must go beyond the current memorandum of understanding and informal meetings between representatives of the agencies. The regulators should be required to provide information to each other and to meet at particular intervals. The exchange of critical information should be required, facilitated and protected.

¹⁷⁰ See HIH Royal Commission, Final Report, vol 3, 466–7 [24.3.4].

¹⁷¹ HIH Royal Commission, Final Report, vol 3, 466–7 [24.3.4].

¹⁷² HIH Royal Commission, Final Report, vol 3, 466–7 [24.3.4].

¹⁷³ See HIH Royal Commission, Final Report, vol 3, 466–7 [24.3.4]. See also Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Collapse of Trio Capital*, May 2012. I say no more about that report.

The financial regulators must not be permitted to pursue what they independently perceive to be their own interests in respect of entities or laws in respect of which there is joint responsibility.

While many of the arrangements for inter-regulator collaboration will need to be worked out and agreed between the regulators, the approach should be founded on unambiguous rules for co-operation and information sharing.

6.3 Co-operation

To give statutory force to the practical necessity of co-operation, a provision should be inserted into each of the ASIC Act and the *Australian Prudential Regulation Authority Act 1998* (Cth) (the APRA Act) to the effect that, so far as is practicable, each regulator must¹⁷⁴ in performing its functions and exercising its powers inform and co-operate with any other financial regulator with regulatory responsibility for an affected entity.¹⁷⁵

That provision should be coupled with a requirement that APRA and ASIC prepare and maintain a memorandum setting out how the agencies intend to comply with their statutory duty to co-operate, including how they will co-ordinate their approach in areas of joint responsibility.¹⁷⁶

Both ASIC and APRA have various memoranda of understanding with each other and other regulators.¹⁷⁷ A joint memorandum was entered into between ASIC and APRA in May 2010 and supplemented by a joint protocol in June 2010. Neither document has since been updated. In the main, both documents use permissive or aspirational language. For example, each agency agrees to ‘endeavour to consult’ with the other about matters relevant to the other’s jurisdiction.¹⁷⁸ **The revised memorandum, which**

¹⁷⁴ Cf APRA Act s 10A.

¹⁷⁵ See, eg, *Australian Crime Commission Act 2002* (Cth) (the ACC Act) s 17 and *Financial Services and Markets Act 2000* (UK) c 8, s 3D.

¹⁷⁶ See, eg, *Financial Services and Markets Act 2000* (UK) c 8, s 3E.

¹⁷⁷ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, Exhibit HR-1-12 [APRA.007.0005.0007]; Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, Exhibit PK-6 [ASIC.0800.0012.0146]. See also Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, Exhibit WB-1-45 [APRA.0075.0001.0306].

¹⁷⁸ Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, Exhibit PK-6 [ASIC.0800.0012.0146 at .0148].

will need to take account of any changes made to implement the recommendations of this Report, should – at least in respect of core obligations – avoid permissive language and instead commit to real obligations.

Because the memorandum will be central to the joint relationship, the regulators should be required to review the operation of the memorandum at least every two years.

Given the importance of the memorandum to the proper administration of the laws that govern large parts of the Australian financial system, the memorandum should be declared to be a legislative instrument and should be laid before each House of Parliament.¹⁷⁹

APRA and ASIC should each be required to report on the operation of the memorandum and steps taken under it in their annual reports.

6.4 Information sharing

The complexities that attend the sharing of information between government agencies are well-acknowledged.¹⁸⁰ There will often be constraints, express or implied, on the use that may be made of documents and information obtained by government agencies by coercive process.¹⁸¹

Under the existing statutory arrangements, both ASIC and APRA are permitted to provide certain information to specified parties. Relevantly, ASIC *can* disclose confidential information (including information obtained by exercise of its compulsory powers) to APRA.¹⁸² APRA *may* also provide information to ASIC,¹⁸³ but only if APRA is satisfied that the disclosure of the information or the production of the document will assist ASIC to perform its functions or exercise its powers.¹⁸⁴

¹⁷⁹ See generally, *Legislation Act 2003* (Cth) ss 6, 38.

¹⁸⁰ Administrative Review Council, *The Coercive Information-gathering Powers of Government Agencies*, May 2008, 65–70.

¹⁸¹ *Johns v Australian Securities Commission* (1993) 178 CLR 408.

¹⁸² ASIC Act s 127(2A)(c).

¹⁸³ ASIC being a ‘financial sector supervisory agency’ within the meaning of the APRA Act: see s 3(1) (definition of ‘financial sector supervisory agency’).

¹⁸⁴ APRA Act s 56(5)(a).

Those provisions, and others found in the ASIC Act and the APRA Act, are of undoubted utility. An inability of financial regulators to share relevant information would lead to duplication of information requests and to agencies acting without all available information. However those provisions, while necessary, are not sufficient. As noted earlier, the changes I have proposed, particularly concerning the SIS Act and the BEAR, will require the regulators to work more closely together than they have before. To make those changes effective the current information-sharing provisions should be changed.

A new statutory scheme for the sharing of information between APRA and ASIC is required. The detail of the scheme will need to be carefully worked through. But it should be founded on the premise that joint responsibility and co-operation necessitates substantial commonality of information.

I favour a model that prefers mandatory, rather than discretionary, sharing of information. ASIC and APRA should, to the greatest extent possible, work from a single body of relevant information.

Information-sharing arrangements are not novel. A ready example may be found in governing legislation of the Australian Crime Commission (ACC). The ACC is responsible for carrying out operations and investigations of potential relevance to many law enforcement agencies, both state and Federal. Information sharing is therefore critical to its task.

The *Australian Crime Commission Act 2002* (Cth) (the ACC Act) requires the CEO of the ACC to assemble any admissible evidence of an offence against the law of the Commonwealth or of a state or territory and give that evidence to various persons, including the relevant law enforcement agency and any relevant prosecution services.¹⁸⁵ That duty is then coupled with a discretionary power to disclose information to government¹⁸⁶ and private¹⁸⁷ bodies in certain circumstances.

¹⁸⁵ ACC Act s 12.

¹⁸⁶ ACC Act ss 59AA, 59AAA.

¹⁸⁷ ACC Act s 59AB.

I recommend that each regulator be subject to a requirement to notify the other whenever it forms the belief, based on information available to it, that a breach may occur, or may have occurred, in respect of which the other regulator has enforcement responsibility. I consider that threshold, which does not require the formation of an opinion that a provision has *in fact* been breached, will more naturally result in regular exchanges of information.

But more is required to ensure that as far as possible, information gaps are closed. A change in both mindset and legislation is required. Rather than proceeding from a premise that certain information belongs to APRA or to ASIC, the preferable position is for information to be deemed to be ‘financial regulator information’. The APRA and ASIC Acts should be amended to *require* each entity to share any ‘financial regulator information’ that comes into their possession. Information coming within that description would include, but not be limited to, information concerning entities in respect of which both regulators have regulatory responsibilities and which is relevant to the exercise, or possible exercise, of a power or function of the other regulator. I suspect the most efficient way of storing that information will be in a shared database. But consideration will need to be given to the mechanics of the system, including how each regulator can be best made aware that documents have been uploaded to the database.

That is not to say that *all* documents and information need be shared. The drafting of the statutory definition of ‘financial regulator information’ will need to be given close attention. There will be some documents that should not come within the shared category. But that must be the exception and not the rule.

The mandatory sharing of information should mean that over time a substantial corpus of material will be collected and available – in as close to real time as technology allows – to each regulator. If properly designed and maintained, the shared database of information should become a valuable tool for the shared and individual work of ASIC and APRA.

Recommendation 6.9 – Statutory obligation to co-operate

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.

Recommendation 6.10 – Co-operation memorandum

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.

7 Governance of the regulators

The Terms of Reference set out in the Letters Patent establishing the Commission require me to inquire into and report on ‘the effectiveness and ability of regulators of financial services entities to identify and address misconduct by those entities’.¹⁸⁸ Consideration of that issue requires me to say something about the internal governance and accountability of both ASIC and APRA.

¹⁸⁸ *Letters Patent*, 14 December 2017, (g).

7.1 Independent non-executive directors?

7.1.1 ASIC

ASIC is a body corporate.¹⁸⁹ Its membership comprises at least three and not more than eight members.¹⁹⁰ At least three members must be appointed as full-time members.¹⁹¹ A Chairperson must be appointed.¹⁹² Up to two Deputy Chairpersons may be appointed.¹⁹³

ASIC's ultimate governing body is now comprised entirely by full-time members. The members of the Commission, the 'Commissioners', are collectively responsible for the achievement of ASIC's objectives.¹⁹⁴ Major strategic decisions are made at bi-monthly Commissioners' meetings.¹⁹⁵

The Commissioners work together, and with other ASIC officers, on a day-to-day basis. The members have in the past exercised considerable independent authority. In many cases, one or more of the members will have had an active role in items discussed at meetings of the Commissioners.

ASIC has recently taken steps that seek to remove Commissioners from operational decision-making. Until those changes came into effect, the members of ASIC exercised considerable executive power in making operational decisions, as well as exercising governance powers.

It has long been considered good practice for a majority of the directors of a publicly listed corporation to be non-executive and independent.¹⁹⁶

¹⁸⁹ ASIC Act s 8(1).

¹⁹⁰ ASIC Act s 9(1).

¹⁹¹ ASIC Act s 9(3).

¹⁹² ASIC Act s 10(1).

¹⁹³ ASIC Act ss 10(2)–(3).

¹⁹⁴ Exhibit 7.63, Witness statement of James Shipton, 7 November 2018, 16 [46].

¹⁹⁵ Exhibit 7.63, Witness statement of James Shipton, 7 November 2018, 16 [47].

¹⁹⁶ ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations 3rd edition*, Australian Securities Exchange Ltd, 2014, Recommendation 2.4, 17.

The United Kingdom's Higgs Review¹⁹⁷ describes non-executive directors as 'custodians of the governance process'.

There may be said to be no obvious reason why ASIC would not benefit in the same ways that listed entities do from the inclusion of non-executive directors on their boards. It may be argued that adding non-executive directors to ASIC may yield three chief benefits.

First, it may be said to improve the scope and quality of internal oversight, by placing independent, disinterested voices within ASIC's highest forum. The non-executive directors would stand apart from operational decision-making and be more distant from the senior executives with operational responsibility. That distance may help to bring different perspectives to important questions.

Second, adding non-executive directors may be said to provide an opportunity to increase – and potentially broaden – the skills and experience of ASIC's ultimate governing body.

Third, non-executive directors may be said to reinforce the independence of the Commission from those it regulates and from the government of the day.¹⁹⁸

To this point, ASIC has not had non-executive members. But there is nothing novel in the suggestion. In Australia, the RBA and the Payments Systems Board each have non-executive directors. In the United Kingdom the Bank of England (which, through the Prudential Regulation Authority, remains the prudential regulator), the Financial Conduct Authority (FCA), the Competition and Markets Authority and the Payments Systems Regulator all have non-executive directors – in some cases, a majority of non-executive directors. And in Hong Kong the Securities and Futures Commission has a number of non-executive directors.

Even so, I am not persuaded that change of this kind should now be made. To do so would add to the already radical changes upon which ASIC must

¹⁹⁷ Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors*, January 2003, 11 [1.6].

¹⁹⁸ For the Minister's power to direct ASIC, see ASIC Act s 12; but see also s 11(17).

now embark. I recommend that its already large remit be expanded in the ways I have described. ASIC itself recognises that its enforcement culture must change. The membership of the Commission has changed. As is explained further below, I recommend that ASIC, and APRA, should be subject to additional external review and accountability. I think the choice of those who are to perform the role of external review is more urgent and important than appointing non-executive members to ASIC. The essential requirement for both the role of external review and for a non-executive member of the Commission would be the same: deeply experienced, independently minded, people prepared to question what the full-time members of ASIC and the staff of ASIC do. The pool of suitable appointees is not large.

All this being so, I do not favour now recommending the appointment of additional, non-executive, members to ASIC.

7.1.2 APRA

In its initial formation, APRA's board was constituted by a full-time chair, a full-time CEO, two representatives of the RBA, a representative of ASIC and four part-time members.¹⁹⁹

That structure was replaced with a smaller board comprised entirely of full-time members following a recommendation by the HIH Royal Commission.²⁰⁰ One reason for that change was a concern that the presence of a member of ASIC on the board of APRA resulted in an assumption by staff of both organisations that information exchange was occurring at that level.²⁰¹ Another concern may have been that there was an insufficient number of full-time executives on the board.²⁰²

Those considerations would not speak against the presence of a small number of non-executive directors being appointed to APRA.

¹⁹⁹ See APRA Act, ss 19 and 27(5) as they stood before Act No 42 of 2003. Those sections were repealed by s 20, *Australian Prudential Regulation Authority Amendment Act 2003* (Cth) (Act No 42 of 2003).

²⁰⁰ HIH Royal Commission, Final Report, vol 1, lxix [18].

²⁰¹ HIH Royal Commission, Final Report, vol 1, 209.

²⁰² HIH Royal Commission, Final Report, vol 1, 207–9.

But, having said that, APRA's remit is more confined than ASIC's. It also has a considerably smaller board, currently comprising four members, with a statutory maximum of five members.²⁰³

While I think that APRA could benefit from the appointment of one or two non-executive directors, I do not recommend making that change. It may be, I do not say it should be, a matter to be revisited as part of the capability review that I recommend below.

7.2 Formalisation of procedure

The APRA Act contains provisions dealing with the times and places of meetings, the quorum required, who is to preside, how voting is to occur and the passing of resolutions without meetings.²⁰⁴ There are no analogous provisions in the ASIC Act.

While only procedural, the formalisation of the requirements for meetings will serve to reinforce the centrality of collective decision-making. The importance of Commissioner meetings, particularly given ASIC's recent internal changes, necessitates legal and procedural formality.

For that reason, I recommend that provisions substantially similar to those set out in the APRA Act be made in the ASIC Act.

Recommendation 6.11 – Formalising meeting procedure

The ASIC Act should be amended to include provisions substantially similar to those set out in sections 27–32 of the APRA Act – dealing with the times and places of Commissioner meetings, the quorum required, who is to preside, how voting is to occur and the passing of resolutions without meetings.

7.3 An accountability regime

The essential thesis that informs the BEAR is that a sound risk culture coupled with effective corporate governance and the imposition of stronger

²⁰³ APRA Act s 16(1).

²⁰⁴ APRA Act ss 27–32.

consequences will improve accountability. Improved accountability ultimately translates to improved performance.

APRA has said that the establishment and continuance of a strong risk culture requires:²⁰⁵

- a clear, transparent and common understanding within an institution of where accountability lies within the senior executive team for any particular part or aspect of the institution's business;
- a clear, transparent and common understanding within an institution of how a given individual meets his or her obligations as the accountable individual including, for example, by making decisions, serving as a point of review or challenge, or escalating matters as appropriate; and
- for those accountable individuals, direct and proportionate consequences of failure to meet their obligations within their area of accountability, whether it is by inappropriate action or failure to act.

The concept of risk culture is as applicable to a statutory authority as it is to a **financial services entity**. The 2003 Review of Corporate Governance of Statutory Authorities and Office Holders (the Uhrig Report) noted that 'accountability frameworks are an essential part of governance'.²⁰⁶

In the United Kingdom, the two regulators with joint responsibility for the Senior Managers Regime have chosen to apply the core elements of the regime to both agencies. The FCA has said:²⁰⁷

[The Senior Managers Regime is a] formal expression of the common sense, good governance practice that any organisation should adhere to. It was created against the backdrop of a clear and shared understanding that a culture of personal responsibility must be embedded at the heart of financial services. This is true of firms and regulators alike. We are not formally subject to the regime but we uphold the highest professional

²⁰⁵ APRA, *Information Paper: Implementing the Banking Executive Accountability Regime*, 17 October 2018, 6–7.

²⁰⁶ John Uhrig, *Review of the Corporate Governance of Statutory Authorities and Office Holders*, June 2003, 52.

²⁰⁷ Exhibit 7.78, Undated, Senior Management Regime, 3.

values and our stakeholders, including Parliament and the Treasury Select Committee rightly expect us to do so. In line with this, we have decided to apply the fundamental principles of the regime to our senior staff.

When asked if ASIC proposed to apply the BEAR principles to its senior staff, Mr Shipton said that he thought it ‘an excellent suggestion’ and that he was ‘minded to apply this form of rigour’ to ASIC. He also said that he thought the preparation of accountability maps ‘was just plain good practice of good governance’.²⁰⁸

Mr Shipton also referred to the ‘hypocritical risks of a regulator’ and added, ‘If we expect something of the regulated community, we must be holding that – that standard to ourselves’.²⁰⁹ I agree.

There are many ways that an accountability regime could be put into force. For example, a specific statutory regime could be designed or parts of the BEAR could be adapted and applied by analogy.

At least as an initial step, I recommend that both APRA and ASIC apply the core tenets of the BEAR to their management structure. The rigour required to produce accountability maps and statements would oblige each regulator to consider its internal arrangements carefully.

The application of the BEAR should be undertaken in consultation with the external oversight body that I recommend below. That role of that body, in so far as the application of the BEAR principles to the regulators is concerned, should be analogous to that of APRA under the current regime. For example, accountability maps should be lodged with the oversight authority and that authority should generally superintend compliance with the BEAR principles.

Recommendation 6.12 – Application of the BEAR to regulators

In a manner agreed with the external oversight body (the establishment of which is the subject of Recommendation 6.14 below) each of APRA and ASIC should internally formulate and apply to its own management accountability principles of the kind established by the BEAR.

²⁰⁸ Transcript, James Shipton, 23 November 2018, 7016.

²⁰⁹ Transcript, James Shipton, 23 November 2018, 7016.

7.4 Periodic capability reviews

The pace of change in the finance sector must be responded to by its regulators. As the market moves, regulators should consider if their structure and processes remain appropriately adapted to market conditions.

ASIC has recently undergone a capability review. APRA has not. I recommend that a formal capability review be undertaken of APRA, with that review being completed as soon as is reasonably practicable after the publication of this Report.

More generally, capability reviews should be seen as part of the regular review of financial regulators. They present an opportunity to consider the operational abilities and requirements of the regulators. That kind of top to bottom consideration is often neglected due to operational demands.

I recommend that both APRA and ASIC be subjected to at least quadrennial capability reviews. Responsibility for the periodic review should rest with the oversight authority. That is not to say that the oversight authority should conduct the review itself. It may, should it wish, appoint an expert panel to undertake the review. But the review should be undertaken at the instruction of the oversight authority and the resulting report provided to both the regulator in question and the oversight authority.

Undertaking capability reviews with reasonable frequency will assist both the regulator and the Government by identifying resourcing and capability gaps. The importance of the financial regulators to the economy demands that they be fit for purpose. Regular, independent reviews will assist in meeting that goal.

Recommendation 6.13 – Regular capability reviews

APRA and ASIC should each be subject to at least quadrennial capability reviews. A capability review should be undertaken for APRA as soon as is reasonably practicable.

8 External oversight

As I have said, the Terms of Reference direct me to consider ‘the effectiveness and ability of regulators of financial services entities to identify and address misconduct by those entities’. The role and effectiveness of external oversight is relevant to that consideration.

It is necessary to begin by noting the mechanisms that now exist.

8.1 Existing mechanisms

8.1.1 Parliamentary oversight

ASIC’s principal external oversight body is the Parliamentary Joint Committee on Corporations and Financial Services.²¹⁰

The Joint Committee consists of 10 members, five from each House of Parliament.²¹¹ Its duties are prescribed by section 243 of the ASIC Act and include inquiring into and reporting to each House on the activities of ASIC,²¹² the operation of the corporations legislation²¹³ and any question connected with the Committee’s duties referred to it by either House.²¹⁴

The Chair of ASIC is required to prepare and give an annual report to the Minister responsible for ASIC.²¹⁵ The report must include certain information²¹⁶ including information about ASIC’s monitoring and promotion

²¹⁰ The Senate Economics Committee and the House Economics Committee also have responsibilities in respect of referred matters concerning ASIC or any Treasury legislation in so far as it concerns ASIC.

²¹¹ ASIC Act s 241(2).

²¹² ASIC Act s 243(a)(i).

²¹³ ASIC Act s 243(a)(ii).

²¹⁴ ASIC Act s 243(c).

²¹⁵ See ASIC Act s 9A; *Public Governance, Performance and Accountability Act 2013* (Cth) ss 12(2), 46.

²¹⁶ ASIC Act s 136.

of market integrity and consumer protection²¹⁷ and ASIC's use of compulsory powers.²¹⁸ The Committee is also responsible for reviewing ASIC's annual report.²¹⁹

APRA is also subject to parliamentary and ministerial oversight. APRA's members and senior executives regularly appear before Senate and House of Representatives parliamentary committees, as well as ad hoc parliamentary committees and inquiries.²²⁰ The Treasurer and APRA's members meet at least annually²²¹ and the Government reviews APRA's annual budget and approves the levies that are imposed on industry each year to fund APRA's operations.²²²

Parliamentary oversight of ASIC and APRA is essential. It is essential because although broadly independent, regulators form part of the executive government and are therefore accountable to the legislature. But parliamentary oversight necessarily has some limitations. Those limitations include the amount of time that can be devoted to a particular entity or topic, the time available to committee members to prepare for the hearings and the training, skill and experience of the members of the committee, who will sometimes need to review and assess complex information on matters of expertise.

Mr Shipton acknowledged that the current arrangements for parliamentary scrutiny of ASIC could be improved. He suggested that ASIC could develop frameworks, metrics and methodologies for review of its performance.²²³ The Joint Committee could then review ASIC's performance against the agreed benchmarks.²²⁴

²¹⁷ ASIC Act s 136(1)(b).

²¹⁸ ASIC Act s 136(2A) and ASIC Regulations 2001 (Cth) reg 8AAA.

²¹⁹ ASIC Act s 243(b).

²²⁰ Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, 25 [112].

²²¹ APRA, Statement of Expectations (2018), 4 December 2018, <www.apra.gov.au/statement-expectations-2018>.

²²² Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, 25 [112].

²²³ Transcript, James Shipton, 23 November 2018, 7023.

²²⁴ Exhibit 7.63, Witness statement of James Shipton, 7 November 2018, 19–20 [61].

8.1.2 Ministerial responsibility

ASIC and APRA are also both accountable to their relevant ministers. Ministerial accountability takes various forms. Both regulators are subject to direction by the Minister in particular respects.²²⁵ Both are issued with statements of expectations from the Government,²²⁶ which they respond to with a statement of intent.

These, too, are essential means of accountability.

The Uhrig Report identified limitations on the ability of ministers to ensure effective governance of statutory authorities, including:²²⁷

- limitations on a minister's capacity to direct authorities in terms of the conduct of their operations;
- the presence of a board which does not have full power to act, having the effect of confusing and diluting accountabilities between the Minister, the board and the chief executive;
- the lack of clarity in relationships and responsibilities reduces the capacity of ministers to be satisfied with existing accountability arrangements; and
- the 'hands off' aura surrounding statutory authorities, which arises from the need for operational independence, means that the boundaries of the relationships between statutory authorities, ministers and portfolio departments are not clear to the participants.

Generally speaking, the power of the Minister is to determine some or all of each regulator's policies or priorities. And while ministers may seek information or assurances from a regulator in connection with a funding request or budgetary cycle, it cannot be expected that ministers will comprehensively review the functioning of a regulator on a rolling basis.

²²⁵ For the Minister's power to direct ASIC see ASIC Act s 12, but note s 11(17). For the Minister's power to direct APRA see APRA Act s 12.

²²⁶ See, eg, Exhibit 7.63, Witness statement of James Shipton, 7 November 2018, Exhibit JS-1 [ASIC.0800.0016.3087].

²²⁷ John Uhrig, *Report of the Corporate Governance of Statutory Authorities and Office Holders*, June 2003, 53.

As with parliamentary accountability, ministerial oversight of regulators is essential but has limitations.

8.1.3 Regulator Performance Framework

Each of ASIC and APRA reports annually against the Government's Regulator Performance Framework.²²⁸ That framework, which was released in October 2014, is designed to apply generically to Commonwealth regulators of all kinds.²²⁹

The Regulator Performance Framework is not intended to serve as an assessment of the overall performance of regulators. It is, by design, more narrow in focus. The framework assesses Commonwealth regulators' performance when interacting with business, the community and individuals against a common set of performance indicators. It is directed to establishing performance measures that encourage regulators to 'minimise their impact on those they regulate while still delivering the vital role they have been asked to perform'.²³⁰

ASIC and APRA each publish self-assessments of their performance against the framework's six indicators.²³¹

²²⁸ Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, 2 [112]; Treasury, Interim Report Submission, 41 [203].

²²⁹ Commonwealth of Australia, *Regulator Performance Framework*, October 2014, i.

²³⁰ Commonwealth of Australia, *Regulator Performance Framework*, October 2014, i.

²³¹ The indicators are: (1) regulators do not unnecessarily impede the efficient operation of regulated entities; (2) communication with regulated entities is clear, targeted and effective; (3) actions undertaken by regulators are proportionate to the regulatory risk being managed; (4) compliance and monitoring approaches are streamlined and co-ordinated; (5) regulators are open and transparent in their dealings with regulated entities; (6) regulators actively contribute to continuous improvement of regulatory frameworks. (See Commonwealth of Australia, *Regulator Performance Framework*, October 2014, 4.)

8.1.4 Other existing forms of oversight

There are some other oversight mechanisms that apply to the regulators.

Both ASIC and APRA submit annual reports that contain certified statements of their performance in accordance with the *Public Governance, Performance and Accountability Act 2013* (Cth). Like other Commonwealth regulators, they are subject to the best practice regulation process administered by the Office of Best Practice Regulation.²³² They also engage with the Treasurer's Financial Sector Advisory Council, which provides a forum for regulated entities to advise Government on financial sector policies and the performance of financial regulators. The Australian National Audit Office also audits ASIC and APRA's annual financial accounts and occasionally undertakes ad hoc reviews of their performance.²³³

8.2 Additional oversight required

Each body with an oversight role in respect of APRA or ASIC serves an important, but limited, function. The current framework is heavily focused on governance and financial accountability.²³⁴ None of the existing processes requires regular and systematic review of how well either regulator discharges its statutory functions or exercises its statutory powers.

The Murray Inquiry recommended that a Financial Regulator Assessment Board be established 'to undertake annual ex post reviews of overall regulator performance against their mandates'.²³⁵

Given the importance and size of ASIC's remit, I have come to the view that a permanent oversight body is now required. Similarly, the significance of APRA's work to the strength of Australia's financial system and the interconnectedness of its work with that of ASIC – which will be significantly amplified if the recommendations I have made are implemented – mean that it too should be subject to more consistent and rigorous assessment.

²³² Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, 25 [112]

²³³ Exhibit 7.145, Witness statement of Wayne Byres, 27 November 2018, 26 [112].

²³⁴ See Treasury, Interim Report Submission, 41 [200].

²³⁵ Murray Inquiry, Final Report, 235. See also John Uhrig, *Report of the Corporate Governance of Statutory Authorities and Office Holders*, June 2003, 52–5.

9 A new oversight authority

The need for a permanent oversight body gives rise to the further questions: What oversight is required, and who should undertake that work?

9.1 The additional oversight required

The essential role of the oversight body should be to assess:

- the effectiveness of each regulator in discharging its functions and meeting its statutory objects;
- the performance of the leaders and decision-makers within the regulator; and
- how the regulator exercises its statutory powers.

While it may become necessary to develop benchmarks or metrics that serve as a shorthand method to assess performance, formal measures should not be allowed to obscure the fact that the role of each regulator is defined by statute and the tasks entrusted to each regulator by its statute must be the foundation of any assessment. In most cases, that assessment will not be capable of measurement or quantitative expression. For example, the number of proceedings filed, or infringement notices issued, will say little about ASIC's enforcement culture unless the decisions behind those numbers are evaluated.

Over time, the oversight authority should develop a comprehensive list of items against which each agency's performance is evaluated. While the broad contours of the areas of enquiry will be largely obvious (for example, licensing, enforcement, consumer protection, regulatory co-operation and market supervision), as ever, the difficulty will come in designing the detail. An important consideration will be how effective the agencies are in enforcing the laws within their remit. (That will determine whether more radical steps, such as creating a specialist civil enforcement agency, should be reconsidered.)

There are three specific matters arising from the reforms that I have proposed in this chapter that should be the subject of oversight and assessment.

The first concerns inter-regulator co-operation. The centrality of regulatory co-operation necessitates that the oversight body review each entity's compliance with the proposed statutory obligation to co-operate with the other, including fulfilling its information-sharing obligations.

The second concerns the proposed memorandum between ASIC and APRA. Because that document will be central to the regulatory arrangements, the oversight authority's mandate should include consideration of the extent to which each entity has complied with the terms of the memorandum and the effectiveness of the operation of the memorandum. Any recommendations made by the oversight authority could then be considered and, if thought appropriate, taken up in the regular (at least biennial) reviews of that document.

Third, the oversight authority's remit should extend to assessing ASIC and APRA's adoption of the BEAR. In that regard, the oversight authority should be seen as having a role broadly analogous to that of APRA under the current BEAR arrangements.

Beyond that, it will be necessary for the oversight authority to determine how it can assess most effectively the extent to which each entity meets its statutory objects.

The oversight authority's work should influence and guide ASIC, APRA and the Government. To do so, the authority should be required to prepare a comprehensive assessment of each regulator biennially and provide that report to the responsible minister. The Minister should be required to cause a copy of the report to be laid before each House of the Parliament within 20 sitting days of that House after the report is received by the Minister. The authority should also be permitted to prepare subject-matter-specific reports on an ad hoc basis if the authority considers that necessary.

9.2 The appropriate oversight body

It remains to be determined which entity should assume responsibility for the additional oversight and assessment I have recommended.

Mr Shipton suggested that the Council of Financial Regulators (CFR) – a body constituted by the heads of the financial regulators and chaired by the Governor of the RBA – could be used as the forum for assessing

‘both the effectiveness of financial regulation (in terms of stability and conduct) in Australia, and the effectiveness of individual regulators’.²³⁶

I am not in favour of the CFR being charged with the second task. The CFR serves as an important, formal occasion for discussion between the financial regulators. It is essentially a forum for co-ordination between the various regulators. I have already emphasised the importance of regulatory co-ordination. Adding an assessment function to the CFR’s remit would mark a radical departure from the current conception of that body. I do not support such a departure.

I consider that a new body is required. Its sole task would be to perform the functions I have described. It should be established by legislation and be independent of Government.

The oversight body should be constituted by three part-time members. Membership of the body should be reserved for people of unquestionable experience in relevant disciplines. Those members should be supported by a permanent staff capable of advancing the work of the authority on a day-to-day basis.

While the staffing arrangements for the new authority are a matter for Government, the appointed members should be supported by a permanent body of staff or secretariat. If the secretariat model was chosen, it could be staffed by, but perform its functions independently from, the Treasury. The permanent office should be led by a head of office capable of directing the daily operations of the authority and advancing the work program determined by the members.

The legislation to establish the oversight body should:

- provide that the authority is independent of Government;
- empower the authority to conduct inspections of either regulator at will;
- empower the authority to issue a notice to either regulator requiring it to produce documents or provide information in any form;
- empower the authority to issue a direction to APRA or ASIC in connection with the adoption and implementation of the BEAR principles;

²³⁶ Exhibit 7.63, Witness statement of James Shipton, 7 November 2018, 20 [62(a)].

- require the authority to report to the Minister, and through the Minister to Parliament, in respect of each regulator at least biennially;
- authorise the authority to report separately on particular matters if the authority thinks it appropriate and necessary; and
- require the authority to produce or commission quadrennial capability reviews of each entity.

Recommendation 6.14 – A new oversight authority

A new oversight authority for APRA and ASIC, independent of Government, should be established by legislation to assess the effectiveness of each regulator in discharging its functions and meeting its statutory objects.

The authority should be comprised of three part-time members and staffed by a permanent secretariat.

It should be required to report to the Minister in respect of each regulator at least biennially.

Conclusion

The twin peaks model of regulation has now operated in Australia for many years. It should be maintained and strengthened. But there should be some adjustments made in respect of the regulation of superannuation and the BEAR.

As I said at the start of this chapter, both ASIC and APRA recognise that their approach to enforcement must change. That change cannot be effected by the passing of legislation. It must come from within the agencies. But it is also important to strengthen the accountability of both – internally, by each separately applying principles modelled on the BEAR, and externally, by both being accountable to a new oversight body.

8. Other important steps

Introduction

In the previous chapters I have sought to explain the conclusions and recommendations I have reached about many of the issues that have arisen in the course of the Commission's work. For the most part, the issues dealt with in the previous chapters have been seen, at least by some, as controversial. But not all of the issues raised in the course of the Commission's work were of that kind.

Some issues were raised in the *Interim Report* but attracted little or no controversy. Mostly, I have addressed these in the earlier chapters of this Report. Other issues already considered and dealt with by other processes, but not implemented pending the outcome of this inquiry, attracted little or no controversy. One issue not raised in the *Interim Report*, but which was the subject of several submissions, is legal assistance and financial counselling services.

That these matters were not the subject of debate does not mean that they are unimportant. Nor is my leaving them to the last chapter of this Report to be taken as suggesting either that they are not significant matters or that they should not be implemented promptly. Each has its own particular part to play in responding to the conduct recorded in this Report and the *Interim Report*.

The last part of this chapter deals briefly with issues of regulatory complexity and proposes a path for achieving some simplification of what now is, or is in danger of becoming, an unduly complicated regulatory scheme.

1 Pending proposals

1.1 A compensation scheme of last resort

The Terms of Reference require me to consider ‘the effectiveness of mechanisms for redress of consumers of financial services who suffer detriment as a result of misconduct by **financial services entities**’.¹ Accordingly, in the *Interim Report*, I asked whether existing dispute resolution mechanisms were satisfactory, and whether a mechanism should be established to provide compensation of last resort.²

In 2016–2017, a panel appointed by Government³ reviewed **external dispute resolution** (EDR) and complaints arrangements in the financial system. The panel delivered a final report in April 2017.⁴ In accordance with the panel’s recommendations, a new EDR body, the Australian Financial Complaints Authority (AFCA), was established to take the place of the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman, and the Superannuation Complaints Tribunal.⁵ AFCA commenced operating in November 2018.⁶

AFCA should be permitted to set about its work. I make no recommendation for any change in its operations. Elsewhere in this Report, I have recommended that **Australian financial services licence** (AFSL) holders should be obliged to take reasonable steps to co-operate with AFCA in its resolution of particular disputes including, in particular, by making available to AFCA all relevant documents and records relating to the issues in dispute.

¹ *Letters Patent*, 14 December 2017, (e).

² FSRC, *Interim Report*, vol 1, 344.

³ Professor Ian Ramsay (Chair), Ms Julie Abramson and Mr Alan Kirkland.

⁴ Ramsay Review, Final Report.

⁵ Ramsay Review, Final Report, 14, Recommendation 1.

⁶ ACFA, ‘Ministerial Authorisation of the Australian Financial Complaints Authority’ (Media Release, 1 May 2018).

In February 2017, the Government had extended the terms of reference of the panel reviewing the EDR and complaints framework to require the panel to make recommendations on the establishment, merits and potential design of a compensation scheme of last resort (CSLR) and to consider the merits and issues involved in providing access to redress for past disputes.⁷ In September 2017, the panel delivered a supplementary final report considering these issues.⁸

As the panel noted in its supplementary final report, the *Corporations Act 2001* (Cth) (the Corporations Act) and the *National Consumer Credit Protection Act 2009* (Cth) (the NCCP Act) oblige licensees to have in place arrangements for providing compensation where certain specified losses occur, and, as a result, consumers and small businesses have a reasonable expectation that they will receive compensation in these circumstances.⁹ The panel said that there was ‘clear evidence’, however, that not all licensees were meeting their obligations, with the result that some consumers and small businesses were not receiving their EDR awards.¹⁰ Failure to pay compensation was concentrated in the financial advice subsector.¹¹

On 21 December 2017 the Government announced that it would defer its consideration of the recommendations made in the supplementary final report until after this Commission had concluded.¹²

In its supplementary final report, the panel made three recommendations for a CSLR:

- A CSLR should be established, but should be limited and carefully targeted at the areas of the financial sector where there is clear evidence of recurrent problems with uncompensated losses.¹³

⁷ Ramsay Review, Supplementary Final Report, 129 [1]–[3].

⁸ Ramsay Review, Supplementary Final Report.

⁹ Ramsay Review, Supplementary Final Report, 3 [17].

¹⁰ Ramsay Review, Supplementary Final Report, 3 [18].

¹¹ Ramsay Review, Supplementary Final Report, 4 [23].

¹² The Hon Kelly O’Dwyer, ‘Release of the External Dispute Resolution Framework Supplementary Final Report’ (Media Release, 21 December 2017).

¹³ Ramsay Review, Supplementary Final Report, 51, Recommendation 1.

- A CSLR should initially be restricted to financial advice failures where a financial adviser (the ‘relevant provider’ as defined in section 910A of the Corporations Act) has provided personal and/or general advice on ‘relevant **financial products**’ to a consumer or small business. A CSLR should be designed for the future and accordingly be scalable, which means it can be expanded over time to cover other types of financial and credit services, should evidence of significant problems of uncompensated losses emerge.¹⁴
- A CSLR should have, among others, the following design features.¹⁵
 - It should apply prospectively (in the sense that it applies only in respect of decisions made after the scheme is established) and be restricted to consumers and small businesses.
 - To access the scheme, claimants should have a decision from AFCA, a court or a tribunal (where the circumstances of that claim would have been eligible for consideration by AFCA) which remains unpaid after reasonable steps have been taken.
 - Applicants will have 12 months to lodge their claim after having completed specified reasonable steps to obtain compensation.
 - Where an uncompensated loss arises from an unpaid EDR determination, AFCA should be required to provide certification that it has completed its processes to enforce the determination and that it does not consider that it will be paid, and then refer the claimant to a CSLR.
 - The CSLR should not independently reassess the merits of claims but must, before paying a claim, be satisfied that the award will not be paid by the financial firm.
 - A compensation cap, aligned to ACFA’s, should apply. The CSLR should set limits on the level and types of legal costs that are recoverable.

¹⁴ Ramsay Review, Supplementary Final Report, 67, Recommendation 2.

¹⁵ Ramsay Review, Supplementary Final Report, 103–5, Recommendation 3.

- It should have the ability to stand in the shoes of a consumer or small business and pursue the financial firm for the compensation amount, where appropriate.
- The CSLR should be funded by financial firms engaged in the types of financial services it covers (initially, specified types of financial advice). Financial firms should be required to contribute to it from its outset, via an appropriate mechanism developed by Government and industry. Financial firms providing the types of services covered should be required to be members and contribute to the funding of a CSLR as a condition of licensing.
- Governance should be by an independent board with an independent chair and equal numbers of directors with industry and consumer backgrounds.
- The Australian Securities and Investments Commission (ASIC) should have oversight of a CSLR, including a general directions power to allow it to compel a CSLR to meet its regulatory and legislative requirements.

I agree with the panel's recommendations, including those it makes about design principles. The approach proposed by the panel should be followed.

I note that the panel made a fourth recommendation about professional indemnity insurance. It said that '[f]irms that rely on [professional indemnity] insurance to meet their licensing obligations should be required to provide additional data to ASIC, to improve ASIC's ability to undertake market surveillance and targeted regulatory action'.¹⁶ This recommendation was consistent with ASIC's submission to the review panel.¹⁷ Its efficacy will depend on what use ASIC makes of the data. I say no more about it.

¹⁶ Ramsay Review, Supplementary Final Report, 113, Recommendation 4.

¹⁷ Ramsay Review, Supplementary Final Report, 111 [5.13]–[5.14].

In its supplementary final report, the panel said that, without accurate quantification of the size, scale and nature of the potential claims that would be made if there were access to redress for *past* disputes, it could not ‘assess the merits and issues in this area’.¹⁸ Accordingly, the panel proposed various options for providing access to redress for past disputes and identified the three considerations that it said ‘are important in any mechanism’ designed to provide that access.¹⁹ Those were that the mechanism be ‘simple and accessible’, that it ‘seek to minimise costs for all stakeholders’ and that it provide ‘adequate support for consumers and small businesses’.

As the panel recognised, there is a deal of uncertainty about what kinds of claim are to be considered when looking at whether there should be access to redress for past disputes. The panel concluded that there was ‘merit in considering’ providing access to redress to consumers and small businesses who had ‘a viable claim against a financial firm at the time of the dispute’ where one or more of four criteria were met:²⁰

- the firm was no longer operating;
- the firm was not a member of an EDR body;
- the monetary value of the claim exceeded the EDR body’s monetary limit *and* the consumer or small business ‘lacked the resources’ to access the courts or other means of resolution;
- the consumer or small business was not in a position to pursue the dispute with the EDR body ‘due to exceptional circumstances’.

The panel proposed further consideration of the issues and there is evident merit in that being done.

¹⁸ Ramsay Review, Supplementary Final Report, 164 [8.5].

¹⁹ Ramsay Review, Supplementary Final Report, 184, Observation 5.

²⁰ Ramsay Review, Supplementary Final Report, 131.

I make only four points about redress for past disputes.

First, cases in which redress has been directed or ordered but not paid stand apart from all other cases of redress for past disputes.

Where a claimant has not been paid the amount that an EDR body (or court) found should be paid, the central issue becomes whether Government or industry should now pay what was owing. As the panel said, a necessary first step would be to identify the scale of the problem before deciding how best to approach providing redress in those cases.

Second, the panel accepted, and I agree, that **there would be no merit in allowing further access to redress in any case where the consumer or small business concerned has already resorted to dispute resolution by a court, tribunal or EDR body or has settled the dispute.**

Third, limiting access to redress to those who ‘had a viable claim’ would be of little practical effect. The merit of the claim could rarely be determined without detailed examination of the facts and circumstances.

Fourth, **if there is to be any access to redress for past disputes, there must be some time limit imposed.**

Recommendation 7.1 – Compensation scheme of last resort

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.

1.2 ASIC Enforcement Review Taskforce Government Response

In December 2017, the ASIC Enforcement Review Taskforce provided its report to Government.²¹ The report made 50 recommendations with respect to, among other things, breach reporting under the Corporations Act, industry codes, and ASIC's licensing, banning, and directions powers. In April 2018 the Government released its response to the report, agreeing, or agreeing in principle, with all of its recommendations.²² In its response, the Government announced that it agreed with some recommendations, and that it agreed in principle with other recommendations but would defer implementing them to enable it to take account of any findings arising out of this Commission.

I have dealt with the recommendations of the Taskforce relating to industry codes elsewhere in this report – chiefly in the chapter about banking.

One other set of deferred recommendations relates to self-reporting of contraventions by financial and credit services licensees.²³

The application to AFSL holders and the enforcement of section 912D have formed an important part of the Commission's work. I support the Taskforce's recommendations about self-reporting, which include the following:

- The significance test should be retained but clarified to ensure that the significance of breaches is determined objectively.
- A self-reporting regime should be introduced for **Australian credit licensees**, equivalent to the regime for AFSL holders under (the amended) section 912D of the Corporations Act.
- The obligation for licensees to report should expressly apply to misconduct by an employee or representative.

²¹ ASIC Taskforce Review, Report.

²² Australian Government, *Australian Government Response to the ASIC Enforcement Review Taskforce Report*, April 2018.

²³ ASIC Taskforce Review, Report, 2–3.

- Significant breaches (and suspected significant breach investigations that are continuing) must be reported within 30 days.
- The required content of breach reports should be prescribed by ASIC and be lodged electronically.
- Criminal penalties should be increased for failure to report as and when required.
- A civil penalty should be introduced in addition to the criminal offence for failure to report as and when required.
- A co-operative approach should be encouraged where licensees report breaches, suspected or potential breaches or employee or representative misconduct at the earliest opportunity.
- The reporting requirements for responsible entities of managed investment schemes should be streamlined by replacing the requirements in section 601FC(1)(l) of the Corporations Act with an expanded requirement in section 912D.
- ASIC should publish breach report data annually.

I make two additional points.

First, although I have no doubt that a co-operative approach is to be encouraged when licensees report breaches, or suspected breaches, it will always be necessary to recognise that making a proper breach report on time is what the law requires.

Second, **I think it preferable that ASIC publish breach report data annually not only aggregated by breach type but also by individual licensee.** Those who deal with licensees should be able to have access to the reports that the law obliges the licensee to make to the regulator about objectively significant breaches or likely significant breaches of the financial services laws that the licensee has identified.

Recommendation 7.2 – Implementation of recommendations

The recommendations of the ASIC Enforcement Review Taskforce made in December 2017 that relate to self-reporting of contraventions by financial services and credit licensees should be carried into effect.

2 Legal assistance and financial counselling services

The asymmetry of knowledge and power between consumers and financial services entities has been evident throughout the Commission's work. Financial products and services have grown ever more complicated, numerous, and difficult to distinguish. Engagement with the financial services industry, by way of bank accounts, insurance and superannuation, is necessary in order to participate in society. Yet financial literacy among Australians is varied, and research suggests that people struggle with more complex financial dealings such as investments and superannuation. And the laws governing the relationship between customers and entities are frequently opaque. Each of these conditions contributes to the onset of disputes and puts customers at a disadvantage in their resolution.

Aggrieved customers can try to negotiate directly with an entity, they can commence legal proceedings, or they can go to alternative dispute resolution. In each case, the existing asymmetry means that legal assistance is often of critical importance to the customer's position.

The majority of the consumer witnesses before the Commission who gave evidence of having resolved their dispute with an entity did so with the assistance of a legal adviser or financial counsellor. That was true of disputes resolved by direct negotiation, farm debt mediation, and recourse to FOS. That is, access to professional legal advice or counselling services assisted claimants to engage in these alternative dispute resolution mechanisms even though they were designed to improve access to justice and do not depend on claimants having legal representation. Most entities have access to expert legal advice throughout the course of a dispute, and it is unsurprising that customers would benefit from being placed on the same footing. Some consumers may not even know that they have a dispute to resolve until they speak to a financial counsellor or legal adviser.

A number of the consumer witnesses before the Commission received free assistance from the legal assistance sector²⁴ or free financial counselling services. Often, perhaps in part by force of the situation that gave rise to the dispute, they could not have afforded private financial advice or legal representation. Often, the difference between the result the witness ultimately achieved and the situation that they initially faced before they received legal assistance was very large.

The legal and other assistance available to disadvantaged members of the community in pursuing claims against financial services entities is therefore relevant to the Commission's considerations. It was not a question on which submissions were specifically called for, although a considerable number addressed it. I therefore make limited observations on this point, but I encourage that it be given careful consideration.

The legal assistance sector and financial counselling services perform very valuable work. Their services, like financial services, are a necessity to the community. They add strength to customers who are otherwise disadvantaged in disputes with financial services entities. In that sense, their role in the financial services sector is complementary to the broader recommendations in this Report that are designed to hold entities to account. Reforms to the law, and to practices of regulators and entities, will not eliminate that need though they will properly aim to reduce it. There will always be sources of legitimate dispute, and there will always be vulnerable individuals with a poor understanding of financial services or limited experience or resources who are nonetheless compelled to use these services.

As I have said elsewhere in this chapter, simplification of financial services laws is broadly supported. However, financial services laws will always involve a measure of complexity. Asymmetry of knowledge and power will always be present. Accordingly, there will likely always be a clear need for disadvantaged consumers to be able to access financial and

²⁴ Paragraph 52(e) of the National Partnership Agreement on Legal Assistance Services defined this term to include community legal centres, family violence prevention legal services, indigenous legal assistance providers and legal aid commissions: Council of Australian Governments, *National Partnership Agreement on Legal Assistance Services* (Undated) Council of Australian Governments <www.ag.gov.au/LegalSystem/Legalaidprogrammes/Documents/NationalPartnershipAgreementOnLegalServices.pdf>.

legal assistance in order to be able to deal with disputes with financial services entities with some chance of equality of arms.

The legal assistance sector and financial counselling bodies are also recognised by ASIC as playing an important broader role in the financial services sector, for example by bringing issues to the attention of the regulator²⁵ or providing a balancing consumer voice in policy development.²⁶

Information about financial counselling services is published on the websites of each of the four major banks.²⁷ Information about legal assistance and financial counselling services is also included on the ACFA website.²⁸

The legal assistance sector and financial counselling services frequently struggle to meet demand, which is increasing.²⁹ Some submissions identified areas where the present coverage of such services could be expanded, for example in the provision of consumer advocacy and representation for superannuation consumers.³⁰ Other areas that were identified were small business assistance³¹ and community-led specialist education for Aboriginal and Torres Strait Islander communities regarding funeral insurance and other financial products.³²

²⁵ For example, through the ASIC Consumer Advisory Panel. ASIC, Consumer Advisory Panel (Undated) ASIC <<https://asic.gov.au/about-asic/what-we-do/how-we-operate/external-panels/consumer-advisory-panel/>>.

²⁶ ASIC, Module 5 Policy Submission, 42–3 [204]–[205].

²⁷ For example, NAB, *NAB Assist Customer Care Kit* (Undated) NAB <www.nab.com.au/personal/help-and-guidance/financial-hardship/customer-care-kit>.

²⁸ AFCA, *Other Places to Get Help* (Undated) AFCA <www.afca.org.au/what-to-expect/other-places-to-get-help/>

²⁹ CALC, *Submission in Response to Initial Request*, 22 January 2018, 8 [2.30]; National Association of Community Legal Centres and FCA, Interim Report Submission, 5; Financial Rights Legal Centre, *Submission in Response to Initial Request*, 5 February 2018, 2.

³⁰ CHOICE and Superannuation Consumers' Centre, Module 5 Policy Submission, 6, 31–2; ASIC, Module 5 Policy Submission, 42–3 [204]–[205].

³¹ National Association of Community Legal Centres and FCA, Interim Report Submission, 9; CALC, Module 3 Submission, 7 [8.1]–[8.2].

³² CALC, Module 4 Submission, 9 [32].

Funding for the legal assistance sector and financial counselling services comes from various sources and structures, but is primarily Federal and state government funded, with pro bono and other donations also contributing. A portion of existing funding to some community services is sourced from arrangements such as community benefit payments under **enforceable undertakings** given to ASIC.³³ However, such funding is ‘one-off’ in nature, and reliance on sources of funding that are uncertain presents a longer-term challenge for community-based services to continue to provide services and maintain expertise and scale.

Proposals have been made over time for other models of funding. For example, one submission made to the Commission contained a proposal for an industry levy to fund financial counselling and consumer legal services.³⁴ The submission stated that this model was operating effectively in the United Kingdom.³⁵

I offer no views about the most appropriate sources, level or mix of funding. However, the desirability of predictable and stable funding for the legal assistance sector and financial counselling services is clear and how this may best be delivered is worthy of careful consideration. Such consideration should look at all options that may be available to supplement existing funding.

³³ ASIC, Module 5 Policy Submission, 43 [207].

³⁴ National Association of Community Legal Centres and FCA, Interim Report Submission, 2 [3]–[5].

³⁵ National Association of Community Legal Centres and FCA, Interim Report Submission, 2 [5]. The UK has adopted an industry levy model to fund financial counselling and financial literacy services: *Free and Impartial Money Advice, Set Up by Government* (Undated) The Money Advice Service <www.moneyadviceservice.org.uk/en>.

3 Simplification so that the law's intent is met

Many submissions responding to the *Interim Report* supported simplification of financial services laws.³⁶ Industry, community groups and regulators agreed the current law is too complex. The effect of legal complexity on each of these groups differs. What would be achieved by simplifying the law?

As is apparent from what is said elsewhere in this Report, the first way to simplify the law, and the first reason for doing it, is to reduce the number of exceptions to otherwise generally applicable norms of conduct. That doing this would simplify the law is self-evident. But doing it will also result in the wider application of the principles that underpin the general rules on which these exceptions have been grafted.

So, eliminating exceptions and qualifications is the first step towards a simpler and more readily understood body of law.

The second step is connected to the first. It is to identify expressly what fundamental norms of behaviour are being pursued when particular and detailed rules are made about a given subject. Hence, to take one example, the detailed rules about conflicts of interest and **conflicted remuneration** should be expressly identified as giving effect to the principle that when a person acts for another, the person must act in the best interests of that other. Obviously, including such a statement of objects is useful in resolving any dispute about how the detailed rules should be construed. And, as I have explained elsewhere, a 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.

³⁶ See, eg, ANZ, Interim Report Submission, 34 [172]; CBA, Interim Report Submission, 47 [260(a)]; NAB, Interim Report Submission, 37 [145]; AMP, Interim Report Submission, 6 [27]; ABA, Interim Report Submission, 44; AFIA, Interim Report Submission, Annex 2, 4; ASIC, Interim Report Submission, 21 [88].

Beyond these steps, the task of simplification grows harder and will take much longer. But it is harder, and will take longer, *because* the law is now spread over so many different Acts and is as complex as it is. That is, the very size of the task shows why it must be tackled.

There would inevitably be many questions about legislative design. I deal with only one.

The basic norms of behaviour I have identified are simply stated. They are the fundamental precepts. And statutes have often given legislative expression to fundamental precepts with little textual elaboration. Statutory provisions about misleading or deceptive conduct are the most recent example. But reference could also be made to the sale of goods legislation provisions about fitness for purpose and merchantable quality.

Debate about legislative design may be diverted into disputes about the competing attractions of ‘principles-based’ or ‘outcomes-based’ laws and ‘rules-based’ laws. But debates of that kind will not assist if the debate falls into disputes about definitions.³⁷

As Treasury pointed out, ‘[p]rinciples-based regulation requires a commitment from policy-makers to the regulatory architecture.’³⁸ Legislative schemes have commenced with principles at the fore only to have the full suite of prescriptions such as those described here grafted on over time.³⁹

Lobbying for prescription, detail and tailoring has been a significant contributor to the current state of the law.⁴⁰ Requests for greater certainty may be justified and often this can be achieved by regulations or other legislative or regulatory instruments rather than amendment to the principal Act. But sometimes the requests for prescription and detail seek to shift responsibility from the regulated to the regulator, by urging the creation

³⁷ Julia Black, ‘Principles Based Regulation: Risks, Challenges and Opportunities’ (Speech delivered at The Banco Court, Supreme Court of New South Wales, 27 March 2007) 3, 7–8.

³⁸ Treasury, Interim Report Submission, 7 [41].

³⁹ Treasury, Interim Report Submission, 5 [25]. See also ASIC, Interim Report Submission, 22–3 [98].

⁴⁰ Treasury, Interim Report Submission, 5 [23]–[25].

of ‘safe-harbour’ provisions that leave the regulated entity with little more than a box-ticking task.

Simplification will not be easy. Like any statutory drafting, **the first requirement will be to settle upon the principle or principles to which the law is to give effect.** Only then can the detailed drafting begin. This drafting must then yield certainty of application and meaning. But often, those aims of certainty of application and meaning will be missed if the drafting seeks to deal with every kind of case imaginable and put each beyond dispute. So many wires are strung between the fence posts that they inevitably overlap, intersect and leave gaps. And, instead of entities meeting the *intent* of the law, they meet the terms in which it is expressed.

Implementing the recommendations I have made in this Report will effect some simplification of the law. Implementing them may provide some opportunities for further simplification. If those opportunities are there, they should be seized. **But the overall task is, I think, much wider. It will require examination of how the existing law fits together and identification of the policies given effect by the law’s various provisions. Only once this detailed work is done can decisions be made about how those policies can be given better and simpler legislative effect.** Implementing the recommendations I have made cannot wait for that larger task to begin, let alone end.

Recommendation 7.3 – Exceptions and qualifications

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

Recommendation 7.4 – Fundamental norms

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.



Final Report

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

VOLUME 2:
CASE STUDIES

© Commonwealth of Australia 2019

ISBN:

978-1-920838-64-5 (print)

978-1-920838-65-2 (online)

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Glossary

Term	Definition
accrued default amount (ADA)	An amount of superannuation accumulated in a situation where (a), the member has not given the fund's trustee any direction about how the amount is to be invested, or (b), the amount is invested in the fund's 'default' investment option.
anti-hawking provisions	Provisions set out in Sections 736, 992AA and 992A of the <i>Corporations Act 2001</i> (Cth) that prohibit offering financial products for issue or sale during, or because of, an unsolicited meeting or telephone call with a retail client.
Australian Credit Licence (ACL)	A licence issued under the <i>National Consumer Credit Protection Act 2009</i> (Cth) that authorises a licensee to engage in particular credit activities.
Australian financial services licence (AFSL), Australian financial services licensee	A licence under the <i>Corporations Act 2001</i> (Cth) that authorises a person who carries on a financial services business to provide financial services. A licensee is the person who provides the services.
authorised deposit-taking institution (ADI)	A body corporate authorised under the <i>Banking Act 1959</i> (Cth) to carry on a banking business in Australia.
Bank Bill Swap Rate (BBSY)	An interest rate used as a benchmark when pricing financial products.
Banking Executive Accountability Regime (BEAR)	A piece of legislation set out in Part IIAA of the <i>Banking Act 1959</i> (Cth) and enacted in February 2018, the BEAR establishes accountability obligations for authorised deposit-taking institutions (ADIs) and their senior executives and directors. It is administered by APRA.
buyer of last resort (BOLR)	Arrangements whereby a licensee or an authorised representative acquires the business of another representative. The purchase price is determined using a specific formula.

Term	Definition
conflicted remuneration	Any benefit, whether monetary or non-monetary, given to a financial services licensee , or their representatives, who provides financial product advice to retail clients that, because of the nature of the benefit or the circumstances in which it is given could reasonably be expected to influence the choice of financial product recommended by the licensee or representative or could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative: see Section 963A of the <i>Corporations Act 2001</i> (Cth).
enforceable undertaking (EU)	An undertaking enforceable in a court. Issued under the <i>Australian Securities and Investments Commission Act 2001</i> (Cth) and the <i>National Consumer Credit Protection Act 2009</i> .
external dispute resolution (EDR)	An independent service for resolving disputes between consumers and providers of financial products and services, as an alternative to the court system.
financial product	Under the <i>Corporations Act 2001</i> (Cth), a facility through which, or through the acquisition of which, a person makes a financial investment, manages financial risk and/or makes non-cash payments.
financial services entity	Defined by the Letters Patent as (among other things) ‘an ADI (authorised deposit-taking institution) within the meaning of the <i>Banking Act 1959</i> ’, ‘a person or entity required by section 911A of the <i>Corporations Act 2001</i> to hold an Australian financial services licence , or who is exempt from the requirement to hold such a licence by virtue of being an authorised representative’, and ‘a person or entity that acts or holds itself out as acting as an intermediary between borrowers and lenders’.

Term	Definition
Financial Services Guide (FSG)	A guide that contains information about the entity providing financial advice, and explains the services offered, the fees charged and how the person or company providing the service will deal with complaints.
financial services licensee	An individual or business that has been granted an Australian financial services licence (AFSL) by ASIC.
Future of Financial Advice (FoFA)	A 2012 package of legislation intended to improve the trust and confidence of Australian retail investors in the financial services sector and ensure the availability, accessibility and affordability of high quality financial advice.
grandfathering arrangements, grandfathered commission	Grandfathering arrangements allow for commissions to continue to be paid to intermediaries who sold financial products prior to the Future of Financial Advice (FoFA) reforms that would otherwise be classified as conflicted remuneration . This source of revenue is known as a grandfathered commission.
group life insurance	Life insurance where a group of people (for example, members of a superannuation fund) are covered by the one contract.
Household Expenditure Measure (HEM)	A measure of what families spend on different types of household items, calculated quarterly by the Melbourne Institute of Applied Economic and Social Research.
mortgage aggregator	An intermediary between mortgage brokers and lenders. Mortgage aggregators have contractual arrangements with lenders that allow brokers operating under the aggregator to arrange loans from those lenders.
mortgage broker	An intermediary between borrowers and lenders of home loans.

Term	Definition
MySuper products	Low-cost, simple superannuation products for members who make no active choice about their superannuation.
registrable superannuation entity (RSE)	A category of superannuation entity, regulated by APRA, that includes regulated superannuation funds, approved deposit funds and pooled superannuation trusts, but does not include self-managed superannuation funds (SMSFs).
successor fund transfer (SFT)	Where a member's benefits are transferred to a successor fund. This is one of the few situations where benefits can be transferred without the member's consent and is subject to strict regulation.
third party guarantor	A person or business other than the borrower who guarantees to pay back a loan if the borrower does not.
Tier 1 Capital	Capital against which losses can be written off while an authorised deposit-taking institution (ADI) continues to operate and can absorb losses should the ADI ultimately fail.
trail commission	A regularly recurring commission to an intermediary, such as a broker, based on a proportion of the current or average loan balance and payable periodically after the loan is made/drawn. Distinct from a commission that is paid up front.
vertical integration	A description of the relationship between entities where financial advice, platforms and funds management are controlled by a single entity.

Abbreviations

ABA	Australian Bankers' Association (now Australian Banking Association)
ABARES	Australian Bureau of Agricultural and Resource Economics and Sciences
ACBF	Aboriginal Community Benefit Fund
ACCC	Australian Competition and Consumer Commission
ACL	Australian Credit Licence
ADA	accrued default amount
ADI	authorised deposit-taking institution
AFA	Association of Financial Advisers
AFCA	Australian Financial Complaints Authority
AFSL	Australian financial services licence
APRA	Australian Prudential Regulation Authority
ASBFEO	Australian Small Business and Family Enterprise Ombudsman
ASIC	Australian Securities and Investments Commission
AUSTRAC	Australian Transaction Reports and Analysis Centre
BEAR	Banking Executive Accountability Regime
BOLR	buyer of last resort
DRE	dual-regulated entity
EDR	external dispute resolution

EU	enforceable undertaking
FASEA	Financial Adviser Standards and Ethics Authority
FoFA	Future of Financial Advice (legislation reforms)
FOS	Financial Ombudsman Service
FPA	Financial Planning Association of Australia
FSC	Financial Services Council
FSG	Financial Services Guide
HEM	Household Expenditure Measure
IDR	internal dispute resolution
KPI	Key Performance Indicator
LVR	loan-to-value ratio
PDS	product disclosure statement
RE	responsible entity
RSE	registrable superannuation entity
SFT	successor fund transfer
SME	small and medium enterprises
SMSF	self-managed superannuation fund

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Australian Securities and Investments Commission Act 2001 (Cth) (the ASIC Act)

Australian Small Business and Family Enterprise Ombudsman Act 2015 (Cth)

Banking Act 1959 (Cth) (the Banking Act)

Competition and Consumer Act 2010 (Cth)

Consumer Insurance (Disclosure and Representations) Act 2012 (UK)

Corporate Law Reform Act 1992 (Cth)

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Superannuation Safety Amendment Act 2004 (Cth)

The Commission's tasks

In the *Interim Report* I pointed out that the first paragraph of the Terms of Reference obliged me to inquire into whether conduct *might* have amounted to misconduct (as defined) and that the second paragraph required me to consider whether any conduct, practices, behaviour or business activities by financial services entities fell below community standards and expectations.

Although it repeats what has already been said in the *Interim Report*, it is important to set out, again, my understanding of my tasks.

The term 'misconduct' is defined in the Letters Patent as including four classes of conduct:

- conduct that constitutes an offence against certain laws;
- conduct that is misleading, deceptive, or both;
- conduct that is a breach of trust, breach of duty or unconscionable conduct; and
- conduct that breaches a professional standard or a recognised and widely adopted benchmark for conduct.

Consistent with the essential character of a Royal Commission (as a non-judicial task) the Letters Patent require me to inquire into whether any conduct *might* have amounted to misconduct. I am not asked to decide whether conduct did constitute an offence, or other contravention of law. If conduct might have amounted to misconduct, I am required and authorised to decide whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, state or territory agency. Any decision about bringing proceedings is a matter for the relevant agency, not for me.

This report sets out conclusions I have reached in relation to the matters explored in public hearings. I set out my conclusions about what happened, what was done or not done, and what legal characterisations might attach to or be associated with those factual conclusions.

The conclusions I reach about whether conduct might have amounted to misconduct are, and must be, based on the information that has been assembled during the course of the Commission's inquiries. Much, but not all, of that information was provided by evidence given in the course of public hearings; some was gathered in other ways, including, for example, from submissions made to the Commission by **financial services entities** and others.

The conclusions that I reach have no binding or enforceable effect, whether against those who are said to have engaged in relevant conduct, against others who have appeared in the course of public hearings or in any other way. I cannot, and do not, decide whether evidence given in hearings conducted by the Commission would support a finding of contravention of law, if this evidence could be, and later was, adduced in properly constituted criminal or civil proceedings.

In their submissions, persons given leave to appear have often emphasised that a conclusion that there might have been misconduct should not be reached lightly. Unsurprisingly, the submissions have been framed in the language of the courtroom, with references to standards and burdens of proof. And references of that kind (especially to notions of burden of proof) originate in the essentially adversarial common law system of judicial trial, in accordance with rules of evidence.

The processes of a Royal Commission, and hence of the inquiry I have conducted, are radically different from those of a court conducting a trial. The Commission is an inquiry instituted by the Executive. It is not bound by the rules of evidence. The notion of a burden of proof has no application. But the essential point made – that a conclusion that there might have been misconduct should not be reached lightly – is undeniably true.

I cannot form a conclusion about what has happened or what has been done or not done without my being persuaded of the relevant fact. And as Dixon J pointed out in 1938, '[t]he seriousness of an allegation made, the inherent unlikelihood of an occurrence of a given description, or the gravity of the consequences flowing from a particular finding are considerations which must affect the answer to the question whether the issue has been proved to the reasonable satisfaction of the tribunal'.¹

¹ *Briginshaw v Briginshaw* (1938) 60 CLR 336 at 361–2.

The conclusions that I express in my reports (interim and final) may have grave consequences. Allegations of misconduct are serious.

Members of society ordinarily do not engage in conduct that is dishonest. Most members of society try to act within legal rules and regulations.

All of these are matters that I have striven to bear at the forefront of consideration when forming the conclusions I express. Most especially has that been so in respect of two kinds of conclusion – first, a conclusion that conduct by a financial services entity (or by directors, officers or employees of an entity or by someone acting on behalf of the entity) might have amounted to misconduct, and second, the related but distinct conclusion about whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, state or territory agency.

It will be seen that there are some cases in which I say that particular conduct *amounted to* misconduct rather than that the conduct *might* be of that character. I have thought it right to go so far in cases where the entity concerned acknowledged in its submissions to the Commission that what had happened amounted to misconduct. Apart from those cases, however, I have sought to express no larger conclusion than that conduct might have amounted to misconduct of a particular kind.

It will also be seen that I have referred aspects of the conduct described in the following case studies to the Australian Securities and Investments Commission (ASIC), the Australian Prudential Regulation Authority (APRA) or, in some cases, both. Those references are in addition to the steps I took, in November 2018, under Section 6P of the *Royal Commissions Act 1902* (Cth), to communicate certain information to ASIC that I considered related, or may relate, to contraventions of the *Corporations Act 2001* (Cth), in particular Section 1041G of that Act (engaging in dishonest conduct, in the course of carrying on a financial services business in this jurisdiction, in relation to a financial product or financial service).

Case studies: Superannuation

Introduction

The Commission's fifth round of hearings explored issues relating to the superannuation industry.

The hearings focused on four topics:

- the proper use of members' money, including inappropriate deductions from members' accounts (such as for services that were not provided), failures to diligently manage investments and spending, and retaining money instead of distributing it to members;
- arrangements between superannuation trustees, related parties, and financial advisers, including where the trustee is part of a broader group;
- governance matters, including board composition, the adequacy of the trustee board's oversight, and merger proposals; and
- the response of superannuation trustees to legislative reforms intended to promote superannuation members' interests.

These topics sometimes overlapped within individual case studies.

One overarching theme recurred: the difficulties that trustees (principally retail trustees) faced in dealing with conflicts between duty and interest. A trustee must act in the best interests of members and prefer their interests over the interests of anyone else. It will breach its duties if it disadvantages its members or disregards their interests for its own, or others', profit or convenience. Contrary to many of the submissions made by retail trustees, these duties are easily understood. But compliance with the duties in the face of some competing interests appeared to be difficult.

In a number of cases, what appeared to be a failure by a trustee to discharge its duties concerned MySuper members or members who ought to have been transferred to a **MySuper product**. In respect of those members, trustees have additional and more specific duties. MySuper members' retirement savings are invested through a default product and, in that way, those members have delegated all aspects of their superannuation to the trustee.¹ For that reason, MySuper members may be seen as more vulnerable than those who have made an investment decision: they depend on the trustee's judgment to place them in a position to receive the best return possible, so they can grow their retirement savings.

The legislation imposes certain rules and characteristics on MySuper products offered by trustees. MySuper products are designed to be low cost, simple and transparent and to provide an appropriate investment strategy for the member. They are designed to ensure that the financial interests of members who make no active choice about their superannuation are protected.² And they play a significant role in superannuation in Australia: as at June 2018, total assets held in MySuper products was \$675.6 billion.³

In the cases examined in the hearings, potential breaches of trustee duties yielded no enforcement action by the regulators. It will be necessary to consider whether the Australian Prudential Regulation Authority's (APRA's) response was adequate.

The choices trustees make for their members can significantly affect members' retirement savings. And, in turn, members' retirement savings are affected by the way in which the regulator monitors and enforces trustees' compliance with their duties, particularly in the case of MySuper products.

APRA's mandate is to protect the Australian community by establishing and enforcing prudential standards and practices designed to ensure that,

¹ See, eg, Explanatory Memorandum, Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 (Cth).

² See, eg, Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Code Provisions) Bill 2011 (Cth).

³ See APRA, *Quarterly Superannuation Performance*, June 2018 (reissued 31 August 2018), 6.

under all reasonable circumstances, financial promises made by institutions it supervises are met within a stable, efficient and competitive financial system.⁴ For superannuation, the promise to a beneficiary of the trust is that the trustee will meet the reasonable expectations of the beneficiary in providing their retirement benefits to them on their retirement or attainment of 65 years. In this way, APRA is concerned with protecting the interests of beneficiaries, and ensuring that the trustee operates in such a way as to be able to meet those reasonable expectations.⁵

APRA is charged with the general administration of the provisions of the *Superannuation Industry (Supervision) Act 1993* (Cth) (the SIS Act) that impose the best interests covenant⁶ on trustees and directors of corporate trustees.⁷ The Australian Securities and Investments Commission (ASIC) has general administration of those provisions to the extent that they relate to the keeping of reports and disclosure of information.⁸

A breach of the best interests covenant gives a cause of action to a person who suffered loss or damage as a result of the breach.⁹ But a breach of the best interests covenant attracts no penal consequence. It is not an offence,¹⁰ and, as the SIS Act currently stands, it does not give APRA a basis to bring a civil penalty proceeding against the trustee (or its directors). APRA's ability to seek a remedy under the SIS Act where there has been a breach of the best interests covenant is limited: APRA may impose a licence condition on the trustee's **registerable superannuation entity** (RSE) licence;¹¹ seek an injunction to restrain the trustee from engaging in the conduct or requiring it to perform an act;¹² or, after conducting an

⁴ APRA, *Statement of Intent*, September 2018, 1.

⁵ See, eg, the definition of 'prudential matter' in SIS Act s 34C(4).

⁶ The best interests covenant is set out in s 52 (for trustees) and s 52A (for directors of corporate trustees), in SIS Act Pt 6.

⁷ See SIS Act s 6(1)(b).

⁸ See SIS Act s 6(1)(d).

⁹ SIS Act s 55(3).

¹⁰ SIS Act s 55(2).

¹¹ See SIS Act s 29E(1). See also the definition of 'RSE licensee law' in SIS Act s 10(1).

¹² See SIS Act s 315.

investigation or examination under part 25, cause proceedings to be begun in the name of the beneficiary to recover damages or property.¹³

The breach may be a failure by the trustee to comply with the condition on its licence that the duties of a trustee are properly performed.¹⁴ APRA may be able to direct the RSE licensee to comply with that condition.¹⁵ But on their face, these are indirect means of enforcing compliance with the covenants.

The Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 (Cth), introduced into Parliament on 14 September 2017, proposes to amend the SIS Act to insert, among other things, a new provision rendering section 52A, which contains the best interests covenant imposed on directors of corporate trustees, a civil penalty provision.¹⁶ The Bill was debated in the Senate in November and December 2017, but, at the time of writing, the government had announced it would table some amendments, and the bill had not progressed to the House of Representatives.¹⁷

The Bill does not propose to change the administration of part 6 of the SIS Act. Accordingly, if this Bill were to be enacted, APRA would be charged with administration of this provision and consequently with bringing any civil penalty proceedings for a breach of the best interests covenant under section 52A, to the extent that the breach did not involve any keeping of reports or disclosure to members.

¹³ See SIS Act s 298. This power is analogous to ASIC's power to bring proceedings in the name of a person under the *Australian Securities and Investments Commission Act 2001* (Cth) s 50.

¹⁴ See SIS Act s 29E(1)(b).

¹⁵ See SIS Act s 29EB.

¹⁶ Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 (Cth) s 55AA.

¹⁷ See the status of the Bill here: www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bld=s1089

A question arises as to whether APRA is best placed to enforce compliance with the best interests covenant in this way. As I observed in my *Interim Report*, APRA has not chosen to carry out enforcement activities in the courts. Indeed, such an approach to enforcement may present some conflict with its mandate of ensuring stability in the financial system. The power to bring proceedings may more properly sit with ASIC, which already has responsibility for regulating and enforcing provisions analogous to the best interests covenant under provisions such as those imposing duties on responsible entities of managed investment schemes.¹⁸

This chapter deals with the issues raised by the case studies in three parts:

- First, issues that arose in respect of particular superannuation trustees, namely:
 - NULIS Nominees (Australia) Limited, part of the NAB group;
 - Colonial First State Investments Limited and Avanteos Investments Limited, part of the CBA group;
 - AMP Superannuation Limited and NM Superannuation Proprietary Limited, part of the AMP group;
 - IOOF Investment Management Limited and Questor Financial Services Limited, part of the IOOF group;
 - OnePath Custodians Pty Limited, part of the ANZ group;
 - Suncorp Portfolio Services Limited, part of the Suncorp group; and
 - Hostplus Pty Limited.
- Second, issues that arose in relation to one or more other superannuation trustees:
 - board governance;
 - consideration of mergers;
 - management of members' money;

¹⁸ See Corporations Act s 601FC.

- payments from investment managers to superannuation trustees or their parent company;
 - fees for no service; and
 - keeping members in higher fee-paying products instead of a simple, low-cost product.
- Third, the regulatory response.

1 NULIS Nominees (Australia) Ltd

1.1 Background

NULIS Nominees (Australia) Limited (NULIS) is an RSE licensee and a wholly owned subsidiary of NAB. It is one of a number of companies in NAB's 'Wealth division'. NULIS is the trustee of the MLC Super Fund and MLC Superannuation Fund. At the time of the Commission's inquiries, those funds had about \$76.4 billion and \$18.7 billion funds, respectively, under management and more than 1.3 million members.¹⁹

Until July 2016, NULIS was one of three RSE licensees within the NAB Group. The two others were PFS Nominees Pty Ltd (PFS) and MLC Nominees Pty Limited (MLC Nominees). The administrator of the funds has varied over time but, at all relevant times, it has been an entity within NAB's Wealth division.

The Commission's inquiries concerned conduct relating to fees charged to members of the funds for no service, the decision of NULIS to maintain grandfathered commissions, and the performance of its MySuper products. The Commission heard evidence from Nicole Smith, the then recently retired Chair of the board of NULIS, Paul Carter, former Executive General Manager for NAB Wealth, and Andrew Hagger, the then Chief Customer Officer for Consumer Banking and Wealth.

¹⁹ Exhibit 5.84, Witness statement of Peggy O'Neal, 19 July 2018, 64–6.

1.2 Evidence

1.2.1 Fees for no service

As my *Interim Report* records, ASIC started its ‘Wealth Management Project’ in 2014.²⁰ This was a major project focusing upon the financial advice businesses conducted by ANZ, CBA, NAB, Macquarie, Westpac and AMP. And, as also recorded in the *Interim Report*, ASIC announced in April 2015 that it was ‘investigating multiple instances of licensees charging clients for financial advice, including annual advice reviews, where the advice was not provided’.²¹ In August 2018, the then Deputy Chair of ASIC told the Commission that about \$260 million had already been paid in compensation for the charging of fees for no service, that the total amount of estimated compensation (including what had already been paid) was about \$850 million and that he ‘wouldn’t be at all surprised if it ends up being in excess of a billion dollars’.²²

The Commission’s inquiries about NAB’s superannuation business and fees for no service examined four matters:

- The charging of ‘Plan Service Fees’ (PSFs) to members of funds of which MLC Nominees and, later, NULIS was trustee;
- NAB’s dealings with ASIC about those matters, in particular in connection with ASIC’s publication, in October 2016, of its *Report 499: Financial Advice: Fees for No Service*;
- The charging of ‘Adviser Service Fees’ (ASFs) to members of funds of which MLC Nominees and, later, NULIS was trustee; and
- NAB’s reporting to ASIC of breaches, or likely breaches, of its obligations under section 912A of the *Corporations Act 2001* (Cth) (the Corporations Act).

²⁰ FSRC, *Interim Report*, September 2018, vol 1, 124.

²¹ FSRC, *Interim Report*, September 2018, vol 1, 124.

²² Transcript, Peter Kell, 17 August 2018, 5254.

Plan service fees

Until July 2016, MLC Nominees was the trustee of The Universal Superannuation Scheme (TUSS) fund. Masterkey Business Super (MKBS) and Masterkey Personal Super (MKPS) were divisions of TUSS.²³ MKBS was described as ‘the corporate employer division’ and MKPS as ‘the personal division to which a member is automatically transferred after ceasing employment with the relevant employer sponsor’.²⁴ MLC Nominees invested the TUSS assets in investment-linked life insurance policies issued by MLC Limited.

From 2012, members invested in MKBS and MKPS were charged a PSF. The PSF was introduced as part of a wider project by MLC Nominees and MLC Limited (called ‘Superannuation with Fee Transparency’ or ‘SWiFT’) to change the structure of fees and charges and, in particular, to replace the then existing asset-based commission and employer service fee with a single fee.²⁵

The PSF was also subsequently applied to members from other funds or products who were ‘traded-up’ to the MKBS and MKPS products. The first relevant trade-up, known as ‘Encompass’, took place in December 2012 and involved the intra-fund transfer of members from other products issued by MLC Nominees to MKBS and MKPS.²⁶ The second relevant trade-up took place in May 2013 and was also an intra-fund transfer, this time of members in The Employee Retirement Plan (TERP) to the MKBS and MKPS products.²⁷

As has been noted, before the PSF was introduced in 2012, members paid an asset-based commission and a fee for general advice services called the ‘Employer Service Fee’.²⁸ The asset-based commission was paid to an adviser for arranging the commencement of an MKBS plan and

²³ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [12].

²⁴ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [11].

²⁵ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 6 [14], [17].

²⁶ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 6 [19].

²⁷ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 6 [20].

²⁸ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [13].

for providing members in MKBS and MKPS access to ‘ongoing general support services’.²⁹ The Employer Service Fee was deducted from member accounts of the MKBS where the employer and the adviser had agreed that the fee would be charged.³⁰ The Employer Service Fee and asset-based commission were deducted by MLC Limited from members’ accounts and paid to the relevant advisers. If there was an adviser linked to the member’s account then MLC Limited paid the asset-based commission and Employer Service Fee to the linked adviser. Documents produced in evidence suggest that it is possible that the latter fee was deducted even where there was no linked adviser, and was retained by either MLC Nominees³¹ or MLC Limited,³² I cannot say which.

The PSF introduced by MLC Nominees was about equal to the total of the amounts that had been charged as asset-based commission and Employer Service Fee. MLC Nominees deducted the PSF from members’ accounts.³³

On 1 July 2016, the members of TUSS were transferred, by **successor fund transfer** (SFT) under the SIS Act, to the MLC Super Fund. NULIS was the trustee of that fund. As a consequence of the transaction, NULIS became the trustee responsible for MKBS and MKPS,³⁴ MLC Limited ceased to be administrator, and National Wealth Management Services Ltd (NWMSL) became administrator in its place.³⁵

ASIC proceedings

On 6 September 2018, after the Commission’s hearings into superannuation had concluded, ASIC commenced proceedings against MLC Nominees

²⁹ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [13].

³⁰ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [13].

³¹ Exhibit 5.388, 14 July 2015, Legal Memorandum – MKBS and MKPS Fees – Final, 9 [3.14], 10 [3.18].

³² See, eg, Exhibit 5.20, 8 January 2018, Briefing Note Concerning PSF Events Prepared by Service Provider Management, 5 [2.15].

³³ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 6 [17].

³⁴ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 7 [21].

³⁵ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 7 [21].

and NULIS in the Federal Court of Australia.³⁶ The proceedings sought a pecuniary penalty under section 12GBA of the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act) and various declarations in relation to the charging of PSFs and related conduct. The documents filed by ASIC alleged that:³⁷

- Contrary to the terms of MKBS and MKPS, the trustees had deducted (or authorised the deduction of) PSFs totalling approximately \$33.8 million from the accounts of approximately 220,000 members who were not 'linked' to a plan adviser (no-adviser members).
- Documents issued to no-adviser members represented that the trustee was entitled to deduct the PSF and that members were obliged to pay it.
- The trustees had deducted (and NULIS continued to deduct) PSFs exceeding \$67 million from the accounts of approximately 305,000 members who were linked to a plan adviser.
- For members who had a plan adviser linked to their account, the trustees were subject to a Licence Remuneration Agreement with each plan adviser's licensee, which did not oblige the adviser to provide any services, but which obliged the trustee to pay the PSF unless the trustee reasonably believed the adviser was no longer providing the services to which it related.
- For linked members, the trustees did not know what services, if any, plan advisers had agreed to provide. They had no system to enable them to know whether advisers were no longer providing the services to which the PSF related and were not aware of any services being provided to linked members in the MKPS division.
- Upon linked members ceasing employment with the employer, they were transferred to the MKPS division and no longer received the services to which the PSF related.

³⁶ *ASIC v MLC Nominees Pty Ltd & Anor* NSD 1654/2018.

³⁷ Concise Statement filed on behalf of ASIC dated 12 October 2018. See also Originating Process filed on behalf of ASIC dated 12 October 2018.

- The trustees did not exercise their right to terminate the PSF for linked members upon that member ceasing employment and being transferred to the MKPS division.
- Documents issued to members, including product disclosure statements, did not inform members that linked members in MKPS had the right to elect to turn off the PSF by notifying the trustee.
- The trustees' documents included statements that positively misrepresented the rights of linked members in MKPS with respect to the PSF.
- The conduct and the representations gave rise to contraventions of law including section 912A(1)(a), 912A(1)(c) and 1041H(1) of the Corporations Act, sections 12DA(1), 12DB(1)(g) and 12DB(1)(i) of the ASIC Act, sections 29E(1)(a), 52(2)(b), 52(2)(c) and 55 of the SIS Act, and certain general law duties of the trustees.

The Commission's Terms of Reference provide that I am not required to inquire, or continue to inquire, into a particular matter to the extent that I am satisfied that the matter is being, or will be, sufficiently and appropriately dealt with by a civil proceeding. I am, of course, satisfied that the matters relating to the charging of PSFs to members, and what the trustees represented to members about the PSFs that are raised in the proceedings, will be sufficiently and appropriately dealt with in those proceedings. I make no findings about the particular contraventions alleged in those proceedings. Whether other forms of proceeding could or should be instituted in respect of these matters in the first instance is a matter for ASIC and I say no more about it.

It remains important, however, to deal here with two matters in respect of the PSFs: first, NAB's internal investigations into the issues with the PSFs and, second, NAB's dealings with ASIC about the PSFs around October 2016, when ASIC published its Fees for No Service report.

Internal investigations

In around August 2015, representatives of MLC Limited and MLC Nominees raised queries internally, including with those in the risk team, in relation to

the introduction of PSFs.³⁸ This led to an event being raised in NAB's risk 'event management system' on 4 September 2015, and investigations into what had happened.³⁹ The event and investigations focused on the charging of PSFs to members who had been part of the TERP trade-up.

The investigations appear to have been conducted by persons working within NAB Wealth and were preceded by investigations relating to ASFs. As part of the investigations, legal advice was received by NAB Wealth that expressed the view that PSFs should be refunded if there was no adviser linked to the member's account.⁴⁰ As NAB had waived legal professional privilege over this advice, a copy was made available to the Commission. The advice noted that employer service fees and ASFs that may have been deducted where there was no adviser linked to the account should also be refunded.⁴¹ A paper presented in October 2015 to the Breach Review Committee (BRC) in respect of the TERP trade-up event expressed the view that the BRC may consider it prudent to notify APRA and ASIC of the event given the large number of members affected. This was said to be 46,875, with the total PSF deducted from the members since the trade-up said to be approximately \$4 million.⁴² The paper noted that PSFs were still being charged to members who did not have an adviser linked to their account.⁴³ On 3 December 2015, the boards of NULIS and MLC Nominees were told that a potential issue had arisen in relation to the PSFs. It was not clear from the evidence why the issues were not communicated to the boards until then.

On 24 December 2015, MLC Nominees (as trustee of TUSS) and MLC Limited (then the administrator of TUSS) lodged a breach notification with

³⁸ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 7 [22].

³⁹ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 8 [26].

⁴⁰ Exhibit 5.388, 14 July 2015, Legal Memorandum – MKBS and MKPS Fees – Final, 5.

⁴¹ Exhibit 5.388, 14 July 2015, Legal Memorandum – MKBS and MKPS Fees – Final, 10–11.

⁴² Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, Exhibit NSS-1 (Tab 6) [NAB.005.848.0001 at .0007].

⁴³ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, Exhibit NSS-1 (Tab 6) [NAB.005.848.0001 at .0005].

ASIC about the issue.⁴⁴ The notice said that when implementing the trade-up, MLC Limited established systems to apply the PSF to the accounts of transferring members including non-advised members and, as a result, the PSF was deducted from those members' accounts and retained by MLC Limited.⁴⁵ On the same day the breach notification was lodged with ASIC, MLC Nominees lodged a similar breach notification with APRA in relation to that event.⁴⁶

Ms Smith told the Commission that a further investigation was then conducted from around early 2016 to September 2016 in relation to PSFs introduced for members who were part of Project SWiFT and the Encompass trade-up.⁴⁷ An event was raised internally on 11 July 2016⁴⁸ and further breach notifications were lodged by MLC Nominees and MLC Limited with ASIC on 14 September 2016.⁴⁹

The investigations in relation to the PSFs were conducted by persons working within NAB Wealth. They considered whether it could be said that general advice services provided to members, such as telephone assistance, could justify retaining the PSFs that had been charged to unadvised members.⁵⁰ Ms Smith told the Commission that she was aware at 'a very high level' of this⁵¹ and that she understood at the time that there were two pieces of legal advice that had differing views.⁵² This further advice, which appears to have been external to NAB, was not before

⁴⁴ Exhibit 5.149, 24 December 2015, Breach Report MLC Nominees.

⁴⁵ Exhibit 5.149, 24 December 2015, Breach Report MLC Nominees, 3.

⁴⁶ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 9 [35]; Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, Exhibit NSS-1 (Tab 13) [NAB.005.067.6509].

⁴⁷ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 9 [37].

⁴⁸ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 9 [38].

⁴⁹ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 10 [42].

⁵⁰ Exhibit 5.14, 3 May 2016, Invitation of 3 May 2016 from Buchanan and Its Attachment Investigation into Project Swift; Exhibit 5.21, 24 August 2016, Email to and from Carter and Others, PSF Management Paper to Trustee, August 2016; Exhibit 5.22, 19 September 2016, Email, Stimson to Carter, Plan for PSF Meeting with Hagger.

⁵¹ Transcript, Nicole Smith, 7 August 2018, 4333.

⁵² Transcript, Nicole Smith, 7 August 2018, 4334.

the Commission. NAB, as it was entitled to do, did not produce to the Commission either the instructions to the external lawyers or the advice itself. At least initially, however, those within NAB Wealth having the carriage of the matter appear to have proceeded on the basis that it may not have been necessary to refund all PSFs charged to members without a linked adviser.

Although Mr Carter did not accept this characterisation of events, what was done at this time was consistent with senior employees in NAB Wealth trying to find a way to retain the revenue derived from PSFs paid by unadvised members.⁵³ Be this as it may, NAB Wealth concluded that the services provided by the administrator did not provide a basis to retain the fee as the services the administrator offered were services generally available to all members and members paid for those services by the administration fee.⁵⁴

Communications with ASIC in relation to Report 499

After the breach notifications were made in respect of the TERP and other PSF events, representatives of NAB Wealth and NULIS had several meetings and discussions with ASIC. In respect of the TERP event, NAB Wealth and NULIS gave ASIC regular updates of the estimated total of PSFs charged and number of members affected, as well as the manner in which NAB might approach a remediation program. But NAB did not give ASIC the figures that it had arrived at internally for remediation of the SWiFT and Encompass events. In particular, as will later be explained, NAB did not give ASIC these figures before ASIC completed and published its report into Fees for No Service as part of its 'Wealth Management Project' despite ASIC asking for revised figures about identified and estimated remediation.

In February 2016, Mr Damian Murphy of NAB Wealth, wrote to ASIC providing an update on the TERP trade-up event. He told ASIC that the issue was estimated to affect 96,920 members and the PSFs totalled

⁵³ Transcript, Paul Carter, 7 August 2018, 4267; see also 4272.

⁵⁴ Exhibit 5.25, 15 October 2016, Emails Bourguignon, Carter and Others, October '16, PSF Management Paper Opt-In Compensation.

\$10,797,403.⁵⁵ An update, provided to ASIC in June 2016, again recorded that the number of members affected had increased from the 47,000 members indicated in the breach report to more than 96,920, but it also said that the financial impact then totalled \$14 million.⁵⁶

On 23 August 2016, ASIC wrote to Ms Smith and Mr Hagger confirming that it had told them that ASIC would be prepared to ‘formalise’ the obligations of NULIS and NWMSL ‘under the TERP trade-up and PSF remediation programs’ on the basis that NULIS and NWMSL committed to remediation in an open letter and acknowledged that ASIC would monitor the implementation of the remediation programs and report publicly on them. ASIC proposed that the obligations be recorded either in an **enforceable undertaking** (EU) or in licence conditions.⁵⁷ ASIC otherwise rejected NAB’s proposal that the matter be resolved by what NAB had called ‘Negotiated Commitments’.⁵⁸ ASIC indicated that it may be willing to resolve the issues arising out of the SWiFT and Encompass matters on a similar basis to the TERP trade-up and PSFs remediation programs.⁵⁹ ASIC said that it expected to be informed of the response of the boards of the relevant NAB entities ‘relatively soon’.⁶⁰ ASIC also said that it considered a separate and more specific ‘Assurance Review’, by an independent external expert, was required.

Shortly after that, in emails dated 6 and 7 September 2016 between Ms Karen-Anne Herald of the Risk team and Damian Murphy, the Chief Risk Officer, Ms Herald acknowledged that provisions had been booked for the remediation of \$13 million for the TERP PSF event and that provisions had been made for the SWiFT and Encompass PSF events in the amount of \$21.6 million.⁶¹

⁵⁵ Exhibit 5.150, 24 February 2016, Letter, NAB Wealth to ASIC.

⁵⁶ Exhibit 5.151, 18 June 2016, Email, Murphy to Hagger and Attached Tables.

⁵⁷ Exhibit 5.49, 23 August 2016, Letter ASIC to Smith and Hagger.

⁵⁸ Exhibit 5.49, 23 August 2016, Letter ASIC to Smith and Hagger.

⁵⁹ Exhibit 5.49, 23 August 2016, Letter ASIC to Smith and Hagger.

⁶⁰ Exhibit 5.49, 23 August 2016, Letter ASIC to Smith and Hagger.

⁶¹ Exhibit 5.393, 7 September 2016, Email Woolrich to Murphy.

As noted above, when the breach notification was formally provided to ASIC in respect of the SWiFT and Encompass PSF events on 16 September 2016, an estimate was given of the number of members affected by the events, but no estimate of financial loss was given.⁶²

On 16 September 2016, ASIC wrote again to Ms Smith and Mr Hagger stating (once more) that ASIC considered that an independent review pursuant to an EU would be an appropriate regulatory outcome.⁶³ ASIC noted that it had not yet received a response from the boards of the relevant NAB entities: NULIS, NWMSL and NAB Wealth.⁶⁴

On 19 October 2016, Mr Hagger provided an update on the PSF events to the Group Risk Return Management Committee, which included NAB's Chief Executive Officer, Andrew Thorburn, and other senior NAB Group executives.⁶⁵ Mr Hagger said that compensation was expected to total \$34.3 million for the three events.⁶⁶

On the same day, ASIC sent an email to NAB to say that it would be publishing a public report with respect to fees for no service in the following week.⁶⁷ Andrea Debenham from NAB's Regulatory Affairs wrote to Mr Hagger, Mr Carter, Mr Murphy and others noting that ASIC's report would include details of the 'TERP PSF breach' but that it was unclear whether it 'would extend to mentioning the SWiFT and Encompass PSF events'. Ms Debenham asked for agreement and instruction on whether the intention was to pre-emptively communicate about the TERP PSF Event and associated remediation; or all PSF events and associated remediation; or Project Rio in total; or none of these. ('Project Rio', an internal review

⁶² Exhibit 5.43.17, Witness statement of Nicole Smith, MLCN ASIC Breach PSF for Swift Encompass, 14 September 2016.

⁶³ Exhibit 5.51, 16 September 2016, Letter ASIC to Smith and Hagger.

⁶⁴ Exhibit 5.51, 16 September 2016, Letter ASIC to Smith and Hagger.

⁶⁵ Exhibit 5.29, 19 October 2016, Extract from Minutes of Group Risk Return Management Committee Meeting.

⁶⁶ Exhibit 5.29, 19 October 2016, Extract from Minutes of Group Risk Return Management Committee Meeting.

⁶⁷ Exhibit 5.405, 19 October 2016, Email, NAB Internal Email about ASIC's Public Report on Ongoing Advice Service Fees.

of the matters raised by ASIC, was considering the appointment of KPMG to conduct an independent ‘assurance review’ of the adequacy of compliance and risk management practices in NAB’s superannuation business as a whole. In about June 2016, there had been some discussions with ASIC about such a review⁶⁸ and, as is explained below, in January 2017, ASIC required NULIS to do it.) Ms Debenham said:⁶⁹

To be clear, I’m not necessarily proposing that we should communicate pre-emptively. Rather, I wanted to flag that if we go down that path I’ll need to engage ASIC as soon as possible. Whichever way it falls, we might need to consider how this lines up with EOY results announcements.

On 20 October 2016, Chris Owens from the Corporate Affairs team sent an email to Mr Hagger, Mr Carter and others noting that ASIC ‘plans to announce the “TERP Plan Service Fee” event as part of its public report on Ongoing Advice Service Fees’ and setting out ‘a number of media options to minimise reputation risk for the Group’.⁷⁰ The email said that Corporate Affairs’ ‘preferred option would see NAB proactively announce all aspects of the PSFs issue, including customer numbers and the total remediation amount’.⁷¹ Mr Owens also suggested that NAB approach ASIC and ask it to consider delaying the announcement until after the banking reporting season.⁷² NAB’s reporting of its annual financial results was scheduled for 27 October 2016.

On 21 October 2016, Ms Louise Macaulay of ASIC sent NAB a redacted draft copy of the ASIC report entitled *Financial Advice: Fees for No Service*.⁷³ The details of financial compensation in respect of NAB ‘fees for no service’ events were set out in a table. The equivalent detail in respect

⁶⁸ Transcript, Andrew Hagger, 13 August 2018, 4734.

⁶⁹ Exhibit 5.146, 19 October 2016, Emails Entitled ASIC ASF/PSF Reporting between Debenham, Hagger and Others, 26 September 2016 and 19 October 2016.

⁷⁰ Exhibit 5.30, 20 October 2018, Emails Carter, Hagger and Others.

⁷¹ Exhibit 5.30, 20 October 2018, Emails Carter, Hagger and Others.

⁷² Exhibit 5.30, 20 October 2018, Emails Carter, Hagger and Others.

⁷³ Exhibit 5.31, 21 October 2018, Email Macaulay of ASIC to NAB Concerning Confidential Draft Report.

of other banks was redacted but the overall totals of compensation paid or agreed to be paid and estimated future compensation by all of the entities the subject of the report were not redacted.⁷⁴ The table said that the total compensation paid or agreed to be paid by all the entities examined was \$23,098,808 and that the estimated future compensation was between \$57 and \$63 million (an overall total of \$80–86 million).

Later that day, Nathan Goonan, the acting Executive General Manager of Corporate Affairs sent Mr Thorburn and others an email saying that ASIC had invited feedback on the draft report. He said:⁷⁵

At this stage, having seen the report, our thinking is to be reactive from a communication perspective given, as drafted NAB is seen as just one 'in the pack' rather than called out as an outlier. Andrew H and team are considering this feedback and we will settle on a recommendation over the weekend.

Mr Goonan's email attached a paper entitled *Project Rio Issue Summary – 21 October 2016 at 4:30pm*.⁷⁶ The paper said that NAB had been named in the ASIC report as having total exposure of compensation of \$16.2 million for about 120,000 customers. It said that the remediation option in respect of the SWiFT and Encompass events was to be presented to NWMSL (the NAB administrator for NULIS's superannuation business) and NULIS for approval on Monday 24 October 2016 and Wednesday 26 October 2016 respectively. The paper went on to say:

... while we can't see the other bank's compensation details, this probably means that NAB is middle of the pack when it comes to compensation.
... remediation has not begun for PSF, as we have been attempting to resolve legal differences of opinion. The most likely remediation will be to ~220,000 members for approximately \$34 million across TERP PSF, SWiFT and Encompass.

...

ASIC has invited feedback on the draft report by 10 am Monday. The relevant executives for the PSF issue (Andrew Hagger and Paul Carter)

⁷⁴ Exhibit 5.32, 21 October 2016, Draft ASIC Report Financial Advice Fees for No Service.

⁷⁵ Exhibit 5.35, 22 October 2016, Email Thorburn to Hagger and others.

⁷⁶ Exhibit 5.36, 21 October 2016, Project Rio Issue Summary Attached to Email.

are considering this feedback. There are two possible outcomes of NAB's feedback to ASIC.

...

ASIC's report is published next week in largely the same form that it is now ... this would mean NAB is seen as just one of the banks tied up in [the matter] ...

[or] ASIC's report is adjusted and/or delayed to include NABs expanded PSF numbers (making NAB the 'worst' of the banks in the report.)

The reference to 'legal differences of opinion' appears to be a reference to the legal advice referred to above.

Mr Hagger was responsible for the feedback that would be provided to ASIC on the draft report.⁷⁷ Mr Thorburn forwarded Mr Goonan's email and attached paper to Mr Hagger and Antony Cahill with the request that they 'please discuss Monday, when we meet'.⁷⁸ By an email sent shortly after that, Mr Hagger emailed Mr Cahill and copied in Mr Thorburn saying that he had had a telephone call with key stakeholders and that they intended to recommend that the current approach was the most suitable one. He said:⁷⁹

the additional nuance is that we think I should call Greg Tanzer or Peter Kell on Monday morning to advise the latest as to where we are up to on the PSFs. All in the ongoing interests of openness and transparency. We doubt they will wish to shoe-horn the matter into their report given deadlines, their multi-phased approach and the very substantial rewrite which would be required to their report overall.

On 24 October 2016 at 8:00am the board of NWMSL met. The minutes of the meeting show that the board resolved to recommend to NULIS that NULIS approve full compensation (plus interest) for the PSF events for all non-linked members and to approve NWMSL indemnifying NULIS for the compensation.⁸⁰ The minutes noted that a full refund of the PSFs was more

⁷⁷ Transcript, Paul Carter, 7 August 2018, 4297; see also Transcript, Andrew Hagger, 13 August 2018, 4371.

⁷⁸ Exhibit 5.35, 22 October 2016, Email Thorburn to Hagger and Others.

⁷⁹ Exhibit 5.153, 22 October 2016, Email Hagger to Cahill and Thorburn.

⁸⁰ Exhibit 5.41, 24 October 2016, Minutes of Meeting at 8am, NWMS Limited.

generous to members and that NWMSL's preferred approach had been for opt-in compensation.

Mr Hagger left the meeting after the resolution had been passed and telephoned Mr Tanzer. On re-joining the meeting, Mr Hagger told the board about the call.

Later that morning, at 10.56am, Mr Hagger sent an email to a number of NAB employees, including Mr Carter, setting out his account of the conversation that he had with Mr Tanzer.⁸¹ In his evidence, Mr Hagger described this email as his 'file note' of the discussion.⁸² The email records that Mr Hagger told Mr Tanzer the NWMSL and NULIS boards were meeting 'that week'. The email does not record Mr Hagger as having told Mr Tanzer that NWMSL had already met and resolved to approve full compensation and indemnify NULIS. The email does not record Mr Hagger as having provided any estimate or range of future compensation or any update to Mr Tanzer in respect of loss or compensation.⁸³

Mr Hagger told the Commission that he said to Mr Tanzer:⁸⁴

... if he wants to know anything further of any of this, so if he said to me what do you think the dollars involved are, I would have referred him to our earlier conversation, which is that they had the number of members and I had given him an indication of approximately what the dollar figure was. So, you know, as an accountant I could have multiplied those two together. He was obviously capable of doing that.

Mr Hagger told the Commission that the 'earlier conversation' was a discussion he had with Mr Tanzer between the date of the breach notification (in respect of the SWiFT and Encompass events) lodged with ASIC in September 2016 and the date of ASIC's draft report into fees for no service.⁸⁵ Mr Hagger's evidence was that he gave 'an indication to

⁸¹ Exhibit 5.37, 24 October 2016, Email Hagger to Debenham.

⁸² Transcript, Andrew Hagger, 13 August 2018, 4758.

⁸³ Transcript, Paul Carter, 7 August 2018, 4300.

⁸⁴ Transcript, Andrew Hagger, 13 August 2018, 4761.

⁸⁵ Transcript, Andrew Hagger, 13 August 2018, 4757.

Mr Tanzer of the ... dimensions of SWiFT and Encompass in roundabout terms' at that time.⁸⁶ He said that he told Mr Tanzer, 'You have the number of members, and the approximate dollars involved in terms of the fees is similar, perhaps slightly bigger, per member than the TERP issue'.⁸⁷ Mr Hagger described his interaction with Mr Tanzer as 'open and transparent'.⁸⁸

Ms Debenham and others at NAB had met with representatives of ASIC on the preceding Friday, 21 October 2016, to discuss NAB's response to ASIC's draft report, and NAB gave ASIC a document setting out some requested alterations and additions to the report. One of the responses confirmed that the compensation amount for the TERP trade-up PSF event was \$12.4 million plus interest and that 108,867 customers had been affected.⁸⁹ NAB said in its document that '[t]he figures included in the DRAFT report were sourced from the March 2016 Quarterly Breach Report Update. These amended figures are correct as at 31 August 2016'.⁹⁰

At about 6 pm on 24 October 2016, Joanna Bird of ASIC sent Ms Debenham and others an email setting out ASIC's responses to NAB's request for alterations and additions to the report. Ms Bird's email noted that 'all institutions have now provided us with updated estimates', noted that ASIC proposed 'to give current estimates' in the relevant tables in the report, noted that ASIC would use the figures given in NAB's 7 October monthly update and said that '[i]f you have an October estimate for the MLC Nominees ... compensation we will include it ... [o]therwise we will use the 108,867, \$12.4M figure'. Ms Debenham replied later that evening. In response to the questions Ms Bird had asked about updated estimates, Ms Debenham annotated Ms Bird's email saying 'Thank you. Please use the 108,867, \$12.4M figure'.⁹¹

⁸⁶ Transcript, Andrew Hagger, 13 August 2018, 4757.

⁸⁷ Transcript, Andrew Hagger, 13 August 2018, 4757.

⁸⁸ Transcript, Andrew Hagger, 13 August 2018, 4771.

⁸⁹ Exhibit 5.157, 24 October 2016, Email Murphy to Hagger and Attached Tables.

⁹⁰ Exhibit 5.157, 24 October 2016, Email Murphy to Hagger and Attached Tables.

⁹¹ Exhibit 5.156, 24 October 2016, Emails between Debenham, ASIC and Others.

Mr Hagger signed a letter dated 24 October 2016, on behalf of NWMSL, to the Board of Directors of NULIS.⁹² The letter had been approved at the board meeting on the morning of 24 October 2016 before Mr Hagger's call to Mr Tanzer. The letter told the board of NULIS that NWMSL intended to indemnify NULIS for the PSF remediation. The letter set out the two alternative approaches to remediation, one described as the 'opt-in' approach and the other as the 'full compensation' approach. The letter said that both approaches were reasonably arguable, although the 'full compensation' approach was preferred. The letter said that the decision rested with NULIS as the trustee.

On 26 October 2016, the joint board of MLC Nominees, NULIS and PFS Nominees met and approved the 'full compensation' approach. This approach affected 220,515 member accounts and was estimated to involve a refund of \$33.7 million in PSFs charged, plus compensation.⁹³ There was no suggestion in the evidence that Mr Hagger or anyone else at NAB or NULIS informed ASIC on that day about this meeting or its outcome.

On the following day, 27 October 2016, ASIC published the Fees for No Service report. The report was circulated by email within NAB and NULIS.⁹⁴ The email said 'of particular note is that the compensation numbers have increased markedly since the draft was issued on Friday – for example, CBA has \$105m to pay'.⁹⁵

Subsequently, on 3 November 2016, representatives of NAB Wealth gave a PowerPoint presentation to representatives of ASIC that provided an update on the PSFs event. The presentation told ASIC that the total PSF amount was approximately \$34.6 million.⁹⁶ After the meeting, an internal email was sent to Mr Tanzer and others within ASIC which said that:⁹⁷

⁹² Exhibit 5.38, 24 October 2016, Letter NWMSL to NULIS.

⁹³ Exhibit 5.39, 26 October 2016, Minute of Resolution of NULIS Board and Accompanying Paper by Carter, Remediation Plan Service Fee Events.

⁹⁴ Exhibit 5.40, 28 October 2016, Email Hopwood to Carter and Others.

⁹⁵ Exhibit 5.40, 27 October 2016, Email Hopwood to Carter and Others.

⁹⁶ Exhibit 5.159, 3 November 2016, Update to ASIC Slide Pack.

⁹⁷ Exhibit 5.319, 3 November 2016, Email Mitchell to Mr Tanzer and Others.

- On 14 September, NAB lodged two fresh breach notices covering these PSF events. The notices have scanty information and no estimates of compensation. ASIC has continued to [seek] further information on these two new PSF breaches but the information was not forthcoming.
- Today's update radically revises the previous compensation estimates to a total of \$34 million including interest. The revised figure is concerning because the company has known about the events for approximately 11 months and has only just presented the figures in a meeting today (no formal letter and just a hardcopy powerpoint presentation). We are questioning whether the imposition of licence conditions is sufficient in this situation.

The evidence was not clear as to whether Mr Hagger was present at the meeting on 3 November 2016, and no-one who attended the meeting gave evidence before the Commission. The contents of the presentation and emails, however, were not challenged by NAB or NULIS.

Ms Smith said that the PSFs were turned off for MKBS and MKPS members with no linked adviser (including those who were part of the Encompass trade-up and Project SWiFT) by 30 October 2016.⁹⁸ She said that a small subset of additional members with no linked adviser was later identified and that their PSFs were turned off by 17 January 2017.

In February 2017, NULIS agreed to ASIC imposing additional licence conditions on NULIS's **Australian financial services licence**. Ms Smith said that NULIS agreed to the imposition of those conditions because it had assumed the rights and liabilities of MLC Nominees as trustee.⁹⁹ One of the added conditions was that NULIS engage an ASIC-approved independent expert to assess and report on the adequacy of its compliance and risk management practices for its superannuation business.¹⁰⁰

⁹⁸ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 10 [44].

⁹⁹ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 10–11 [48].

¹⁰⁰ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 11 [48].

Members affected by the PSF events were paid compensation in June and July 2017.¹⁰¹

On 26 July 2018, NAB published an ASX announcement saying that NULIS would stop deducting the PSF from MKPS member accounts from 30 September 2018 and that all MKPS members would be fully refunded for PSFs paid while in the product.¹⁰² The announcement said that the PSF would be switched off for members of the MKBS on 30 November 2018 and that after this time no MLC products would have a PSF attached.

Adviser Service Fees

PSFs were not the only form of fees charged by MLC Nominees, and then NULIS, where there were issues about charging fees for no service. In its 29 January 2018 submission in response to my initial inquiries, NAB said that ASFs had been incorrectly charged to customers between 2008 and 2015. The submissions said that:

In some cases, ongoing advice fees were charged when no adviser was attached to the client. Estimates (as at 30 September 2017) are that approximately 25,000 customers were affected and approximately \$6.6 million of fees were charged.

A further issue that is being investigated is whether, in cases where advisers were attached to the customer, the relevant services were provided to the customer. This is a review into whether the contracted services were provided, not whether the advice was appropriate.

Although NAB's 29 January 2018 submission referred to charging ASFs incorrectly between 2008 and 2015, Ms Smith gave evidence that between July or August 2014 and May 2018, NAB entities had identified four events, and made three breach reports to ASIC and APRA in relation to the charging of ASFs.¹⁰³ Something more must be said about each of these identified events.

¹⁰¹ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 10 [46].

¹⁰² Exhibit 5.44, Witness statement of Nicole Smith, 3 August 2018, Exhibit NSS-2 (Tab 1) [NAB.005.817.0001].

¹⁰³ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 15–16 [70]–[73].

Four identified events

In July or August 2014, NAB identified that members continued to have ongoing ASFs deducted from their accounts despite a request having been received to remove the allocated adviser from a member's account.¹⁰⁴ The event was reported to APRA and ASIC on 22 December 2014.¹⁰⁵ Ms Smith said that 8,126 members were affected and that the quantum of fees (gross of tax) in issue was \$1,541,748.¹⁰⁶

In about August 2015, NAB identified an issue relating to ASFs deducted from members' accounts and paid to advice licensees (both external and related party licensees) where the adviser was 'inactive' or the advice dealer group was 'inactive'. Ms Smith said that the first kind of case (where the adviser was inactive) was determined not to be reportable;¹⁰⁷ the second kind of case was notified to ASIC in correspondence on 25 November 2016 as a non-significant breach.¹⁰⁸ Ms Smith said that neither the number of members affected nor the quantum of fees in issue in respect of the first kind of case was available 'as a remediation plan is being finalised'.¹⁰⁹ She said that the second kind of case affected 4,687 members and that \$308,497 fees were in issue.¹¹⁰

In about May 2017, NAB identified a control breakdown in the process of adviser remuneration, which resulted in ASFs being retained by the trustee instead of being paid to the advice licensee of the financial adviser listed on the member account.¹¹¹ This was known as 'Adviser Remuneration Suppression' and was reported to ASIC and APRA on 20 July 2017.¹¹²

¹⁰⁴ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 14 [67], 15 [70].

¹⁰⁵ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 17 [78]–[79].

¹⁰⁶ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 16 [74].

¹⁰⁷ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 19 [95].

¹⁰⁸ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 18 [93].

¹⁰⁹ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 16 [74].

¹¹⁰ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 16 [74].

¹¹¹ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 15 [72].

¹¹² Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 19 [100]–[102].

The NULIS Board received an update on the Adviser Remuneration Suppression event at a board meeting on 18 April 2018. The update said that the event went beyond ASFs and that members had also paid PSFs and commissions that had not been paid to advisers and had, instead, been retained by the trustee as revenue.¹¹³ An appendix to the paper showed a breakdown of the event's effect that suggests that NULIS retained in excess of \$18 million in commissions and in excess of \$800,000 in ASFs.¹¹⁴ Ms Smith told the Commission that 14,663 members were affected and that \$1,879,903 fees (gross of tax) were in issue.¹¹⁵ In March 2018, NULIS told APRA that the 'total suppression' value since 2001 was about \$1.5 million, of which about \$750,000 would be 'released to members' because the advice licensee was no longer active.¹¹⁶ In the end I am unable to say from the evidence what amounts would be required to be paid to advisers or returned to members.

In May 2018, NAB identified that, after notification of some members' deaths, ASFs had continued to be deducted from those members' accounts for a period, or until the finalisation and distribution of the benefit.¹¹⁷ On 15 June 2018, NAB reported the matter to ASIC and APRA.¹¹⁸ Ms Smith said that 'based on current analysis' 4,135 member accounts were affected and \$3,018,945 in fees were in issue.¹¹⁹ Ms Smith said that, from 25 May 2018, NULIS ceased deducting ASFs from member accounts upon notification of the member's death, and that, by 27 June 2018, it had ceased deducting ASFs from individual members' accounts where notification of death had been received before 25 May 2018.¹²⁰

¹¹³ Exhibit 5.398, 18 April 2018, Wealth Entities – Board/Committee Paper Coversheet.

¹¹⁴ Exhibit 5.399, Undated, Appendix 2: Impacted Product Breakdown.

¹¹⁵ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 16 [74].

¹¹⁶ Exhibit 5.436, 4 March 2018, 20180305 NULIS APRA Qrtly Liaison Mtg Briefing Planner Updated 4 March 930pm.docx, 11.

¹¹⁷ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 15 [67], 16 [73].

¹¹⁸ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 20 [109]–[110].

¹¹⁹ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 16 [74].

¹²⁰ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 21 [112]–[114].

It may be observed that NAB took the steps it did only after there had been a lot of adverse public comment provoked by evidence given to the Commission about other entities continuing to charge advice fees after the death of the client. Ms Smith said in her statement to the Commission in August 2018 that she understood that a remediation plan was then being developed.¹²¹

Taken together, the four events concerning ASFs that were described by Ms Smith affected more than 31,000 customers and related to more than \$6.6 million in fees. But these were anything but final figures. Ms Smith told the Commission that the issue of incorrect charging of ASFs was the subject of continuing investigation and review within the NAB Group, with a particular focus on NAB's advice licensees.¹²² When Ms Smith gave her evidence, NAB was still negotiating with ASIC about how NAB licensees should go about compensating affected members.

It is necessary to say something more about NAB's negotiations with ASIC about the issues relating to fees for no service. The negotiations extended over about three years. The various positions taken by NAB in those negotiations appeared primarily directed to minimising the amount that NAB would have to refund.

NAB's negotiations with ASIC in relation to ASFs

On 5 June 2015, Ms Louise Macaulay from ASIC wrote to Andrew Hagger noting that ASIC had commenced an investigation regarding **financial services licensees** charging ASFs without providing advice.¹²³ Mr Hagger was then Group Executive for NAB Wealth. Ms Macaulay asked Mr Hagger to 'scrutinise the operation of all of the Australian financial services licensees that form part of the NAB Group which provide personal financial advice to retail clients, to ascertain whether there are issues related to

¹²¹ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 21 [115].

¹²² Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 15 [69].

¹²³ Exhibit 5.160, 5 June 2015, Letter ASIC to Hagger.

incorrect charging of advice fees', to the extent that this had not already been done.¹²⁴

Mr Hagger told the Commission that NAB disagreed with ASIC about the way to establish whether services had been provided or not.¹²⁵ The methodology was financially significant to NAB. NAB entities would have to refund the fees to customers when the chosen methodology identified that they, or the advisers concerned, had not provided the service that had entitled them to the fee.

During 2016, NAB developed a method of assessing service delivery. It depended upon 'sampling' and appears to have begun in May 2016. Deloitte was retained to examine a sample of cases and confirm whether an annual review of a customer's financial arrangements had been provided or an offer of a review had been made by phone or letter.¹²⁶ NAB may have expected that the sampling would reveal no failures.¹²⁷ However, in respect of NAB Financial Planning, the Deloitte sampling concluded that 54 (92%) 'passed' the requirement, but 5 (8%) 'failed'. The results of the sampling were provided to ASIC in October 2016.

In December 2016, NAB told ASIC about a different approach.¹²⁸ NAB introduced the notion that it would look at whether there had been a 'fair exchange of value' rather than whether the specific, and contractually stipulated, ongoing services had been provided.¹²⁹ NAB said this was a 'customer centric approach', which would look at a range of factors and would 'outscope clients where we can see evidence points to

¹²⁴ Exhibit 5.160, 5 June 2015, Letter ASIC to Hagger.

¹²⁵ Transcript, 13 August 2018, Andrew Hagger, 4795–6.

¹²⁶ Exhibit 5.69, 3 November 2017, Letter from ASIC to Cook, 4.

¹²⁷ Exhibit 5.69, 3 November 2017, Letter from ASIC to Cook, 5.

¹²⁸ Exhibit 5.60, 18 January 2017, Emails Concerning Assurance Review of Adviser Service Fees, January 2017 between Hopwood, ASIC and Others.

¹²⁹ Exhibit 5.60, 18 January 2017, Emails Concerning Assurance Review of Adviser Service Fees, January 2017 between Hopwood, ASIC and Others, 3.

demonstrating service delivery over a 7 year period'.¹³⁰ ASIC rejected the approach. ASIC said that it was not a 'customer centric approach'.¹³¹

During 2017, NAB made new remediation proposals. In July 2017, Mr Hagger wrote to ASIC outlining an approach that included 'assurance' for one segment of members, for which there was a level of 'interaction data of the nature to be expected consistent with the customer access to services'. For another segment, for which there was 'no digital interaction in the duration of the customer relationship over the period in question', Mr Hagger said that other forms of evidence would be sought 'which may include paper files (where appropriate), adviser attestation and contacting clients'. The letter set out a list of 'information points' that were said to demonstrate that advisers and licensees had met their contractual obligations, including statements of advice and other advice documents, product transaction data, client meeting records, fee disclosure statements and emails and file notes.¹³²

In October 2017, ASIC provided NAB with a paper titled *Outline of Suspected Offending by the NAB Group*. The *Outline* set out ASIC's views about fees for no service conduct of NAB and NAB's related entities, as well as other issues.¹³³ ASIC said it did not accept NAB's proposed methodology of testing whether a 'customer–adviser interaction' had taken place instead of whether the stipulated services had been delivered to customers.¹³⁴ ASIC said that NAB's approach might fail to identify and compensate customers who did not receive the ongoing services they paid for. ASIC said that it expected that NAB would

take all necessary steps to ensure that:

¹³⁰ Exhibit 5.60, 18 January 2017, Emails Concerning Assurance Review of Adviser Service Fees, January 2017 between Hopwood, ASIC and Others, 3.

¹³¹ Exhibit 5.60, 18 January 2017, Emails Concerning Assurance Review of Adviser Service Fees, January 2017 between Hopwood, ASIC and others, 2–3.

¹³² Exhibit 5.162, 5 July 2017, Letter, Hagger to Macaulay.

¹³³ Exhibit 5.68, 27 October 2017, Outline of Suspected Offending by NAB.

¹³⁴ Exhibit 5.68, 27 October 2017, Outline of Suspected Offending by NAB, 13.

- affected customers are identified and continue to be remediated; and
- services are provided to clients in accordance with contractual obligations, financial services laws and applicable Australian financial services licence conditions.

On 3 November 2017, Ms Macaulay of ASIC wrote to Sharon Cook, General Counsel of NAB.¹³⁵ She noted that Ms Cook had recently taken over responsibility for the fees for no service issues, and attached a timeline of past events. The timeline set out the negotiations that had taken place and NAB's most recent proposal, referred to above. The letter reiterated that NAB's proposal to take account of evidence of, for example, an email with a newsletter to a customer, was not evidence of an annual review and therefore not evidence that NAB had provided the services set out in customer service agreements.¹³⁶ Ms Macaulay's letter also said that NAB's approach to remediation was 'out of step with some of its major peers that have reported fees for no service failures and are close to finalising their customer review and remediation programs for these failures'.

At a NULIS Board meeting held on 7 and 8 December 2017, a paper was presented to the board entitled *Risk Review of ASF Controls*.¹³⁷ The paper contained an assessment of controls in place in relation to ASFs. Appendix 1 to the paper said that, in relation to the control environment for ASFs:

- The controls for ensuring that all fees were paid to advisers were 'ineffective overall'. One reason for this was that no reconciliation was performed by the Finance division to ensure that all ASFs were paid onto advisers and not retained by NULIS.
- The controls for monitoring the charging of fees against the delivery of services were 'non-existent'. For example, no attestations were obtained from advisers to confirm that a service had been provided for the fee paid and there was too much reliance on member communications.

¹³⁵ Exhibit 5.69, 3 November 2017, Letter from ASIC to Cook.

¹³⁶ Exhibit 5.69, 3 November 2017, Letter from ASIC to Cook, 5.

¹³⁷ Transcript, Nicole Smith, 9 March 2018, 4479–81; Exhibit 5.71, 12 August 2017, Extract from Board Papers, MLC Nominees, PFS Nominees, NULIS.

- The controls for ensuring that customers provided consent to ASFs were ‘ineffective’.
- The controls for monitoring that fees are reasonably commensurate with the expected service were ‘ineffective’.
- The obligation and control documentation controls were ‘ineffective’.
- The adviser on-boarding enhancement controls were ‘ineffective’.
- The controls for member communication and disclosure pre/post an ASF being initiated were ‘ineffective’.

The paper said, in respect of next steps, that actions to remediate and uplift the control environment would be worked through with executive management.

Ms Smith told the Commission that this review was requested by the board as a result of the succession of events in respect of ASFs. She said that, at the time of giving her evidence, the trustee had not looked back as a result of these findings, but that she expected that any failings would be revealed during the control improvement process.¹³⁸

On 13 April 2018, Ms Cook wrote to ASIC proposing another approach to remediation in relation to the ASFs. She said to ASIC that, for customers who commenced their ongoing service arrangements with NAB Financial Planning prior to the commencement of the **Future of Financial Advice** (FoFA) reforms, NAB would offer ASIC the opportunity to request a review of service delivery under their ongoing service arrangements during the relevant period. That is, she proposed an ‘opt-in’ method of remediation. She said that:¹³⁹

Our approach may not be consistent with steps being taken by some of our industry peers, however, we consider a different approach is warranted given NAB led the industry away from commission based adviser remuneration structures ...

¹³⁸ Transcript, Nicole Smith, 9 August 2018, 4484–5.

¹³⁹ Exhibit 5.76, 13 April 2018, Letter from NAB to ASIC.

Hindsight suggests that NAB might be better served if we elected, like many of our peers did, to take the easier and more commercially attractive option of placing continued reliance on commission arrangements until the long tail of the generous FoFA grandfathering regime eventually runs out. Instead, NAB backed the views of ASIC, along with our own convictions, as we believed it to be the right thing to do to move the industry away from commissions and give customers visibility over the fees they pay. This was in the best interests of our customers.

Asking that NAB now conduct a historical (pre-FoFA) review of how we transitioned customers, advisers and product issuers to fee for service arrangements (in circumstance[s] where there was no corresponding regulatory requirement to do so) challenges whether NAB ought to have taken a leadership position in this regard. But for the changes, the Pre-FoFA Customers would have continued to be in commission paying arrangements.

The appeal, in this letter, to what NAB might have done is important and revealing. It focused upon how NAB might have charged and retained the revenue that it now faced having to repay to clients. The reference to what NAB might have done, and the letter generally, ignored the more basic facts that NAB entities had promised to provide services, had not provided the services but had charged for what had not been provided. Even up to April 2018, NAB continued to deal with ASIC on a basis that sought to put these basic facts aside.

On 9 May 2018, Mr Mullaly and Ms Bird wrote to Ms Cook and Ms Smith noting that NAB had failed to deal with all of ASIC's concerns raised in the Outline of Suspected Offending ASIC had given NAB in October 2017.¹⁴⁰ The letter said that the 'proposed resolution set out in your letter fails to adequately reflect any insight into the seriousness of the suspected misconduct, which took place over an extended period of time and affects a substantial number of customers.'

¹⁴⁰ Exhibit 5.77, 9 May 2018, Letter from ASIC to Cook and Smith.

On 7 June 2018, representatives of NAB, including Ms Smith and Ms Cook, met with representatives of ASIC. NAB provided to ASIC a draft EU in relation to the ASFs.¹⁴¹

On 26 June 2018, NAB wrote to ASIC. It said that it would be remediating clients and members who had paid ASFs where there was no evidence to substantiate the provision of service.¹⁴² This proposal was made more than four years after NAB had first reported an ASFs event to ASIC. Ms Smith told the Commission that she expected that the advice licensee, in its review of whether or not a service has been provided, 'will ensure that any superannuation members who have paid an advice fee and not received a service will be identified during that review process and will be remediated by the advice licensee'.¹⁴³

Mr Hagger told the Commission that NAB had agreed to use a methodology in relation to NAB Financial Planning's remediation that was closer to what ASIC had proposed.¹⁴⁴ When he gave evidence, he said that NAB had not yet agreed to this methodology for its other advice licensees.¹⁴⁵

Breach reporting

As appears from the description given above of events relating to charging fees for no service, NAB did not always notify ASIC of a significant breach, or likely significant breach, within the time required by section 912D of the Corporations Act.

After the Commission's hearings into superannuation had ended, ASIC published its *Report 594*, entitled *Review of Selected Financial Services Groups' Compliance with the Breach Reporting Obligation*. The report examined the breach reporting processes of 12 financial services groups, including NAB. The key findings of the report included that:¹⁴⁶

¹⁴¹ Exhibit 5.81, 28 June 2018, Letter from ASIC to Cook and Smith.

¹⁴² Exhibit 5.80, 26 June 2018, Letter from NAB to ASIC.

¹⁴³ Transcript, Nicole Smith, 9 August 2018, 4485.

¹⁴⁴ Transcript, Andrew Hagger, 13 August 2018, 4801.

¹⁴⁵ Transcript, Andrew Hagger, 13 August 2018, 4801.

¹⁴⁶ ASIC, Media Release 18-284MR, 25 September 2018.

- Financial institutions are taking too long to identify significant breaches, with the major banks taking an average of 1,726 days (more than 4.5 years).
- There were delays in remediation for consumer loss. It took an average of 226 days from the end of a financial institution's investigation into the breach and first payments to impacted consumers. (This was on top of already significant delays in institutions starting and concluding their investigations after the breach had been discovered, which averaged across all institutions as 1,517 days.)
- The significant breaches (within the scope of the review) caused financial losses to consumers of approximately \$500 million, with millions of dollars of remediation yet to be provided.
- The process from starting an investigation to lodging a breach report with ASIC also took too long, with major banks taking an average of 150 days.

To the extent that these findings related to NAB or its associated entities, ASIC's finding were consistent with evidence given and other material available to the Commission.

On 26 April 2018, Mr Shipton, Chair of ASIC, discussed NAB's breach reporting with Mr Thorburn, CEO of NAB. The briefing prepared for Mr Thorburn in advance of the meeting said that ASIC was conducting a project on breach reporting and that 'ASIC will likely seek further engagement with NAB about the extent of the issue noting that NAB appears to be an outlier to industry'.¹⁴⁷

On 27 April 2018, after the meeting between Mr Thorburn and Mr Shipton, ASIC wrote to NAB saying that, during the period between 2014 and 2017, there appeared to be 110 breach reports from licensees within the NAB

¹⁴⁷ Exhibit 5.78, 8 May 2018, Briefing Planner for Meeting of 26/05/2018 between Thorburn and Shipton.

group that were lodged with ASIC in excess of the maximum allowable 10 business days.¹⁴⁸

On 15 May 2018, NAB responded and said that between 2014 and 2017 there had been 84 reports of significant breaches provided beyond the statutory requirement of within 10 business days.¹⁴⁹ Eighty-three of these were said to relate to NAB Wealth.¹⁵⁰

Ms Smith told the Commission that a breach review committee for wealth entities within NAB considered breach events and whether they were reportable.¹⁵¹ She said that, from the trustee's perspective, 'we had probably poor performance on-time delivery to ASIC up until around 2015 where we had an independent review from PwC on the breach review committee process. And I think from that date we've shown improvement in our timing'.¹⁵²

1.2.2 Grandfathering of commissions

As I have previously noted, until July 2016, NULIS was one of three RSE licensees within the NAB Group; the other two were PFS and MLC Nominees.

On 1 July 2016, the members of the TUSS fund previously under the trusteeship of MLC Nominees were transferred to the MLC Super Fund by way of an SFT.¹⁵³ NULIS, the new trustee, considered maintaining, and decided to maintain, payments of grandfathered commissions that were being paid by members of the TUSS fund to advisers. Both Mr Carter and Ms Smith agreed that the proposal presented two main issues. First, was it lawful under the FoFA legislation to grandfather commissions after an SFT?

¹⁴⁸ Exhibit 5.44, Witness statement of Nicole Smith, 3 August 2018, Exhibit NSS-2 (Tab 6) [NAB.005.827.0002].

¹⁴⁹ Exhibit 5.44, Witness statement of Nicole Smith, 3 August 2018, Exhibit NSS-2 (Tab 8) [NAB.005.827.0006].

¹⁵⁰ Exhibit 5.44, Witness statement of Nicole Smith, 3 August 2018, Exhibit NSS-2 (Tab 8) [NAB.005.827.0006].

¹⁵¹ Transcript, Nicole Smith, 7 August 2018, 4311.

¹⁵² Transcript, Nicole Smith, 7 August 2018, 4311.

¹⁵³ Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 6 [21].

Second, was it in the best interests of members to do so?¹⁵⁴

The legal issue was thought to be resolved by treating the trustee that paid the commission as a ‘platform operator’. For present purposes I need say no more than that this view of how the relevant provisions of the Act operate may be thought not to leap from the page of the statute.¹⁵⁵ But the point need not be examined. It is enough to record that NAB discussed the proposal with ASIC and ASIC did not object.¹⁵⁶

The issue about best interests was resolved by reference to two points: first, that if commissions were not maintained, advisers would become disaffected and the fund would receive fewer new members and contributions; and second, that the proposal left members no worse off in the sense that they would continue to pay the amounts they would have been paying before the transaction.

On 10 June 2016, the board of NULIS considered a management paper on the issue. The paper gave three options for consideration:¹⁵⁷

- *Option 1:* Continue the grandfathering arrangements and pay commission to advice licensees.
- *Option 2:* Cease the payment of grandfathered commission by terminating the remuneration arrangements with advice licensees; and
- *Option 3:* Stop commission payments and set up alternative remuneration arrangements for advisers.

¹⁵⁴ Transcript, Paul Carter, 6 August 2018, 4210; Transcript, Nicole Smith, 7 August 2018, 4386–7.

¹⁵⁵ Exhibit 5.7, 10 June 2016, Board Papers MLC Nominees, NULIS and PFS Nominees, 21.

¹⁵⁶ Exhibit 5.7, 10 June 2016, Board Papers MLC Nominees, NULIS and PFS Nominees, 22.

¹⁵⁷ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 20.

The paper said that management had examined several issues in connection with each proposal: whether the proposal was legally permissible; whether the proposal maintained equivalency of members' rights and was in members' best interests; other member consequences; and implications for the SFT and the associated future member benefits.

Ms Smith accepted that the members' best interests was a question for the trustee to decide.¹⁵⁸ She said that the trustee 'turned their mind to best interests of the SFT as a whole and determined that the SFT, including the grandfathering of commission, was in the best interests of members'.

The management paper set out the background to the then current payment arrangements.¹⁵⁹ It pointed out that there were about 188,000 members 'in commission paying retail super/pension products in TUSS', and that these members made up about 63% of members holding about 47.7% of funds under management in TUSS.¹⁶⁰ It said that approximately '\$56 million in commission per annum is paid in respect of TUSS products'.¹⁶¹

When discussing termination of remuneration arrangements with advice licensees, the paper said that separate advice would have to be obtained about whether termination would expose MLC Nominees, NULIS or any other entity in the NAB Group to liability for breach of contract.¹⁶² No estimate was given of the compensation that might be payable to advisers if liability arose. The only reference to quantum was to the total commission

¹⁵⁸ Transcript, Nicole Smith, 8 August 2018, 4387.

¹⁵⁹ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 20.

¹⁶⁰ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 20.

¹⁶¹ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 20.

¹⁶² Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 23.

paid per annum in respect of TUSS Products, which was said to be \$58 million.¹⁶³

Ms Smith agreed, however, that NULIS did not have any legal obligation to pay commissions at the time¹⁶⁴ and Mr Carter also agreed that NULIS would not have been in breach of contract, as it did not have any contracts with advisers prior to the SFT.¹⁶⁵

The paper said that ceasing commissions may lead to significant member attrition due to ‘financial adviser dissatisfaction’. It said that this, in turn, may lead to a significant reduction in funds under management, leading to higher costs for remaining members and reduced competitiveness of each product, thereby threatening the sustainability of the fund as a whole.¹⁶⁶

The paper said: ‘In a post FoFA world, where monetary incentives are removed, financial adviser satisfaction is paramount’.¹⁶⁷ Mr Carter agreed that if NULIS maintained commissions for financial advisers, then advisers would not look to move their clients to another superannuation provider.¹⁶⁸

The paper recommended that the directors approve maintaining current grandfathered commission arrangements. The paper said that management believed that the cost and effort required to adopt the third approach (of stopping commission payments and setting up alternative remuneration arrangements for advisers) was not in members’ best interests.¹⁶⁹

The management paper told the board that the SFT may be delayed by as much as 12 months if option three was adopted. It said this would ‘impact

¹⁶³ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 20.

¹⁶⁴ Transcript, Nicole Smith, 8 August 2018, 4391.

¹⁶⁵ Transcript, Paul Carter, 6 August 2018, 4217, 4219.

¹⁶⁶ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 6.

¹⁶⁷ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 5.

¹⁶⁸ Transcript, Paul Carter, 6 August 2018, 4220.

¹⁶⁹ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 6–7.

future initiatives as the work effort will divert time, resources and funding away from other strategic initiatives'.¹⁷⁰ But Mr Carter's evidence was that all of the benefits of the SFT could be achieved without grandfathering commissions.¹⁷¹

As already mentioned, NAB had consulted with ASIC about the intention to grandfather commissions.¹⁷² The management paper said that the purpose of this consultation was to seek ASIC's views on the legal application of the grandfathering provisions given the level of 'interpretation risk' due to the fragmentary and untested nature of the FoFA regulations.¹⁷³ A briefing paper dated 20 May 2016 was provided to ASIC and was annexed to the management paper.¹⁷⁴ It set out the bases upon which NAB said that NULIS was a platform operator and told ASIC of its intention to continue grandfathering commission payments.¹⁷⁵ The evidence was that, after providing ASIC with the briefing paper, representatives of NULIS met with ASIC and indicated that it was not seeking a 'no action' letter, but would proceed on the basis of the legal advice it had received.¹⁷⁶

1.2.3 MySuper

The Commission considered the steps taken by NULIS to transfer **accrued default amounts** (ADAs) to MySuper products and some issues about what appeared to be the poor performance of its MySuper products.

¹⁷⁰ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 6–7.

¹⁷¹ Transcript, Paul Carter, 6 August 2018, 4216.

¹⁷² Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 4.

¹⁷³ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 3.

¹⁷⁴ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, Appendix 4.

¹⁷⁵ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 49.

¹⁷⁶ Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 5–6; Transcript, Peter Kell, 17 August 2018, 5256.

NAB RSE licensees initially offered two MySuper products: an MLC MySuper product of which MLC Nominees was trustee and a Plum MySuper product of which PFS Nominees was trustee.¹⁷⁷

The NAB RSE licensees did not transfer the majority of ADAs into a MySuper product until 2016.¹⁷⁸ They transferred other ADAs to a MySuper product in 2017.¹⁷⁹ The speed of transfer can be indicated by observing that, at 30 June 2014, the total ADAs across the whole superannuation industry were worth about \$73.1 billion, of which MLC held \$17 billion.¹⁸⁰ By 30 June 2015, the industry-wide value of ADAs had fallen to \$59.2 billion but MLC's had fallen only slightly: to \$16.1 billion.¹⁸¹ At 30 June 2016, the equivalent figures were \$41.3 billion and \$13.9 billion.¹⁸² That is, at the start of the industry-wide process of transferring ADAs to MySuper, MLC had less than one quarter of all ADAs but two years later, at 30 June 2016, it held more than one third of all ADAs.¹⁸³

Ms Smith accepted that one consequence of not moving ADAs into MySuper until 2016 or 2017 was that members paid higher fees, including the PSFs, for longer than they would have paid if the transfers had been made sooner.¹⁸⁴ She also accepted that members with ADAs would have been paying a higher administration fee in MKBS/MKPS than in the MySuper product¹⁸⁵ and may have been paying adviser contribution fees.¹⁸⁶

Each year, the trustee of a MySuper product must determine whether the beneficiaries of the fund who hold the MySuper product are disadvantaged

¹⁷⁷ Transcript, Nicole Smith, 8 August 2018, 4398.

¹⁷⁸ Transcript, Nicole Smith, 8 August 2018, 4400.

¹⁷⁹ Transcript, Nicole Smith, 8 August 2018, 4405.

¹⁸⁰ Transcript, Nicole Smith, 8 August 2018, 4404.

¹⁸¹ Transcript, Nicole Smith, 8 August 2018, 4404.

¹⁸² Transcript, Nicole Smith, 8 August 2018, 4404.

¹⁸³ Transcript, Nicole Smith, 8 August 2018, 4404.

¹⁸⁴ Transcript, Nicole Smith, 8 August 2018, 4400.

¹⁸⁵ Transcript, Nicole Smith, 8 August 2018, 4401.

¹⁸⁶ Transcript, Nicole Smith, 8 August 2018, 4401.

by factors such as the fund's scale, when compared to MySuper beneficiaries of other funds.¹⁸⁷

NULIS has made the necessary scale determinations each year. The papers put to NULIS's board in October 2016 for the purposes of the 2016 scale determination recorded that various 'MySuper investment structure enhancements had been implemented over the last 12 months'.¹⁸⁸ Among other things, the trustee (NULIS from 1 July 2016) reduced its profit margin on the operations of the product by five basis points.¹⁸⁹

The papers put to the board noted that 'when standard fees are compared against the ChantWest universe of MySuper products', the MLC Super Fund MySuper product and the NAB Staff MySuper product ranked 66th and 44th respectively.¹⁹⁰ The analysis also said that the MLC MySuper product was in the bottom quartile of MySuper products for performance, after investment fees were taken into account.¹⁹¹

Why this was so was explored in evidence.

A quarterly investment report dated June 2017 conducted by JANA Investment Advisers Pty Ltd and considered by the board of NULIS,¹⁹² said that the initial fee budget for the NAB MySuper products placed a significant limitation on the level of illiquid assets in the portfolio and that creating a new option with 'zero dollars' on 'day one' meant that the relevant MySuper option was going to have a lower allocation to illiquid assets relative to peers. The report said that the underweighting of illiquid assets in the MySuper option occurred when illiquid assets were having their strongest historical gains due to a low interest rate environment.¹⁹³

¹⁸⁷ SIS Act s 29VN(b).

¹⁸⁸ Transcript, Nicole Smith, 8 August 2018, 4406.

¹⁸⁹ Transcript, Nicole Smith, 8 August 2018, 4406.

¹⁹⁰ Transcript, Nicole Smith, 8 August 2018, 4407.

¹⁹¹ Transcript, Nicole Smith, 8 August 2018, 4409.

¹⁹² Exhibit 5.58, 22 August 2017, Minute of NULIS Nominees, 22 August '17 and JANA, June '17 Quarterly Investment Report.

¹⁹³ Transcript, Nicole Smith, 8 August 2018, 4417.

Performance was also affected by fees. NULIS retains the portion of the investment fee charged to members that is not paid to others for managing the assets of the fund. The amounts retained by NULIS are paid as dividends to NULIS's shareholder, NWMSL (the administrator).¹⁹⁴ Ms Smith said she believed that the dividend NULIS paid was usually more than \$100 million per year.¹⁹⁵ (She said that dividends were payable quarterly but that 'as a result of the PSF matter' there had been two quarters where NULIS had not paid a dividend.)¹⁹⁶

Ms Smith said that NULIS had made the decision referred to in the papers for the 2016 Scale Assessment (to take a lower profit margin from the superannuation activities) so that more money could be applied to investments¹⁹⁷ to deal with the underperformance of the MySuper option.¹⁹⁸ She said that the budget for investment options and the profit to the NAB Group comes from the investment management fee and that, if a larger amount of the investment fee collected were allocated to investment options, the NAB Group would take less profit, or the fee would have to increase, so that profits of the NAB Group did not decrease.¹⁹⁹ Ms Smith said that before the SFT in 2016, MLC Limited (not MLC Nominees) had controlled how much of the investment fee would be used for the management of assets,²⁰⁰ but that since the SFT, NULIS has had control over how much of the investment fee would be used for the management of assets. She said that NULIS had not yet allocated more of that fee to the management of MySuper assets.²⁰¹

¹⁹⁴ Transcript, Nicole Smith, 8 August 2018, 4422.

¹⁹⁵ Transcript, Nicole Smith, 8 August 2018, 4423.

¹⁹⁶ Transcript, Nicole Smith, 8 August 2018, 4422–3.

¹⁹⁷ Transcript, Nicole Smith, 8 August 2018, 4406.

¹⁹⁸ Transcript, Nicole Smith, 8 August 2018, 4407.

¹⁹⁹ Transcript, Nicole Smith, 8 August 2018, 4420.

²⁰⁰ Transcript, Nicole Smith, 8 August 2018, 4422.

²⁰¹ Transcript, Nicole Smith, 8 August 2018, 4422.

1.3 What the case study showed

1.3.1 Conduct in respect of PSFs

As noted above, I make no findings about the matters alleged by ASIC in its proceedings against NAB in relation to PSFs. I do, however, wish to say something about the actions of those within NAB Wealth after the identification of issues about PSFs and about NAB's dealings with ASIC at the time of ASIC's publication of its *Report 499: Financial Advice: Fees for No Service*.

In the written submissions of NAB and NULIS, and in the evidence, it was said that NAB Wealth had undertaken 'an investigation to identify the nature and character of the PSF'.²⁰² I do not consider this a sufficient or accurate description of what was done. The description is incomplete, and to that extent inaccurate, because it ignores the purpose for which the inquiries were being made. The overall purpose was to minimise the amount that NAB would have to repay. That purpose was effected in two ways: first, by trying to find some legal basis for retaining what had been paid; second, by devising a remediation approach that would minimise the amount to be repaid.

The former is evident from the documents that discussed whether any of the services provided by the administrator could form a basis for charging PSFs.²⁰³ The latter is clear from the documents that proposed an opt-in approach to any remediation for unadvised members.²⁰⁴

The steps taken by NAB showed either that NAB did not grasp that it had charged fees for services it had not provided, or that NAB was unwilling to face the consequences of having agreed to provide services to clients,

²⁰² NAB and NULIS, Module 5 Case Study Submission, 11 [61(a)]; Transcript, Paul Carter, 6 August 2018, 4271–2.

²⁰³ Exhibit 5.14, 3 May 2016, Invitation of 3 May 2016 from Buchanan and Its Attachment Investigation into Project Swift; Exhibit 5.21, 24 August 2016, Emails to and from Carter and Others, PSF Management Paper to Trustee; Exhibit 5.22, 19 September 2016, Email, Stimson to Carter, Plan for PSF Meeting with Hagger.

²⁰⁴ Exhibit 5.26, 16 October 2016, Email Carter, Hagger and Others, October '16 Concerning PSF Letter.

having not provided the services, and yet having charged clients for what it had not done.

As I said in the *Interim Report*, charging for what you do not do is dishonest.²⁰⁵ That NAB either did not grasp this basic proposition or was unwilling to face the consequences of having done so is troubling. That its General Counsel should be complaining to ASIC, as recently as April 2018, that having to pay back what had been taken was unfair to NAB, is, if anything, even more troubling. It suggests an abiding blindness to the seriousness of the underlying conduct.²⁰⁶

Like any listed company, NAB owes obligations to its shareholders. NAB, like any listed company, is not just entitled, but is bound, to consider carefully whether it should pay compensation to others. And it is entitled, and bound, to take proper steps to pay only such compensation as can be shown to be justified. But NAB's conduct in connection with fees for no service went beyond taking proper steps to ensure that it paid no more than was proper compensation for its wrong. It sought to avoid repaying to customers money to which it was not, and never had been, entitled.

Until it agreed to make full compensation, NAB's conduct fell short of community standards and expectations. Moreover, the conduct that has been described reflected a culture, demonstrated by senior executives within the NAB Group, of unwillingness to put right, wholly and promptly, what was evidently wrong conduct. And the conduct had been allowed to continue for many years.

It is now necessary to say something about NAB's dealings with ASIC in connection with ASIC's publication of its Fees for No Service report.

Both NAB and Mr Hagger described NAB's communications with ASIC as 'open and transparent'. NAB and NULIS submitted that Mr Hagger's communications with ASIC demonstrated 'a willingness to engage in proactive and transparent communications with the regulator'.²⁰⁷

²⁰⁵ FSRC, *Interim Report*, September 2018, vol 1, 73.

²⁰⁶ Exhibit 5.76, 13 April 2018, Letter from NAB to ASIC.

²⁰⁷ NAB and NULIS, Module 5 Case Study Submission, 17 [91].

NAB and NULIS submitted that there was no reason to doubt Mr Hagger's account of his conversation with Mr Tanzer and that no ASIC witness offered or was asked to provide any criticisms about the conduct of Mr Hagger or NAB more generally.²⁰⁸

I accept that Mr Hagger believed what he said to the Commission in evidence. But, given what was known at the time, I do not accept that what he said to Mr Tanzer is properly described as 'open and transparent'. I do not accept that Mr Hagger told Mr Tanzer that NAB had revised estimates of the amount it would have to pay as compensation. The evidence demonstrates, in my view, that Mr Hagger did not tell Mr Tanzer that the board of NWMSL had decided, by the time of the conversation, to recommend to NULIS that it make full remediation and that NWMSL would indemnify NULIS for the whole cost of that remediation. Instead, he left Mr Tanzer with the impression that these issues had not yet been decided by either the board of NWMSL or the board of NULIS. And that was not right. Why not tell ASIC what had transpired that morning in the board meeting from which Mr Hagger had emerged to make the call?

If, as Mr Hagger may be understood as having suggested, he said enough to allow Mr Tanzer to draw his own conclusions about how much would have to be paid out, why not just tell ASIC the truth? His evidence could be understood as saying that he somehow was inviting Mr Tanzer to 'ask the right questions'. If that is the case, how was that 'open and transparent'? Why not tell ASIC of the internal estimates?

The answer to all of these questions can only be that NAB wished ASIC's report to still show the bank's conduct as 'middle of the pack', regardless of NAB's knowledge when it responded to ASIC's inquiries about the draft report and when Mr Hagger spoke with Mr Tanzer. And NAB wanted to remain 'middle of the pack' lest news of what it had discovered overshadow its CEO's announcement of full year results.

NAB told ASIC of its revised estimates on 3 November 2016, a week or so after Mr Hagger had spoken to Mr Tanzer. ASIC's reaction to these later disclosures tells of the quality of the communications that had taken place

²⁰⁸ NAB and NULIS, Module 5 Case Study Submission, 16 [89].

before ASIC published its report. ASIC was not satisfied with NAB's dealings with it, and rightly so.

NAB's conduct fell short of what the community would expect of NAB, or any other large financial entity, in dealings with ASIC of the kind under consideration.

1.3.2 Misconduct in respect of fees for no service

In NAB's initial submissions to the Commission in January 2018, it acknowledged misconduct concerning ongoing ASFs charged without the provision of services to primarily retail customers between 2008 and 2015.²⁰⁹ In their written submissions to the Commission dated 31 August 2018, NAB and NULIS submitted that they fully accepted the seriousness of the matters that were the subject of the breach reports tendered concerning ASFs, and that these events involved previously acknowledged and reported instances of misconduct, and conduct falling below community standards and expectations.

The notifications lodged with regulators contained acknowledgments of a breach or likely breach of section 912A(1) of the Corporations Act and section 52(2)(b) of the SIS Act by the relevant RSE licensee. In its written submissions, NULIS accepted that, on the evidence, it was open to the Commission to find that there had been a breach or likely breach of section 912A(1)(a) of the Corporations Act with respect to each notified event.

I agree.

More must be said, however, about fees for no service and the trustee's covenants set out in section 52(2)(b) and 52(2)(c) of the SIS Act. The first of those covenants requires the trustee 'to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation trustee would exercise in relation to an entity of which it is trustee and on behalf of the beneficiaries of which it makes investments'. The second requires the trustee 'to perform the trustee's duties and exercise the trustee's powers in the best interests of the beneficiaries'.

²⁰⁹ Exhibit 5.4, 29 January 2018, Extract of NAB Submission, 1.

In their written submissions, NAB and NULIS submitted that there was no support in the text of the Act or in prior authority that the care, skill and diligence covenant imposed an ‘absolute standard’ on a superannuation trustee in NULIS’s position to ‘ensure’ that a service is provided in each case where there was an arrangement between an adviser and a member by directly monitoring advisers.²¹⁰ They submitted that the evidence demonstrated that MLC Nominees or NULIS (as applicable) had complied with the covenant because:

- first, controls existed in the form of underlying contractual obligations and at the point of the member and the adviser agreeing to the payment;²¹¹
- second, an administrator was legally liable for breaches of its contractual obligations, which were required to be reported to the trustee under the Administration Agreement;²¹² and
- third, when specific controls with respect to delivery of service were found to be deficient, measures were put in place to remedy those deficiencies. More generally, it was submitted that measures were taken in response to failures in controls, and to uplift the control environment and introduce reforms (such as an independent customer advocate program).²¹³

The general law requires a trustee to discharge its duties to the standard of what an ordinary prudent person of business would do in managing similar affairs of his or her own.²¹⁴ The statutory covenant refers to the ‘care, skill and diligence ... a prudent superannuation trustee would exercise in relation to an entity of which it is trustee’. On its face, the statutory covenant permits,

²¹⁰ NAB and NULIS, Module 5 Case Study Submission, 4 [17].

²¹¹ NAB and NULIS, Module 5 Case Study Submission, 4 [14].

²¹² NAB and NULIS, Module 5 Case Study Submission, 4 [15].

²¹³ NAB and NULIS, Module 5 Case Study Submission, 4 [16].

²¹⁴ *Austin v Austin* (1906) 3 CLR 516, 525; *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 235; *Cowan v Scargill* [1984] 2 All ER 750, 762.

perhaps requires, reference to the fact that NULIS and other RSE licensees are professional trustees.²¹⁵

In the present context, the question may become whether a prudent person of business, who acts as a professional trustee, would allow payments to be made to a service provider without first verifying that the services have been provided? In this regard, it may be noted that Ms Smith said that, in her view, the trustee had owed members a duty of care – to consider whether services had been provided in exchange for the ASFs and PSFs that had been charged.²¹⁶

NULIS did not monitor advisers or the provision of specific advice. When fees were paid for no service, the trustee had no controls that prevented charging fees for no service. The Risk Review of ASF Controls paper given to NULIS's board recorded many respects in which controls were deficient.²¹⁷ The bare fact that the trustee, the administrator, the adviser and the ultimate client were each a party to one or more contracts regulating the charging and payment of fees does not conclude any issue about the trustee taking reasonable care. Whether the trustee exercised reasonable care, skill and diligence asks whether the trustee should have taken steps to determine whether the contracts that had been made were performed in accordance with their terms. And in that regard, it may be that different considerations would arise in cases where the adviser charging the fees in question was an authorised representative of a NAB advice licensee.²¹⁸

What the trustee should have done in the exercise of the required care, skill and diligence should be considered in the light of another and fundamental obligation of trustees. A trustee must not allow the trust fund to be dissipated in an unauthorised way.²¹⁹ A trustee who wrongly pays away trust money,

²¹⁵ *ASIC v Drake (No 2)* [2016] FCA 1552 [272]–[273].

²¹⁶ Transcript, Nicole Smith, 9 August 2018, 4480.

²¹⁷ Transcript, Nicole Smith, 9 March 2018, 4479–81; Exhibit 5.71, 12 August 2017, Extract from Board Papers, MLC Nominees, PFS Nominees, NULIS.

²¹⁸ Transcript, Paul Carter, 6 August 2018, 4221; see also Transcript, Nicole Smith, 9 August 2018, 4469.

²¹⁹ *Youyang Pty Ltd v Minter Ellison Morris Fletcher* (2003) 212 CLR484, 501–2.

like a trustee who makes an unauthorised investment, commits a breach of trust.²²⁰

Absent express provision to the contrary, the authority a member gives to a trustee to pay an advice fee would be construed as authorising payment in return for the provision of service. (From time to time, advice licensees have suggested that their advice agreements permitted deduction of a fee in return *for the offer* to provide advice. But even in that case, the authority would ordinarily be understood as requiring that offer be taken up before the adviser would be entitled to receive the fee.)

Some of the events reported by NAB and NULIS concerned cases where requests had been received to remove the adviser from members' accounts. In cases of that kind, a necessary part of the contractual foundation for deduction of fees has gone and the trustee has been told that it has gone. Paying away trust money in payment of advice fees in those cases appears to me very likely to be a breach of trust. If it is a breach of trust it would be misconduct.

The trustee's covenant in section 52(2)(c) is to perform its duties and exercise its powers in the best interests of beneficiaries. When the purpose of a trust is to provide financial benefits for beneficiaries, as it is with a superannuation fund, the best interests of the beneficiaries are normally their best financial interests.²²¹

NAB and NULIS submitted that the 'best interests' duty, both in the SIS Act and at general law, operates to qualify the performance of a particular specified duty or the exercise of a specified power and that no relevant duty or power had been identified in connection with the payment of fees for no service.²²² As I have explained elsewhere, this may not be a complete statement of the general law, or of the operation of the covenant.²²³

²²⁰ *Youyang*; see also *Target Holdings Ltd v Redferns* [1996] AC 421, 437, per Lord Browne-Wilkinson.

²²¹ *Cowan v Scargill* [1985] Ch 270, 286–7.

²²² NAB and NULIS, Module 5 Case Study Submission, 5 [20].

²²³ *Manglicmot v Commonwealth Bank Officers Superannuation Corp Pty Ltd* [2010] NSWSC 363 [121], per Giles JA.

But when fees were paid for no service, the relevant duty was the trustee's duty to preserve the trust fund (not paying it away without authority) and the relevant power was to make proper payments on behalf of members by deducting the payment from the member's account.

NAB and NULIS did not dispute that the trustee deducted the ASFs from members' accounts and did not contend that the trustee lacked power under the trust deed²²⁴ to deduct ASFs (if the deduction was authorised by the member).

NAB and NULIS pointed out that it has been said that the best interests test is concerned with process, not outcome.²²⁵ Like all aphorisms, the proposition may very well be too compressed, and obscure more than it reveals. But even if it does sufficiently capture a relevant point, the fact remains that the contractual and other controls that NULIS submitted were in place to ensure proper deduction of ASFs were not sufficient to protect the financial interests of members.

One other, statutory, obligation of the trustee should be mentioned. Section 62 of the SIS Act obliges the trustee to ensure that the fund is maintained solely for the purposes identified in that section.

I consider that it is arguable that the trustee's conduct in using trust funds to pay for services to members that had not been provided may have been a breach of one or more of the covenants that have been mentioned and of the statutory obligation. That conclusion rolls up consideration of several distinct obligations. But separate and sequential consideration of the obligations runs a real risk of attributing to each too confined an operation. Each of the covenants, like the statutory sole purpose obligation, takes its operation and content from the context within which it is to operate: a context in which the trustee has several, related obligations designed to ensure that the funds that the trustee holds are applied only for proper purposes. And the central complaint being considered is that the trust funds were not applied for a proper purpose; they were applied to pay amounts

²²⁴ The trust deeds of the two funds appeared at Exhibit 5.84, Witness statement of Peggy O'Neal, 31 July 2018, Exhibit PYO-1 (Tab 2) [NAB.005.546.0001], (Tab 3) [NAB.005.546.0089].

²²⁵ *Manglicmot v Commonwealth Bank Officers Superannuation Corp Pty Ltd* [2010] NSWSC 363; NAB and NULIS, Module 5 Case Study Submission, 5 [22].

that were not properly charged and payable. A conclusion that the trustee *did not* breach its duties when it permitted that to occur would be surprising. A conclusion that the trustee *did* breach one or more of the obligations that have been mentioned would not.

The conduct of the NAB trustees in connection with the payment of fees for no service might have been a breach of obligation and therefore constitute misconduct. These matters having already been reported to ASIC, it must decide what, if any, further action should be taken.

Next, it is necessary to consider the conduct of NULIS and other NAB entities in connection with remediation.

NAB and NULIS submitted that there was no evidence that MLC Nominees or NULIS had inappropriately failed to exercise any discretion independently of NAB with respect to the remediation of ASF events. It will be recalled that when Mr Hagger gave evidence about these matters, NAB had not at that point agreed to full remediation by all of its licensees. Indeed, much of NAB's and NULIS's correspondence with ASIC involved negotiations toward a different outcome.

I consider that, in allowing remediation proposals to be put forward to the regulator that did not provide for full compensation, it is arguable that the board of NULIS prioritised the financial interests of others within the NAB Group over the interests of members. If the board did this, it may have been a breach of the covenant prescribed by section 52(2)(c). But, if it was a breach, later events overtook it and nothing came of it.

NAB and NULIS submitted that the progression of discussions over time with ASIC with respect to the remediation approach neither established any intention or effect of minimising the quantum of remediation, nor was it 'ethically unsound'.²²⁶ To repeat a point already made, the submission is consistent with NAB either not grasping that to charge a fee for a service not provided was dishonest, or being still unable or unwilling to accept the consequences that follow from its conduct.

²²⁶ NAB and NULIS, Module 5 Case Study Submission, 14–15.

One consequence of NAB's protracted negotiations with ASIC was that customers have not been compensated promptly. NAB and NULIS accepted that the ASFs events took too long to discover, investigate and remediate.²²⁷ I agree. But NAB's conduct prolonged the process. The public would rightly have expected NAB not to do that.

1.3.3 Misconduct in relation to reporting of breaches

As noted above, in its communications with ASIC, NAB agreed that 84 significant breach notifications were provided by NAB entities later than the 10 business days required by statute.²²⁸ I have no reason to doubt that this represents at least the minimum number of such cases. Although the number of cases acknowledged by NAB is 26 less than ASIC's calculation of 110 breach reports, the figures are troubling. Each departure from the legislative requirement is a breach of section 912D(1B) of the Corporations Act. The breaches acknowledged in the breach reports were breaches, or likely breaches of sections 912A(1)(a), 912A(1)(c), 912A(1)(ca) and 912A(1)(h).

Each failure to report within the stipulated timeframe is conduct amounting to misconduct. Each breach or likely breach that is the subject of each report might itself amount to misconduct.

As has been mentioned already, ASIC's report into selected financial services groups' compliance with the breach reporting obligation found that industry is taking far too long to identify and investigate potential breaches. At the time the report was released, Mr Shipton observed two related problems:²²⁹

The first is that industry is taking far too long to identify and investigate potential breaches. Whilst this is not of itself a breach of the reporting requirement, this is the greatest source of delay and thus of most significant detriment to consumers.

²²⁷ NAB and NULIS, Module 5 Case Study Submission, 14 [76].

²²⁸ Exhibit 5.44, Witness statement of Nicole Smith, 3 August 2018, Exhibit NSS-2 (Tab 8) [NAB.005.827.0006].

²²⁹ ASIC, Media Release 18-284MR, 25 September 2018.

The second problem is that even having identified an issue and concluded, following an investigation, that it is a breach, institutions are failing to then report it to ASIC within the required 10 business days. The delays here are much shorter (75% were late by 1–5 days) but still represent a breach of the legal requirements.

NAB's conduct in respect of breach reporting accords with those observations.

Failing to comply with the statutory breach reporting requirements showed NAB to be unwilling, in that respect at least, to obey the law. That is a troubling observation. That the failures to obey the law were so many and occurred over so many years is more troubling because it bespeaks a culture that treated not only the immediate breach (constituted by failure to report), but also the breaches or likely breaches that gave rise to the obligation to report as either matters of no real importance or as matters that need not be brought to the regulator's attention.

When these observations are joined, as they must be, to the other criticisms I have made about NAB's response to fees for no service, they speak poorly of NAB's regard for compliance with the law, they speak poorly of NAB's willingness to face the consequences of breach of the law, and they speak poorly of NAB's willingness to do all things necessary to *ensure* that the financial services it provides are provided efficiently, honestly and fairly.²³⁰

1.3.4 Misconduct in relation to grandfathered commissions

In their written submissions, NAB and NULIS submitted that the board resolution approving the maintenance of grandfathered commissions cannot be divorced from its context.²³¹ They submitted that the SFT involved a package of changes that NULIS considered, overall, to be in the best interests of members.²³² They noted that the equivalence of rights was maintained and members were no worse off.

²³⁰ Corporations Act s 912A(1)(a).

²³¹ NAB and NULIS, Module 5 Case Study Submission, 18 [101].

²³² NAB and NULIS, Module 5 Case Study Submission, 18 [101].

I should say at once, in response to the last point about equivalence of rights, that the best interests duty, whatever its content, cannot properly be understood as no more than an obligation ‘to do no harm’.

A trustee has a duty to identify relevant considerations before making a decision and to use all proper care and diligence in obtaining the relevant information and advice relating to those considerations.²³³ It has been said that if the consideration of the trustee is not properly informed, it is not genuine.²³⁴ The duty to take these steps flows both from the best interests obligation and also from the duty of care, skill and diligence.

There are at least two things that are troubling about the management paper upon which the decision was taken to maintain grandfathered commissions. First, the paper focused closely upon the possibility of increased costs due to member attrition because of financial adviser dissatisfaction. No estimates of that loss were attempted. And no particular attention was given to the amounts members would continue to pay if commissions were maintained. Second, the paper identified the need for separate legal advice about claims by advisers if commissions were not to be maintained. Yet management did not obtain this advice before making its recommendation. By contrast, management obtained legal advice about the legality of maintaining commissions.

The relevance and importance of these issues to the decision-making process would seem obvious. It may be that the absence of legal advice about claims by advisers points towards the trustee not having performed its duties properly.

As the High Court has observed, ‘superannuation is not a matter of mere bounty, or potential enjoyment of another’s benefaction ... It is “deferred pay”. The legitimate expectations which beneficiaries of superannuation funds have that decisions about benefit will be soundly taken are thus high.

²³³ *Abacus Trust co (Isle of Man) v Barr* [2003] 1 All ER 705, [23]; *Scott v National Trust for Places of Historic Interest or Natural Beauty* [1998] 2 All ER 705, 717.

²³⁴ *Finch v Telstra Super Pty Ltd* (2010) 242 CLR 254, [66] citing *Kerr v British Leyland (Staff) Trustees Ltd* [2001] WTLR 1071, 1079; *Stannard v Fisons Pension Trust Ltd* [1992] IRLR 27, 31.

So is the general public importance of them being sound'.²³⁵ I consider this reasoning to be no less forceful when it comes to other decisions that will affect member benefits. The trustee may have breached its duty to act in the best interests of the affected members. The matter not having been drawn to the attention of the regulators so far, I will refer the matter to APRA to consider whether to take action.

1.3.5 Misconduct in relation to MySuper and transition of accrued default amounts

In respect of the transition of ADAs to MySuper, it is to be remembered that the statute required trustees to attribute default contributions to their MySuper products and to do this *by* 1 July 2017.

In its written submissions, NULIS submitted that the evidence as a whole did not establish that either MLC Nominees or NULIS delayed the MySuper transition.²³⁶ NULIS submitted that the transition of all ADAs was completed by 31 March 2017, in advance of the 1 July 2017 deadline, and that the majority of ADAs were transferred to 'transition investment options' in June and July 2017.²³⁷ NULIS referred to a number of impediments to an earlier transition, including the complexity of and risk associated with the exercise.²³⁸

To observe that ADA balances had to be transferred *by* 1 July 2017 puts unwarranted emphasis on the date fixed as the *outer* limit for compliance and does not take account of trustees' other obligations in the Act, in particular the covenant prescribed by section 52(2)(c). The considerations identified in NULIS's submissions were to be considered in light of the fact that commissions, PSFs and other payments to advisers would continue to be paid by members whilst the transition of their ADAs was delayed. Ms Smith acknowledged that one of the consequences of the delay was that members paid higher fees for longer than they would have had their

²³⁵ *Finch v Telstra Super Pty Ltd* (2010) 242 CLR 254, [33] (French CJ, Gummow, Heydon, Crennan and Bell JJ).

²³⁶ NAB and NULIS, Module 5 Case Study Submission, 20 [109].

²³⁷ NAB and NULIS, Module 5 Case Study Submission, 21 [112].

²³⁸ NAB and NULIS, Module 5 Case Study Submission, 20 [110]–[112].

ADAs been transferred earlier.²³⁹ For some members, this was not merely a risk, but a certainty. Advisers, including advisers within the NAB Group, stood to benefit from this to the financial detriment of those members.

Taken as a whole, the evidence shows that NAB and NULIS (and before NULIS, MLC Nominees) did not move with all deliberate speed to effect the transfers. I consider that they did not do that for fear of how advisers would react to the loss of commissions that would follow from the transfer.

I consider, then, that the better view of the evidence is that the trustees did not pay sufficient regard to the financial interests of those members affected by adviser payments and, instead, prioritised the commercial interests of the NAB Group or the interests of advisers, or more probably, both. It would further follow that the trustee might have contravened the covenant set out in section 52(2)(c) of the SIS Act. I refer the conduct to APRA under paragraph (a) of the Commission's Terms of Reference for the agency to consider whether to take action.

1.3.6 Conclusion

This case study demonstrates two things.

First, lack of insight and accountability on the part of those most senior in a retail group can lead to delayed and poor outcomes for the members of a fund. NULIS and other NAB entities were aware of the ASF and PSF issues from at least 2015. Rather than remediate promptly at that time, management and senior executives took steps to negotiate an outcome with ASIC that would minimise the financial and reputational fall-out for the NAB Group. NAB was unwilling to acknowledge that this behaviour was wrong. That in itself is telling.

Second, the case study highlights the importance of a regulator monitoring and enforcing trustees' compliance with their duties. Taking action in response to misconduct is backward-looking. The conduct that gives rise to the action has already occurred. The *purpose* of taking the action, on the other hand, is forward-looking. It sets the standards for trustees' conduct in the future. It should prompt trustees to take steps to embed those standards, and respect for them. Monitoring and enforcement

²³⁹ Transcript, Nicole Smith, 8 August 2018, 4401.

by a regulator play an important role not only by dealing with poor outcomes for members, but also by seeking to prevent them in the future.

APRA has the general administration of important parts of the SIS Act. In particular, subject to some exceptions that need not be noticed, section 6 of the SIS Act gives APRA the general administration of part 6, which provides, in section 52, that the governing rules of an RSE are taken to contain the covenants set out in that section. It also gives APRA the general administration of part 7, which includes the sole purpose test prescribed by section 62. As already noted, the covenants set out in section 52 include the covenant to exercise care, skill and diligence,²⁴⁰ the best interests covenant,²⁴¹ and the covenant about conflicts of interest that obliges the trustee to give priority to the duties to and interests of the beneficiaries over the duties to and interests of others.²⁴²

So far as the evidence goes, APRA has taken no step in response to the reports it received, from NAB entities and from others, about fees for no service. It should be said at once that section 62(1), prescribing the sole purpose test, is a civil penalty provision, but section 52 is not. Hence, contravention of section 62(1) may attract civil and criminal consequences.²⁴³ By contrast, breach of a section 52 covenant is not an offence.²⁴⁴ A person who suffers loss and damage as a result of conduct that contravenes a covenant may recover the amount of the loss or damage by action against the contravener or against any person involved in the contravention.²⁴⁵

APRA is tasked to regulate the conduct of superannuation trustees under the SIS Act. Yet APRA was invisible after repeated instances of fees for no service conduct were reported to it by NAB entities and by ASIC publicly in 2016. Fees for no service conduct is, as I have said already in this report and the *Interim Report*, conduct that is dishonest. A trustee that stands by whilst advisers or advice licensees – particularly related parties –

²⁴⁰ Section 52(2)(b).

²⁴¹ Section 52(2)(c).

²⁴² Section 52(2)(d).

²⁴³ Section 62(2), read with SIS Act s 92 and Pt 21.

²⁴⁴ Section 55(2).

²⁴⁵ Section 55(3).

engage in dishonest conduct at the expense of its members is failing in its promise and duty to act in the best interests of members.

In its submissions, APRA said that it intended to carefully evaluate the evidence that has emerged from this case study and to seek further information to determine the relevant facts and whether there is a need for further action on its part. That submission is surprising when important evidence – the trustee’s own admission – has been in APRA’s possession all along. APRA did not point to what it had done in response to the notice.

2 CBA superannuation funds

2.1 Background

Colonial First State Investments Limited (CFSIL) and Avanteos Investments Limited (Avanteos) are two RSE licensees in the CBA Group. Each is part of the Colonial First State (CFS) business.²⁴⁶

CFSIL is the trustee of Colonial First State FirstChoice Superannuation Trust (FirstChoice fund), a public offer fund with over \$71 billion funds under management and around 735,793 members.²⁴⁷ The fund offers a range of products under the FirstChoice brand.²⁴⁸ CFSIL is also the trustee of another fund called Commonwealth Essential Super.²⁴⁹

Avanteos is the trustee of various funds and the operator of investor directed portfolio services.²⁵⁰ It provides products and services to around 71,000 investors and members holding superannuation, investment

²⁴⁶ Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 1 [2].

²⁴⁷ Exhibit 5.180, Witness statement of Linda Elkins, 26 July 2018, 2 [14], 37, Annexure A.

²⁴⁸ Exhibit 5.180, Witness statement of Linda Elkins, 26 July 2018, 3 [14]–[15]; Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, 2 [11].

²⁴⁹ Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, 3 [14].

²⁵⁰ Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 2 [7].

and pension assets invested through Avanteos with an approximate value of \$29 billion.²⁵¹

On 25 June 2018, CBA announced its intention to demerge its wealth management business, including the CFS businesses.²⁵² The CFS businesses (with other CBA wealth and mortgage broking businesses) will be transferred into a new entity, shares in which will be issued to CBA shareholders.

The Commission's inquiries examined four aspects of the conduct of CFSIL and Avanteos:

- the transition of accrued default account (ADA) balances and default contributions to a MySuper product;
- the charging of fees for no service;
- the sale of superannuation in CBA branches; and
- the performance of members' cash investments and related party arrangements.

The Commission heard evidence from Ms Linda Elkins, the Executive General Manager of CFS and a director of CFSIL and Mr Peter Chun, the General Manager of Distribution for CFS.

2.2 Evidence

2.2.1 Conduct in respect of MySuper

CFSIL obtained authorisation to offer a MySuper product in 2013.²⁵³ The product was a life stages offering made available through the FirstChoice Employer Super product.²⁵⁴ CFSIL also obtained authorisation in 2013 to offer a MySuper product named Essential Super through the

²⁵¹ Exhibit 5.179, Witness statement of Linda Elkins, 26 July 2018, 2 [14].

²⁵² Exhibit 5.180, Witness statement of Linda Elkins, 26 July 2018, 4 [20].

²⁵³ Exhibit 5.181, Witness statement of Linda Elkins, 30 July 2018, 2 [10], 15 [57(a)].

²⁵⁴ Exhibit 5.181, Witness statement of Linda Elkins, 30 July 2018, 2 [10].

Commonwealth Essential Super fund.²⁵⁵ No MySuper offering was established within the FirstChoice Personal Super product.²⁵⁶

Two issues arose in respect of CFSIL's implementation of the MySuper provisions. The first concerned its treatment of the contributions of a cohort of members who were invested in the FirstChoice Personal Super product. The second concerned the transition of accrued default amounts (ADAs) into a MySuper product. An accumulated amount attributed to a member is an ADA if that member has not given the trustee a direction as to how the assets of the fund attributed to the member are to be invested.²⁵⁷

The first issue related to about 13,000 members of the FirstChoice Personal Super fund. In February 2014, soon after the MySuper changes had taken effect (on 1 January 2014), CFSIL told APRA that it had no investment directions on file for these members, but it had continued to receive contributions from or in respect of the members and had not treated those contributions as default contributions and paid them into a MySuper account.²⁵⁸

In November 2013, APRA had written to RSE licensees reminding them that after 1 January 2014 default contributions could only be paid into authorised MySuper products.²⁵⁹ APRA's letter also reminded licensees that failure to comply was an offence under the SIS Act.²⁶⁰ Section 29WA(3) of the SIS Act creates the offence; the offence is one of strict liability. That is, there are no fault elements for any of the physical elements of the offence, but the defence of mistake of fact is available.²⁶¹

At a meeting held on 21 February 2014 between representatives of CFSIL and representatives of APRA, CFSIL told APRA that it may be in breach of

²⁵⁵ Exhibit 5.181, Witness statement of Linda Elkins, 30 July 2018, 3 [14].

²⁵⁶ Transcript, Linda Elkins, 14 August 2018, 4879.

²⁵⁷ SIS Act s 20B.

²⁵⁸ Transcript, Linda Elkins, 14 August 2018, 4879–80.

²⁵⁹ Exhibit 5.183, 15 November 2013, Letter from APRA to RSEs.

²⁶⁰ Exhibit 5.183, 15 November 2013, Letter from APRA to RSEs, 1.

²⁶¹ *Criminal Code Act 1995* (Cth) s 6.1.

section 29WA in respect of the contributions of members who were invested in the FirstChoice Personal Super product, which had not been attributed to a MySuper product.²⁶² CFSIL later said in its letter to APRA dated 6 March 2014²⁶³ that it could not determine whether about 13,000 members invested in the FirstChoice Personal Super product who had made contributions after 1 January 2014 had given any investment direction about the contributions. The members affected had been transferred into the FirstChoice Personal Super product as a result of a successor fund transfer (SFT) or due to the operation of an automatic transfer from the employer division of the fund on cessation of the member's employment.

In its letter, CFSIL told APRA that it had considered several options in its efforts to comply with section 29WA. These included:

- contacting affected members to encourage them to provide an investment direction;
- implementing a system to allow CFSIL to reject undirected contributions;
- setting up a second account for members in the MySuper product; and
- transferring contributions to a MySuper product at the same time as transferring the member's ADA.

CFSIL asked APRA to agree to a proposal that it:²⁶⁴

- continue to accept undirected contributions into the FirstChoice Personal Super product;
- transfer undirected contributions into the MySuper product of the fund at the same time as the ADA balance of affected members was to be transferred; and
- contact all affected members without an ADA balance by telephone in order to obtain an investment direction.

²⁶² Exhibit 5.185, 6 March 2014, Letter, Colonial First State to APRA, 1.

²⁶³ Exhibit 5.185, 6 March 2014, Letter, Colonial First State to APRA.

²⁶⁴ Exhibit 5.185, 6 March 2014, Letter, Colonial First State to APRA, 2.

APRA wrote to CFSIL on 14 March 2014.²⁶⁵ It agreed that CFSIL was in breach of section 29WA. APRA said that it considered that CFSIL had had sufficient time to prepare for the introduction of the MySuper requirements to avoid such a breach, that it did not consider CFSIL's proposal to be acceptable and that it expected CFSIL to 'determine a course of action so that it ceases to be in breach of section 29WA of the SIS Act as soon as possible'.²⁶⁶

Following a further meeting held on 18 March 2014,²⁶⁷ CFSIL formally notified APRA on 19 March 2014 that it was in breach of section 29WA and had been since 1 January 2014.²⁶⁸ CFSIL said in the breach notification that it was unable to determine whether approximately 13,000 members of the FirstChoice Personal Super product who had made a contribution since 1 January 2014 had given an investment direction in relation to all or part of that contribution. It said that CFSIL had not paid those contributions to a MySuper product.

CFSIL set out its proposal to rectify the breach in a separate letter to APRA of the same date. CFSIL told APRA that it had commenced proactive outbound calls to affected members via a call centre to obtain and record a valid investment direction.²⁶⁹

CFSIL later gave APRA a copy of the call-out script²⁷⁰ and the letter that CFSIL proposed to send to affected members.²⁷¹ The call-out script directed the caller to tell the member that there had been a recent change to

²⁶⁵ Exhibit 5.299, 14 March 2014, Letter from APRA to CFSIL.

²⁶⁶ Exhibit 5.299, 14 March 2014, Letter from APRA to CFSIL.

²⁶⁷ Exhibit 5.186, 19 March 2014, Letter, Colonial First State to APRA.

²⁶⁸ Exhibit 5.184, 19 March 2014, Breach Notice Colonial First State Investment to APRA.

²⁶⁹ Exhibit 5.186, 19 March 2014, Letter, Colonial First State to APRA.

²⁷⁰ Exhibit 5.187, 26 March 2014, Email CBA to APRA and Attached Call Script.

²⁷¹ Exhibit 5.189, 4 April 2014, Email Sutherland to APRA and Attached Template Letter to Members.

legislation that required confirmation of the investment option or options into which the member would like their superannuation contributions to be paid. Ms Elkins said that call centre operators would record any investment direction provided by a member over the telephone and then complete the form on behalf of the member.²⁷²

The template letter said that there had been a recent change to superannuation legislation that required CFSIL to hold an investment direction from the member in relation to future contributions paid into FirstChoice Personal Super.²⁷³ The letter said that if such a direction was not held, CFSIL would be unable to accept contributions into the member's account.

Neither the script nor the template letter referred to the possibility of a member giving no direction and contributions being directed to a MySuper account. Both the script and the letter described the issue in a way that was directed to keeping members in the fund and out of a MySuper product.

By a letter dated 29 April 2014,²⁷⁴ APRA requested further information from CFSIL. It otherwise said that CFSIL's plan was acceptable to APRA. The letter also noted that APRA expected the CFSIL Board and management to satisfy itself that all other new obligations under the SIS Act and prudential standards 'are being implemented appropriately and in members' best interests.'

Thereafter, CFSIL proceeded to contact tranches of members in accordance with its proposal. Each tranche of members corresponded with a particular period of time between 2014 and 2016 during which a contravention of section 29WA was identified. CFSIL gave APRA regular reports on progress.²⁷⁵ At various times, CFSIL identified further members who had not previously been identified as having ADAs, which required

²⁷² Transcript, Linda Elkins, 14 August 2018, 4889.

²⁷³ Exhibit 5.189, 4 April 2014, Email Sutherland to APRA and Attached Template Letter to Members.

²⁷⁴ Exhibit 5.190, 29 April 2014, Letter from APRA to Elkins.

²⁷⁵ See, eg, Exhibit 5.191, 29 March 2015, Email, Clemence of Colonial First State to APRA, Re Section 29WA Update Number 13.

a further tranche of members to be contacted. So, for example, CFSIL told APRA by email dated 22 February 2016 that it had identified a sixth tranche of members who were 100% invested in a cash option, which CFSIL had failed to identify as having ADAs.²⁷⁶ By an update numbered 24 and dated 13 September 2017, APRA was told that the transfer of ADAs for the FirstChoice Personal Super members was complete.²⁷⁷

The second aspect of conduct examined in respect of MySuper concerned the transfer of ADAs into MySuper products. The MySuper provisions required RSE licensees who had the authority to offer a MySuper product to attribute ADAs to that MySuper product unless the member directed the RSE licensee in writing to attribute the amount to another MySuper product or investment option.²⁷⁸ RSE licensees were required to do so by no later than 1 July 2017.

Ms Elkins said that the ADAs of members who were invested in the FirstChoice Employer product were transferred to the MySuper offering in two tranches:²⁷⁹

- the first tranche of 98,700 members was transferred on 12 November 2016;
- the second tranche of 3,400 members was transferred on 24 May 2017.

The ADAs of members who were invested in the FirstChoice Personal product were not transferred into a MySuper product. CFSIL told APRA in its letter of 6 March 2014²⁸⁰ that system restrictions meant that it was not possible for these members to be invested in that product without establishing a second account, which it said might lead to the member paying two sets of fees and insurance premiums.

²⁷⁶ Exhibit 5.192, 22 February 2016, Email, Colonial First State to APRA Concerning Section 29WA Update Number 17.

²⁷⁷ Exhibit 5.195, 21 September 2017, Email, APRA to Colonial First State Concerning Section 29WA Update Number 24.

²⁷⁸ The legislative framework for this transition was laid down in SIS Act s 387.

²⁷⁹ Exhibit 5.181, Witness statement of Linda Elkins, 30 July 2018, 15 [56].

²⁸⁰ Exhibit 5.185, 6 March 2014, Letter from Colonial First State to APRA.

In its letter of 19 March 2014, CFSIL told APRA that trustee approval would be sought to commence the attribution of ADAs for these members to a suitable MySuper product and that it expected approval by 30 April 2014. The relevant board meeting took place on 30 April 2014. The CFSIL Board determined that Essential Super was a suitable MySuper product for the transfer of ADAs of FirstChoice Personal Super members.²⁸¹ The board approved transfers where no contrary instruction was provided by the affected member.

In its letter to CFSIL dated 29 April 2014,²⁸² APRA noted that CFSIL had informed it of approximately 70,000 FirstChoice Personal Super members with ADAs of whom approximately 14,000 had received a contribution since 1 January 2014. It also noted that the latter cohort were being dealt with via the process outlined above (in respect of the section 29WA breach) and recommended that, for the remaining accounts, CFSIL put in place appropriate controls and monitoring to avoid further breaches of section 29WA. The letter said that:

From a conversation with CFSIL on 22 April 2014 we understand that work is underway to consider steps CFSIL can take to address this risk such as introducing a phone campaign for the remaining ADA members to obtain a valid investment direction and bringing forward the date for ADA transition earlier than 2016.

At a meeting of the CFSIL Board held on 3 June 2014, management noted the proposed transition plan for ADAs for affected members and ‘the recent suggestion by APRA that the Board consider bringing forward the transition for 60,000 members’.²⁸³ Management told the board that this would have ‘significant business implications as the original transition date is 2016’. The minutes record that the board considered and discussed the management paper and, in its capacity as trustee of CFSIL:

²⁸¹ Exhibit 5.197, 30 April 2014, Board Pack for Colonial First State Investments Limited.

²⁸² Exhibit 5.190, 29 April 2014, Letter APRA to Elkins.

²⁸³ Exhibit 5.219, 30 June 2018, Minutes CFS Investments Limited.

- noted the updated information regarding the identified breach of section 29WA of the SIS Act and the rectification process being undertaken;
- noted that it may not be in the best interest of members with ADAs to transfer them to Commonwealth Essential Super at that point;
- noted that ‘robust processes’ were in place for the 60,000 members with ADAs;
- noted the principles and process in relation to the remediation of affected members; and
- subject to the incorporation of the requested changes, approved the changes to the trustee’s MySuper Transition Plan giving effect to the proposed rectification process.

The board did not resolve to bring forward the transition date. APRA was later told that there were several reasons: potential operational risk; a possibility of members’ interests being adversely affected; a low probability of a section 29WA breach in the future; and the fact that work was already planned to engage with members and advisers regarding their intentions.²⁸⁴

At a meeting of representatives of APRA and CFSIL on 29 July 2014, APRA expressed concern that CFSIL’s transition approach was ‘reactive’ and may result in a delay of up to 10 months for members who had made contributions after 1 April 2014.²⁸⁵

As well as communicating with affected members during the period of transition of ADAs, CFS also communicated with their advisers. The letters sent to advisers and planners set out the value of assets under management in respect of which commissions were being paid to the adviser or planner and which were commissions that would be lost if

²⁸⁴ Exhibit 5.198, 4 July 2014, Email, Colonial First State to APRA.

²⁸⁵ Exhibit 5.420, 29 July 2014, File Note of Meeting Held on 29/07/2014 between APRA and CFS Regarding ADA Transition.

clients moved to a MySuper product.²⁸⁶ In one standard email sent to financial planners, planners were told that the transfer date for ADAs was approaching; they were reminded of the amount of funds under administration and that commissions would be lost if these were transferred to a MySuper product.²⁸⁷

Ms Elkins agreed that emails like the one just described encouraged advisers to stop ADAs being transferred to a MySuper product by obtaining an investment direction.²⁸⁸ She said that it was never discussed that CFSIL wanted to maximise the time that ADAs remained in default products so as to maximise commissions.²⁸⁹ But she agreed that one of the purposes of the communications sent to advisers and members asking them to confirm their investment directions was to benefit advisers.²⁹⁰ Ms Elkins also gave evidence that moving ADAs into the MySuper product early may have affected the relationship between CFSIL and its aligned advisers.²⁹¹

The final tranche of FirstChoice Personal Super member accounts was transferred into the Essential Super product in August 2016.²⁹² A total of 23,451 ADA accounts, with balances totalling more than \$279 million were transferred.

2.2.2 Fees for no service conduct

After the Commission heard evidence in April 2018 about fees for no service, CFS management conducted a review to identify whether adviser service fees (ASFs) had been or were being deducted from the accounts of deceased superannuation fund members. Management identified that

²⁸⁶ See, eg, Exhibit 5.201, 6 July 2016, Email between CFSIL and Financial Planner Concerning CFS Updated Transfer ADA Accounts; see also Transcript, Linda Elkins, 14 August 2018, 4907.

²⁸⁷ Transcript, Linda Elkins, 14 August 2018, 4910–11; Exhibit 5.202, 16 September 2016, Email CFSIL to Financial Planner.

²⁸⁸ Transcript, Linda Elkins, 14 August 2018, 4911–12.

²⁸⁹ Transcript, Linda Elkins, 14 August 2018, 4884–5.

²⁹⁰ Transcript, Linda Elkins, 15 August 2018, 4946.

²⁹¹ Transcript, Linda Elkins, 15 August 2018, 4946.

²⁹² Exhibit 5.194, 1 September 2016, Email, Colonial First State to APRA Concerning Section 29WA Update Number 19; Transcript, Linda Elkins, 14 August 2018, 4896.

accounts in Avanteos funds had ASFs deducted following a member's death and that the relevant product disclosure statement (PDS) did not disclose the ongoing deduction of those fees.²⁹³ Ms Elkins said that this issue did not affect any other CBA RSE licensee.²⁹⁴

Ms Elkins' said that, before June 2018, Avanteos' business rules had allowed ASFs to be deducted from a member's account even after it had received notification of the member's death.²⁹⁵ Ms Elkins also acknowledged that Avanteos did not require advisers to provide any positive confirmation that the adviser had supplied ongoing services,²⁹⁶ unless the adviser was specifically investigated by Avanteos or CFSIL.²⁹⁷

The management review also found that in late 2015 or early 2016, Avanteos had become aware that relevant PDSs did not disclose that fees might be deducted after death of the member. Changes were proposed to be made to the relevant PDSs, and the register used to capture and manage proposed changes to PDSs issued by Avanteos included the change. But the change was not made. Ms Elkins said that the relevant entry was moved to the 'completed' section of the register before it was carried into effect.²⁹⁸ No steps were taken at that time either to switch off the ASFs or report the matter to ASIC or APRA.²⁹⁹

Ms Elkins told the Commission that when she was told of the review's findings in late April 2018, she immediately requested that steps be taken to switch off ASFs for affected member accounts and to prevent future

²⁹³ Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 4 [19].

²⁹⁴ Transcript, Linda Elkins, 15 August 2018, 4963.

²⁹⁵ Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 3 [12].

²⁹⁶ Transcript, Linda Elkins, 15 August 2018, 4964.

²⁹⁷ Transcript, Linda Elkins, 15 August 2018, 4965.

²⁹⁸ Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 4 [20].

²⁹⁹ Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 4 [20].

deductions from accounts of members who died.³⁰⁰ She also requested that the regulators be notified.³⁰¹ This was done on 1 May 2018.³⁰²

At the time of the Commission's inquiries, the exact amount of ASFs that had been deducted from member accounts after the member's death had not been determined. The preliminary estimates Ms Elkins provided the Commission were that 1,714 member accounts had been affected and a total of \$2.93 million had been deducted.³⁰³ A remediation program had also commenced by the time of the hearings and was expected to be substantially completed by February 2019.³⁰⁴

On 9 October 2018, after the Commission's hearings into superannuation had concluded, CBA announced certain actions it would take in respect of adviser fees, including:³⁰⁵

- rebating of grandfathered commissions for Commonwealth Financial Planning (CFP) customers;
- reviewing any advice fees charged to deceased estates across its advice licensees and refunding with interest any instances where unauthorised fees have been charged;
- taking steps to remove certain fees on legacy wealth products from January 2019, which it said would benefit around 50,000 customer accounts by approximately \$20 million annually; and
- providing all customers of CFP with an option to review their ongoing service arrangements every two years.

³⁰⁰ Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 4 [21].

³⁰¹ Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 4 [21].

³⁰² Exhibit 5.182 Witness statement of Linda Elkins, 7 August 2018, Exhibit LME-2 [CBA.0002.2558.7264]; see also Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, Exhibit LME-3 [CBA.1004.0085.0001].

³⁰³ Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 9 [46].

³⁰⁴ Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 10 [49].

³⁰⁵ Exhibit 5.437, 9 October 2018, CBA ASX Announcement 9 October 2018.

At the time of the announcement, CBA Wealth Management Chief Operating Officer Michael Venter said:³⁰⁶

Charging unauthorised advice fees to deceased estates is unacceptable. A broader review of deceased estates is underway across our advice licensees. It will go back seven years to ensure that any instances where unauthorised fees have been charged are identified and refunded with interest.

2.2.3 Commissions, contribution fees and grandfathering

When considering what CFSIL and other superannuation entities did in response to the introduction of the MySuper arrangements three points need to be borne in mind.

First, the trustee of the MySuper fund could charge only fees of the kinds permitted by section 29V of the SIS Act. Second, when ADAs were transferred into a MySuper account, advisers could no longer be paid any trailing or other commissions out of the amounts standing to the credit of that account.³⁰⁷ Third, because transferring ADAs to a MySuper account cut the flow of commissions, the transfer worked to the financial detriment of advisers. That detriment could be avoided by the adviser or fund obtaining from an existing member of a fund an investment direction. It followed that superannuation entities that relied on advisers introducing new members to their funds had reasons to delay transferring ADAs to a MySuper product, thus preserving the flow of commissions and providing time to secure investment directions.

³⁰⁶ Exhibit 5.437, 9 October 2018, CBA ASX Announcement 9 October 2018.

³⁰⁷ This was the effect of SIS Act ss 29SAC, 29S(2)(f) and 29T(1)(a), which together required an RSE licensee to elect that it would not charge a member who holds a MySuper product, in relation to that product, a fee all or part of which relates directly or indirectly to costs incurred by the RSE licensee: (a) in paying conflicted remuneration to a financial services licensee, or a representative of a financial services licensee; or (b) in paying an amount to another person that relates to conflicted remuneration paid by that other person to a financial services licensee, or a representative of a financial services licensee. The definition of 'conflicted remuneration' would include trail and other commissions.

CFSIL is a dual-regulated entity. It is both the responsible entity (RE) for managed investment schemes and trustee of superannuation funds. As RE, it charged commissions on funds invested in the scheme. And, as RE, CFSIL paid the amount of commission charged to the client's adviser, if the commission was 'grandfathered'. (The commission was treated as 'grandfathered' if the advice licensee to whom the commission was paid had been engaged by the client before the FoFA changes came into force.) If there was no linked adviser, CFSIL retained the commission for itself.³⁰⁸ If the member later engaged a new adviser, Ms Elkins said that CFSIL would still retain the trailing commission charged to that account.³⁰⁹ And trailing commissions would continue to be paid after members died.³¹⁰ These commissions continued to be paid by the reversionary beneficiary (the person nominated by the member to receive that member's benefits in the event of their death) even if the beneficiary had been nominated before the effective date of the FoFA legislation.³¹¹

Ms Elkins told the Commission that, at the time of giving her evidence, CFSIL did not have the capability to rebate commission amounts to members³¹² and had not reduced its fees to remove the commissions.³¹³ She said that, other than at the time of FoFA's introduction and CFSIL's subsequent work to ensure compliance with the legislation's grandfathering provisions, the trustee had not considered whether to continue charging trailing commissions.³¹⁴ However, the issue was under review at the time of the hearings.³¹⁵ Ms Elkins said that CBA's strategic position with respect to trailing commissions, generally, would need to be determined and taken

³⁰⁸ Transcript, Linda Elkins, 14 August 2018, 4920.

³⁰⁹ Transcript, Linda Elkins, 14 August 2018, 4915.

³¹⁰ Transcript, Linda Elkins, 15 August 2018, 4967.

³¹¹ Transcript, Linda Elkins, 15 August 2018, 4967.

³¹² Transcript, Linda Elkins, 14 August 2018, 4918.

³¹³ Transcript, Linda Elkins, 14 August 2018, 4918; see also Transcript, Linda Elkins, 15 August 2018, 4968.

³¹⁴ Transcript, Linda Elkins, 14 August 2018, 4920.

³¹⁵ Transcript, Linda Elkins, 14 August 2018, 4918; see also Transcript, Linda Elkins, 15 August 2018, 4968.

into consideration before CFSIL could make a decision to remove trailing commissions.³¹⁶

As noted above, after the superannuation hearings concluded, CBA announced that it would rebate grandfathered commissions for CFP customers.³¹⁷ It was not clear from CBA's announcement whether this would extend to grandfathered commissions paid to other CBA advice licensees. Mr Venter said at the time: 'We support the removal of grandfathered commissions from superannuation and investment products across the wider industry and believe a legislative approach should be considered'. This suggests he believed that CBA may see a first-mover disadvantage if it were to make such changes voluntarily.

CFSIL also paid commissions in respect of members who had joined the fund before 1 July 2014, but who had switched from the accumulation to pension phase between 19 November 2014 and 30 June 2015. This was against the regulations but would have been allowed under regulations made but disallowed by the Senate.³¹⁸

To elaborate, after the FoFA legislation took effect, regulations were introduced that provided that where a member with a superannuation interest in the 'growth phase' before 1 July 2014 elected to receive a pension, the election or receipt of pension was not treated as having occurred on or after 1 July 2014.³¹⁹ The effect of these regulations would have been to permit the grandfathering provisions to apply. The regulations were disallowed by the Senate. ASIC announced that it would 'take a practical and measured approach to administering the law' as it stood after the disallowance of the regulations and that it would work with Australian financial services licensees by 'taking a facilitative approach' until 1 July 2015.³²⁰

³¹⁶ Transcript, Linda Elkins, 15 August 2018, 4951–3.

³¹⁷ Exhibit 5.437, 9 October 2018, CBA ASX Announcement 9 October 2018.

³¹⁸ Transcript, Linda Elkins, 14 August 2018, 4926.

³¹⁹ *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014* (Cth).

³²⁰ ASIC, Media Release 14-307MR, 19 November 2014.

In May 2015, CBA wrote to ASIC noting the relevant background and said that confusion had resulted from the disallowance of the regulations.³²¹ It set out various potential interpretations of the legislation that might permit the fund to grandfather commission payments.³²² CBA said that, if narrower interpretations of the applicable grandfathering provisions were to be adopted, CFSIL would require time to assess and address a number of issues so that there was an orderly and staged implementation process. CBA asked ASIC to consider issuing the affected Group entities with a 'no-action' letter or extend the facilitative compliance period to 31 July 2015 in order to allow the Group time to engage with ASIC.³²³

In a letter dated 22 July 2015, ASIC refused to provide the extension sought, but gave a limited no-action letter.³²⁴ ASIC said that the facilitative compliance period was not equivalent to a transition period and could only be relied upon by licensees that were making reasonable efforts to comply with the law. ASIC said that licensees did not appear to be doing this.³²⁵ However, ASIC said that it understood that the relevant licensees, including CFSIL, may need to undertake a range of steps in order to permanently cease the relevant payments of **conflicted remuneration**. It was on this basis that ASIC said it had decided to provide the limited no-action letter. ASIC confirmed that, subject to certain qualifications, it did not intend to take action for breaches of the relevant provisions where:

- the breach occurred from 1 July 2015 to 22 October 2015; and
- the breach occurred as a result of a benefit being given or received in relation to a client who switched from the accumulation to the pension phase within FirstChoice from 19 November 2014 to June 2015.

Ms Elkins told the Commission of efforts in October 2013 by representatives of CBA and CFSIL (including herself) to lobby Treasury officials and a ministerial adviser to allow the continuation of grandfathered commissions

³²¹ Exhibit 5.210, 29 May 2015, Letter CBA to Commissioner Tanzer of ASIC.

³²² Exhibit 5.210, 29 May 2015, Letter CBA to Commissioner Tanzer of ASIC, 7.

³²³ Exhibit 5.210, 29 May 2015, Letter CBA to Commissioner Tanzer of ASIC, 10.

³²⁴ Exhibit 5.211, 22 July 2015, Letter ASIC to CBA.

³²⁵ Exhibit 5.211, 22 July 2015, Letter ASIC to CBA.

when a member switches from the accumulation to the pension phase.³²⁶ Ms Elkins said that she lobbied for clarification in the law,³²⁷ but agreed that it was not in the interests of members that grandfathered commissions be continued when the member switched from superannuation to pension. She said, in hindsight, CFSIL should not have been lobbying for that.³²⁸

The Commission also heard evidence about the grandfathering and payment of 'contribution fees'. Ms Elkins said that contribution fees are payable as a percentage on each contribution made by a member³²⁹ and were maintained and grandfathered after FoFA. Ms Elkins was not certain whether contribution fees were payable when the member was not linked to an adviser and whether, in that event, parts of the fee flowed to CBA or CFSIL.³³⁰ CFSIL said in its submissions that if contribution fees were grandfathered, they may still be payable after a member had been delinked from an adviser and that, in that situation, CFSIL would retain the fees.³³¹

During the Commission's hearings, Ms Elkins said that, as trustee, CFSIL had not considered removing contribution fees until recently.³³² At a meeting held on 21 June 2018, the Product Governance Forum of CFS endorsed a recommendation to remove contribution fees.³³³ On 9 October 2018, as noted above, CBA announced that it would take steps to rebate grandfathered commissions for CFP customers and to remove 'certain fees' on legacy wealth products from January 2019.³³⁴ The announcement did not say whether those fees included contribution fees.

³²⁶ Exhibit 5.212, 25 October 2013, Email Russel to Rubinsztein and Others.

³²⁷ Transcript, Linda Elkins, 14 August 2018, 4926.

³²⁸ Transcript, Linda Elkins, 15 August 2018, 4926.

³²⁹ Transcript, Linda Elkins, 15 August 2018, 4965, 4950.

³³⁰ Transcript, Linda Elkins, 15 August 2018, 4950.

³³¹ CFSIL and Avanteos, Module 5 Case Study Submission, 11 [30].

³³² Transcript, Linda Elkins, 15 August 2018, 4950.

³³³ Exhibit 5.221, 21 June 2018, Minutes of CFS Product Governance Forum.

³³⁴ Exhibit 5.437, 9 October 2018, CBA ASX Announcement 9 October 2018.

2.2.4 Selling of superannuation through CBA branches

In 2012, CFS and CBA started developing a program for CFSIL to create a superannuation product that CBA would sell in its branches.³³⁵ The product was to be Essential Super. As already explained, Essential Super was intended to be a low cost, simple, superannuation product.³³⁶ The original target market was CBA customers who came through CBA's branches and distribution network.³³⁷

In June 2013, CFSIL and CBA made a Distribution and Administration Services Agreement.³³⁸ The Agreement said that CBA would provide 'Services' to CFSIL (including distribution of Essential Super using training and compliant 'resources'), as well as the use of its branches and the development of marketing materials and web content.³³⁹ In exchange, CFSIL was required to pay CBA an annual fee of 30% of the total net revenue earned by the trustee in relation to the fund in the relevant financial year.³⁴⁰ Mr Chun said this fee was based on the costs that CBA bank incurred versus the costs that CFSIL incurred.³⁴¹

Mr Chun told the Commission the parties presented the proposed distribution model to ASIC in 2012 and early 2013. He said that they did so because they recognised that there were 'potential risks around the general advice distribution model ... potentially blurring into personal [advice]' and because the distribution model was a major undertaking of CBA, and a new one.³⁴²

³³⁵ Exhibit 5.233, Witness statement of Peter Chun, 7 August 2018, 4 [14]; Transcript, Peter Chun, 15 August 2018, 4987.

³³⁶ Transcript, Peter Chun, 15 August 2018, 4988; see also, Transcript, Linda Elkins, 15 August 2018, 4968.

³³⁷ Transcript, Peter Chun, 15 August 2018, 4988.

³³⁸ Exhibit 5.233, Witness statement of Peter Chun, 7 August 2018, 4 [16].

³³⁹ Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-1 [CBA.0001.0398.3229 at .3258].

³⁴⁰ Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-1 [CBA.0001.0398.3229 at .3258].

³⁴¹ Transcript, Peter Chun, 15 August 2018, 4988.

³⁴² Transcript, Peter Chun, 15 August 2018, 4989.

Under the model CBA presented to ASIC, its branch staff would seek to create customer ‘interest’ in taking up Essential Super after either a transaction, financial ‘health check’ or a request or referral involving that customer.³⁴³ Mr Chun told the Commission that ‘the person in the branch is not attempting to make any assessment of whether [Essential Super is] appropriate for the member’. He said, ‘[w]e were not recommending other products to the customer. We were making them aware of this particular superannuation offering.’³⁴⁴

After the distribution model was introduced, CBA engaged KPMG to conduct ‘mystery shopper’ exercises in various branches. CFSIL received copies of the reports for each exercise.³⁴⁵ In its first report, in respect of an exercise conducted in September 2013, KPMG found that:³⁴⁶

- there was a high volume of compliance exceptions;
- 85% of shoppers were not provided with a **Financial Services Guide**;
- 40% of shoppers were not provided with a PDS (for the Essential Super product);
- 95% of customer service representatives did not follow the application process in detail; and
- 85% of shoppers were not provided with a general advice warning as part of the inquiry/sale.³⁴⁷

³⁴³ Transcript, Peter Chun, 15 August 2018, 4990.

³⁴⁴ Transcript, Peter Chun, 15 August 2018, 4993–4.

³⁴⁵ Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, 4 [28].

³⁴⁶ Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-27 [CBA.0001.0463.6783].

³⁴⁷ Transcript, Peter Chun, 15 August 2018, 4991.

Mr Chun said that further changes and improvements were made to the sales approach as a result of this report, particularly about providing a general advice warning, which he described as ‘an important element of the control’.³⁴⁸

KPMG conducted further mystery shopper exercises in December 2013 and September 2014. These exercises revealed some improvement, but compliance exceptions persisted.³⁴⁹ Mr Chun said that CFSIL was aware that the conduct identified in the mystery shopper reports may have constituted breaches of applicable legislation.³⁵⁰

CFSIL did not give ASIC the results of KPMG’s mystery shopper exercises until December 2014.³⁵¹ In the meantime, in August 2014, ASIC had issued a notice to CBA seeking books and records in respect of the sale of Essential Super by CBA branch staff.³⁵² ASIC had become concerned about the use of the ‘financial health check’ alongside a recommendation of Essential Super.³⁵³ Mr Chun said that he became aware of ASIC’s concerns towards the end of 2016 or beginning of 2017 and that steps were taken by CBA to make changes.³⁵⁴ The changes included no longer allowing consolidation of superannuation funds in branches in January 2017.³⁵⁵

Towards the end of 2016 or in early 2017, ASIC told CBA that it was concerned about CBA’s conduct.³⁵⁶ A position paper provided by ASIC dated 20 February 2017 set out ASIC’s concerns.³⁵⁷ These included that:

³⁴⁸ Transcript, Peter Chun, 15 August 2018, 4991–2.

³⁴⁹ Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-27 [CBA.0001.0463.6783], Exhibit PC-28 [CBA.0001.0463.6838], Exhibit PC-29 [CBA.0001.0463.6720].

³⁵⁰ Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, 5 [31].

³⁵¹ Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, 5 [32].

³⁵² Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-24 [CBA.0001.0463.0629].

³⁵³ Transcript, Timothy Mullaly, 17 August 2018, 5225.

³⁵⁴ Transcript, Peter Chun, 15 August 2018, 4992–3.

³⁵⁵ Transcript, Peter Chun, 15 August 2018, 4992–3.

³⁵⁶ Transcript, Timothy Mullaly, 17 August 2018, 5230.

³⁵⁷ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-16 [ASIC.0041.0002.6128].

- ASIC suspected that branch staff employed by CBA had been providing personal advice, as opposed to general advice, in the sale of Essential Super. This gave rise to contraventions by CBA of a number of provisions of the Corporations Act including sections 961B, 961K, 961L, 952C(1) and 912A(1);
- the general advice model adopted by CBA carried the inherent risk that personal advice would be given – and that CBA was aware of this;
- this risk was exacerbated by the discussion of Essential Super being linked to, or following directly on from, the conduct of a financial health check;
- if personal advice was provided, the customer would not have the benefit of the protections afforded by Chapter 7 of the Corporations Act; and
- ASIC suspected that CBA had contravened its general obligation to ensure that financial services covered by its Australian financial services licence are provided efficiently, honestly and fairly in accordance with section 912A(1)(a).

In its response dated 17 March 2017, CBA said that it ‘firmly believed that at all times it has acted in accordance with its legal obligations, ASIC regulatory guidance and, more broadly, its objective to put customers first in respect of the distribution of Essential Super’.³⁵⁸ Although no particular outcome was referred to in ASIC’s paper, CBA said that it did not consider that court proceedings would be an appropriate enforcement outcome and that a ‘negotiated outcome’ would represent ‘the most appropriate and efficient outcome’.³⁵⁹ CBA also said that ‘[b]ecause court proceedings are not warranted, we also do not consider that the present is a case in which an enforceable undertaking is required’.³⁶⁰ CBA proposed some changes

³⁵⁸ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-4 [ASIC.0041.0005.0407 at .0408].

³⁵⁹ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-4 [ASIC.0041.0005.0407 at .4093].

³⁶⁰ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-4 [ASIC.0041.0005.0407 at .0410].

to its distribution model. In July 2017, ASIC told CBA that it remained concerned that CBA's proposal was still likely to result in personal advice being given by staff.³⁶¹ ASIC told CBA that it was prepared to resolve the matter on the basis of an enforceable undertaking (EU), the terms of which would include that CBA cease selling Essential Super in conjunction with a financial health check or any other 'needs based discussion'.

In August 2017, CBA discussed internally how the matter might best be brought to an end. An internal email of that time suggested that CBA's preferred approach was to resolve the matter without an EU if possible and by way of a media release, although the email acknowledged that ASIC was unlikely to resolve the matter other than through an EU. Ms Elkins said that CFS and CBA's position was that ASIC should 'put out a media release'.³⁶²

CBA wanted to ensure that, if an EU was required, the terms of the undertaking would permit retail banking and wealth management to 'move forward with Project Everest', which would put Essential Super 'back into the branches' under a general advice model 'without the risk of straying into the personal advice territory'.³⁶³

Ultimately, in July 2018, about a year after CBA and CFS had begun to discuss resolution of the issues with ASIC, CBA agreed to give, and gave, an EU.³⁶⁴ Ms Elkins said that she thought the lapse of time was 'just the normal course of negotiating the EUs'.³⁶⁵

2.2.5 Returns to members on cash investments

On 11 June 2018, the *Australian* newspaper published an article saying that many investment options provided by retail superannuation funds were paying returns well below the actual market rates, with those

³⁶¹ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-22 [ASIC.0041.0001.2789].

³⁶² Transcript, Linda Elkins, 15 August 2018, 4968.

³⁶³ Exhibit 5.227, 8 August 2017, Email Shafir to Comyn and Others; Transcript, Linda Elkins, 15 August 2018, 4970.

³⁶⁴ Transcript, Linda Elkins, 15 August 2018, 4969; Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-34 [ASIC.0041.0001.4378].

³⁶⁵ Transcript, Linda Elkins, 15 August 2018, 4976.

lower returns not explained by differences in fees. CFSIL and CBA did not accept the criticisms they understood the article to be making and internal communication followed within CFSIL and CBA. But the internal analysis made of returns on cash investments and fees charged showed, among other things, that the fee being charged for the cash option in the FirstChoice Pension product included a trailing commission of 60 basis points.³⁶⁶

When asked why members were paying a trailing commission on cash investment options, Ms Elkins said that the cash investment options were under review.³⁶⁷

2.2.6 Related party arrangements

Two issues arose about CFSIL's related party arrangements. The first concerned one of its investment managers, Colonial First State Asset Management (Australia) Limited (Asset Management), while the other concerned the group insurance provider, CommInsure.³⁶⁸ At the relevant times, both entities were part of the CBA group and related to CFSIL.

CFSIL invests money in managed investment schemes of which CFSIL is the RE.³⁶⁹ Those investments are then managed by Asset Management, which charges CFSIL fees.³⁷⁰

Ms Elkins said that the business team for CFSIL would negotiate with the business team for Asset Management to determine the fees that CFSIL would pay to Asset Management. An example was provided to the Commission in the form of a recent negotiation in respect of

³⁶⁶ Transcript, Linda Elkins, 15 August 2018, 4948; see Exhibit 5.220, 11 June 2018, Summary of Page 1 Article, the Australian.

³⁶⁷ Transcript, Linda Elkins, 15 August 2018, 4948.

³⁶⁸ Transcript, Linda Elkins, 15 August 2018, 4957.

³⁶⁹ Transcript, Linda Elkins, 15 August 2018, 4954.

³⁷⁰ Transcript, Linda Elkins, 15 August 2018, 4954.

the distribution and marketing of investment options that used to reside in CFSIL, but were moved across to Asset Management.³⁷¹

Ms Elkins said that the board of CFSIL did not need to sign off on the agreement reached between CFSIL and Asset Management about the investment management fees – including distribution and marketing fees – which would be paid by members to Asset Management.³⁷² A benchmarking report produced by ChantWest showed that the majority of products were outside of the benchmarking range.³⁷³

In respect of CommInsure, Ms Elkins told the Commission that CFSIL conducts an annual review of CommInsure in line with the CFSIL insurance management framework.³⁷⁴ I take this to mean that CFSIL conducts an annual review of whether CommInsure should be its chosen insurer. The Commission received evidence of various premium comparisons included in a Rice Warner insurance benchmarking review dated 11 April 2017.³⁷⁵ This contained a number of findings, including that:

- in respect of default insurance for Commonwealth Essential Super members, CommInsure does not distinguish between blue-collar and white-collar workers or between smokers and non-smokers;³⁷⁶
- the non-smoker rates for Commonwealth Essential Super are on average 34% more expensive than the median of the peer group for death only cover;³⁷⁷

³⁷¹ Transcript, Linda Elkins, 15 August 2018, 4955.

³⁷² Transcript, Linda Elkins, 15 August 2018, 4956.

³⁷³ Exhibit 5.223, 24 February 2017, Board Paper 24 February '17, Concerning Investment Management Fee Negotiations.

³⁷⁴ See Exhibit 5.179, Witness statement of Linda Elkins, 26 July 2018, Exhibit LME-27 [CBA.0517.0169.4554]; Transcript, Linda Elkins, 15 August 2018, 4958.

³⁷⁵ Exhibit 5.224, 11 April 2017, Rice Warner Insurance Benchmarking Review.

³⁷⁶ Transcript, Linda Elkins, 15 August 2018, 4959.

³⁷⁷ Transcript, Linda Elkins, 15 August 2018, 4960.

- the rates for white-collar non-smokers are on average 61% more expensive than the median of the peer group for death only cover;³⁷⁸
- the rates for blue collar non-smokers are on average 19% more expensive than the median of the peer group for death only cover;³⁷⁹
- for death and total and permanent disability combined cover for female non-smoker white-collar workers aged between 41 and 45, the premium is on average 132% higher than the median;³⁸⁰
- when CommInsure does worse than the median in respect of Commonwealth Essential Super insurance, it does much worse than the median;³⁸¹ and
- when CommInsure for Commonwealth Essential Super insurance does better than the median, it only does a little bit better than the median.³⁸²

These annual benchmarking reports go to CFSIL's board,³⁸³ and the Office of the Trustee oversees the annual review of CommInsure.³⁸⁴ Ms Elkins said that despite the benchmarking results, the board has continued to use CommInsure for its group insurance.³⁸⁵ She said that the decision to retain CommInsure came down to whether CFSIL would be better off negotiating with CommInsure as the incumbent or selecting a new insurer.³⁸⁶ She acknowledged that the question of changing insurer has arisen, but said that the discussion has not been minuted.³⁸⁷

³⁷⁸ Transcript, Linda Elkins, 15 August 2018, 4960.

³⁷⁹ Transcript, Linda Elkins, 15 August 2018, 4960.

³⁸⁰ Transcript, Linda Elkins, 15 August 2018, 4961.

³⁸¹ Transcript, Linda Elkins, 15 August 2018, 4961.

³⁸² Transcript, Linda Elkins, 15 August 2018, 4961.

³⁸³ Transcript, Linda Elkins, 15 August 2018, 4960.

³⁸⁴ Transcript, Linda Elkins, 15 August 2018, 4962.

³⁸⁵ Transcript, Linda Elkins, 15 August 2018, 4960.

³⁸⁶ Transcript, Linda Elkins, 15 August 2018, 4962.

³⁸⁷ Transcript, Linda Elkins, 15 August 2018, 4962.

2.2.7 Intra-fund advice and a banned adviser

Financial Wisdom Limited (Financial Wisdom), another company in the CBA group at relevant times, provide intra-fund advice to members of funds of which CFSIL is the RSE licensee, pursuant to an agreement between Financial Wisdom and CFSIL.³⁸⁸ Mr Chun said that the advice was not ‘personal advice’, but limited to ‘factual information and general advice’.³⁸⁹

A financial adviser, who was an authorised representative of Financial Wisdom, was permitted to provide intra-fund advice pursuant to an agreement with Financial Wisdom.³⁹⁰ Under the agreement, the adviser provided intra-fund advice to a subset of members of FirstChoice Employer Super.³⁹¹ The adviser received trailing commissions from some of the members to whom he provided intra-fund advice.³⁹²

The adviser made contact with members in respect of whom the adviser was receiving trailing commissions in relation to the upcoming ADA transfers that would be part of the MySuper transition.³⁹³ Mr Chun said that the particular communication that adviser made³⁹⁴ did not follow the template provided by CFSIL to advisers. The communication said:³⁹⁵

Around three years ago the government changed super legislation and it’s coming into effect now. As a result, if you don’t actively make an investment choice in your super account you are deemed to be disengaged and the government will make an investment choice for you.

³⁸⁸ Transcript, Peter Chun, 15 August 2018, 4979–80.

³⁸⁹ Transcript, Peter Chun, 15 August 2018, 4980.

³⁹⁰ Transcript, Peter Chun, 15 August 2018, 4980.

³⁹¹ Transcript, Peter Chun, 15 August 2018, 4980.

³⁹² Transcript, Peter Chun, 15 August 2018, 4981.

³⁹³ Transcript, Peter Chun, 15 August 2018, 4982. For an example of correspondence sent by the financial adviser, see Exhibit 5.235, 3 January 2018, Template Financial Planner Email Concerning Important Superannuation Changes.

³⁹⁴ Exhibit 5.235, 3 January 2018, Template Financial Planner Email Concerning Important Superannuation Changes.

³⁹⁵ Exhibit 5.235, 3 January 2018, Template Financial Planner Email Concerning Important Superannuation Changes.

...

Your investment will be moved to a government-selected investment called MySuper. It is different and may not be best for you.

Mr Chun agreed that CFSIL regarded these statements to be potentially misleading.³⁹⁶ Mr Chun also accepted that CFSIL was concerned that such statements may have influenced members to provide an investment direction and avoid transfer to the MySuper product because they 'might make a member think that it would be bad for them to transfer to MySuper'.³⁹⁷ Mr Chun accepted that the communication was drafted in a way that may make the member fearful and influence them to make an election.³⁹⁸ Not only that, the communication did not disclose the adviser's potential conflict of interest in relation to the receipt of trailing commission.³⁹⁹

Between 1 July 2013 and 30 June 2017, about 1,380 of this adviser's clients made an investment direction, the effect of which was that their accounts were not transferred to MySuper.⁴⁰⁰

In 2017, the financial adviser was identified by ASIC and notices were issued in respect of his conduct in late 2017.⁴⁰¹ On 26 July 2018, CFSIL took steps to seek information from Financial Wisdom in relation to the financial adviser. At the time of the hearings, the adviser had 'very recently' been suspended from providing intra-fund advice to the fund.⁴⁰²

Mr Chun said that CFSIL will require Financial Wisdom to refund the fees for intra-fund advice where advisers were not providing the relevant service to clients.⁴⁰³ But the refund would not be returned to members. Mr Chun explained that he considered that 'the community would not expect [CFSIL] to be paying fees'. Asked whether 'the community would expect that

³⁹⁶ Transcript, Peter Chun, 15 August 2018, 4983.

³⁹⁷ Transcript, Peter Chun, 15 August 2018, 4983.

³⁹⁸ Transcript, Peter Chun, 15 August 2018, 4984.

³⁹⁹ Transcript, Peter Chun, 15 August 2018, 4983.

⁴⁰⁰ Transcript, Peter Chun, 15 August 2018, 4983.

⁴⁰¹ Exhibit 5.432, Witness statement of Mark Ballantyne, 1 August 2018, 19 [102].

⁴⁰² Transcript, Peter Chun, 15 August 2018, 4984.

⁴⁰³ Transcript, Peter Chun, 15 August 2018, 4984.

if [CFSIL] charged to members an administration fee, that includes the provision of intra-fund advice, and no intra-fund advice has been provided, that [CFSIL] would make some refund to the members', Mr Chun said he did not think this would be the case.⁴⁰⁴

2.3 What the case study showed

2.3.1 The MySuper transition

It is to be recalled that section 29WA of the SIS Act required RSE licensees to treat any contribution to the fund in relation to which no investment direction has been given as a contribution to be paid into a MySuper product of the fund. CFSIL did not do that in respect of contributions it received in relation to about 13,000 members of its FirstChoice Personal Super product. In both its notification to APRA and in its submissions to the Commission, CFSIL accepted that it had contravened the section. CFSIL also accepted that the conduct breached its obligations under section 912A(1)(c) of the Corporations Act and section 29E(1)(a) of the SIS Act.

I agree. CFSIL was right to make the acknowledgments it did.

In its written submissions CFSIL said that, at the relevant time, it held the view that all members of FirstChoice Personal were 'choice' members.⁴⁰⁵ This is not what Ms Elkins said but, as I have noted, she said that she was not certain of her recollection of events. CFSIL rightly submitted that a mistake of fact was a defence available in respect of a contravention of section 29WA of the SIS Act,⁴⁰⁶ but it accepted that a mistake would not excuse the breach of section 29E of that Act or section 912A(1)(c) of the Corporations Act.⁴⁰⁷

The evidence and submissions from CFSIL did not explain how or why management of CFSIL were unaware in 2013 of the difference between, on the one hand, an investment direction given by a member as to how amounts attributable to that member were to be invested and, on the other

⁴⁰⁴ Transcript, Peter Chun, 15 August 2018, 4985–6.

⁴⁰⁵ CFSIL and Avanteos, Module 5 Case Study Submission, 3–4 [10], 20 [53].

⁴⁰⁶ CFSIL and Avanteos, Module 5 Case Study Submission, 20 [53].

⁴⁰⁷ CFSIL and Avanteos, Module 5 Case Study Submission, 20 [55].

hand, a choice by a person as to the superannuation fund into which her or his contributions were to be paid. Nor did the evidence or submissions from CFSIL explain how CFSIL could have identified that there were ADAs in FirstChoice Personal but not understood that the relevant members were not 'choice' members. Those are matters that may suggest there was no reasonable basis for CFSIL to believe (mistakenly) that all members of FirstChoice Personal were 'choice' members. It may further be noted that CFSIL did not submit, and did not invite me to find, that the belief it held at the time was reasonable.

It is not clear to me that a belief about the application of the SIS Act would be a mistake of fact but I need not offer a concluded view. If holding this belief were to be regarded as a mistake of fact, it would then be important to notice that CFSIL was told that it was mistaken about the application of the Act during its meeting with APRA on 21 February 2014. It follows that, even if CFSIL did make a mistake, and if that mistake might be a defence to some contraventions, it could not be a defence after it became aware that its belief was mistaken. Yet CFSIL continued to receive default contributions that it did not attribute to an authorised MySuper product.

On the material available to me, I consider that CFSIL may have contravened section 29WA.

In respect of the transition of ADAs, it is to be remembered that the section required trustees to attribute default contributions to their MySuper product and to do so *by* 1 July 2017. In its submissions CFSIL said that 'ADA balances were not required to be transferred until 1 July 2017'.⁴⁰⁸ This submission puts unwarranted emphasis on the outer limit of the time for compliance. It implies that RSE licensees were entitled to wait until 30 June 2017 before complying. But that is a submission that does not take account of other obligations in the Act, including, among others, the trustee's covenant to act in the best interests of members. Absent reason to the contrary, and none was identified, trustees were bound to transfer ADAs promptly. CFSIL did not.

⁴⁰⁸ CFSIL and Avanteos, Module 5 Case Study Submission, 6 [16(b)].

APRA expressed concern about CFSIL's delay in transitioning certain cohorts of ADAs. I have no reason to doubt that APRA's concern was well-founded. In the circumstances, I consider that the failure to transfer at least those cohorts of ADAs identified by APRA might have breached CFSIL's covenants, including its duty to act in the best interests of the affected members, and constitute misconduct.

These matters having already been reported to APRA, it is a matter for it to decide what, if any, further action should be taken.

I also consider that the communications from CFSIL to affected members in respect of the section 29WA breach might also constitute misconduct. CFSIL rejected characterisation of the communications as 'misleading'. Ms Elkins accepted that characterisation but, in its written submissions, CFSIL argued that the communications must be considered in the context⁴⁰⁹ and were to be understood as reflecting the belief that the relevant members were 'truly "choice" members'.⁴¹⁰

CFSIL's communications to members said that the legislation had changed and that CFSIL must have an investment direction from the member. There was no relevant difference in this respect between, the telephone script and the template letter. APRA submitted that the script gives an incomplete picture of the courses of action (or inaction) open to the member.⁴¹¹ I agree. The focus of the communications was on keeping members in their existing investment option. The words used may be found to have conveyed to the member that the member was required to take steps to achieve that outcome. I consider that the communications to members might have breached CFSIL's covenant to act in their best interests. They also departed from community standards or expectations. The community expects trustees to communicate with members clearly and transparently. The script and template did not do this.

This issue has not so far been drawn to the attention of ASIC. I will refer the matter to it so it can consider whether to take action.

⁴⁰⁹ CFSIL and Avanteos, Module 5 Case Study Submission, 22 [58].

⁴¹⁰ CFSIL and Avanteos, Module 5 Case Study Submission, 5 [14].

⁴¹¹ APRA, Module 5 Case Study Submission, 11–12 [50]–[51].

2.3.2 Fees for no service

When Avanteos reported to ASIC and APRA that it had taken fees for no service, its breach notifications said that Avanteos had breached:

- Section 29E(1)(a) and 52(2)(b) of the SIS Act;
- Regulation 5.08 and 6.21 of the SIS Regulations; and
- Sections 912A(1)(a) and (c) of the Corporations Act.

Ms Elkins said that Avanteos formed the view that it had breached these provisions by way of a lack of disclosure in relevant disclosure documents.⁴¹² I consider the better view to be that, whatever may have been said or not said in disclosure documents, the charging of ASFs to deceased member accounts when CFSIL had been told that the member had died is the conduct that might constitute breach of the identified provisions. Once Avanteos knew that the member had died, it knew that no services then could be or would be provided to warrant the fee.

As Avanteos was aware of this issue from late 2015 or early 2016 and took no steps at that stage to notify ASIC or APRA, it is also likely to have been in breach of the reporting requirements of section 912D of the Corporations Act. The evidence was that Avanteos itself formed the view that it had contravened the section.⁴¹³ I see no reason to disagree with that view. The matters having been reported to the regulators, it is for them to decide what, if any, further action should be taken.

2.3.3 Grandfathering commissions

As explained earlier, two issues about grandfathering arrangements were examined in connection with CFSIL. One concerned CFSIL retaining trailing commissions charged to members who either no longer had any adviser linked to their account, or whose linked adviser was not the adviser who had initially charged the commission or fees. The other arose out of the making and subsequent disallowance of regulations that affected the application of the grandfathering provisions to commissions paid in connection with

⁴¹² Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 3 [15].

⁴¹³ Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 3 [16].

members who had joined a fund before 1 July 2014, but had elected, after that date, to receive a pension from the fund. That is, it related to commissions charged to members who had moved from ‘accumulation’ to ‘pension’ after 1 July 2014.

CFSIL did not accept that its conduct in respect of these commissions amounted to misconduct.⁴¹⁴ In respect of its own retention of commissions, CFSIL accepted that such conduct may have fallen short of community standards and expectations, but submitted that it was legally permitted to retain those because the relevant trust deed permitted it to charge fees and to use and apply those fees at its discretion upon their receipt.⁴¹⁵ In respect of the grandfathering of commissions for members switching from accumulation to pension, CFSIL submitted that it worked with the regulator to try to understand the complex regime of regulations and to act in a manner consistent with them.⁴¹⁶

Even accepting those submissions, the question remains whether a trustee acting in the best interests of its members would continue to deduct grandfathered commissions from the accounts of members in the circumstances in which CFSIL did? CFSIL’s written submissions set out six matters ‘by way of example of the complex considerations that arise in determining whether a trustee has complied [with] its duty to act in the best interests of members’.⁴¹⁷ The matters identified ranged from having regard to the superannuation context to the decision-making process. But ultimately, what the best interests covenant requires will depend on the circumstances.⁴¹⁸ CFSIL’s written submissions acknowledged this.⁴¹⁹ In the case of grandfathered commissions, it is necessary to begin by recognising not only that commission payments reduce members’ benefits, but also that no service or other benefit is provided to the member in return for the payment. Other considerations, if relevant, must be understood in the light of these facts. The deduction of commissions, and retention of them

⁴¹⁴ CFSIL and Avanteos, Module 5 Case Study Submission, 26 [69], 27 [73].

⁴¹⁵ CFSIL and Avanteos, Module 5 Case Study Submission, 27 [72].

⁴¹⁶ CFSIL and Avanteos, Module 5 Case Study Submission, 26 [69], 27 [73].

⁴¹⁷ CFSIL and Avanteos, Module 5 Case Study Submission, 17 [50(c)].

⁴¹⁸ See *Cowan v Scargill* [1985] Ch 270, 287–8; *Finch v Telstra Super Pty Ltd* (2010) 242 CLR 254, 270–1 [32]–[33].

⁴¹⁹ CFSIL and Avanteos, Module 5 Case Study Submission, 17 [50(c)].

where there is no linked adviser, even if legally permissible, was not in the best interests of members. As stated earlier, the best interests of the beneficiaries are normally their best financial interests.⁴²⁰ CFSIL did not contend that members obtained any benefit from the commissions that were deducted and retained from their accounts by CFSIL. Regarding the deduction of commissions in respect of members who switched from accumulation to pension, I consider that this also was not in the best interests of members. Again, neither CFSIL (nor any RSE licensee) sought to explain how extending the grandfathering provisions in this way, and the continued deduction of commissions from those members' accounts, would benefit members. The matter not having been reported to APRA, I will refer CFSIL's conduct in deducting commissions to APRA for its consideration of whether there is action it can and should take.

It remains for something to be said about CBA's lobbying in respect of the extension of the grandfathering provisions. In its written submissions, CFSIL accepted that in meeting with Treasury officials and others in 2013 to lobby for the extension of the grandfathering provisions in respect of members who switched from superannuation (accumulation) to pension, it may have failed to meet current community standards and expectations.⁴²¹ I agree. The community is entitled to expect that RSE licensees will not lobby for outcomes that are contrary to the financial interests of their members.

2.3.4 Misconduct in respect of distribution through CBA branches

The distribution of Essential Super through CBA branches was conduct that might have amounted to the provision of personal advice to retail clients. If it did, the requirements prescribed by division 3 of part 7.7 of the Corporations Act prescribing additional requirements for personal advice provided to a retail client were not met and the failure to meet those requirements was misconduct.

The premise for distributing Essential Super through the CBA branch network was that the product could be sold without providing personal

⁴²⁰ *Cowan v Scargill* [1985] Ch 270, 286–7.

⁴²¹ CFSIL and Avanteos, Module 5 Case Study Submission, 35 [102].

advice. The model, as initially presented to ASIC, was that branch staff would seek to create an ‘interest’ in the customer for the product. And branch staff would do this in circumstances that included, but were not limited to, completing a ‘financial health check’ designed to identify the customer’s ‘needs’. The premise for saying that a branch staff member moving from a financial health check that focused on the particular circumstances of the customer to discussing Essential Super would not be providing personal advice, was that the staff member would give the customer a ‘general advice warning’. That is, that the advice would not be ‘personal’ if the staff member told the customer ‘I can give you general advice about Simple Super ... I won’t be able to give you personal advice. You will need to decide if this product is suitable for you.’⁴²²

It may readily be accepted that the line between personal advice and general advice may not always be marked clearly or easily. But one important feature of the distinction drawn by the Corporations Act between personal advice and general advice is whether the advice has been prepared without ‘taking account of the client’s objectives, financial situation or needs’.⁴²³ Personal advice is given where the adviser has considered one or more of the person’s objectives, financial situation and needs, or a reasonable person might expect the provider to have considered one or more of those matters.⁴²⁴ The central purpose of the general advice warning that staff members were supposed to offer was to mark a boundary between what had been said and done and what was about to be said so that personal advice was not given.⁴²⁵ More precisely it was to convey to the customer that whatever you, the customer, have just told me, the staff member, is entirely irrelevant to me and will wholly be ignored by me when I tell you what I am about to say. But why would the customer believe that? Why would the customer think that, having learned about at least some aspects of the customer’s objectives, financial situation or needs, the staff member would go on to tell the customer about a product that was not suitable to whatever objectives, situation or needs had been revealed?

⁴²² Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-20 [CBA.0517.0176.2000 at .2011].

⁴²³ Corporations Act s 949A(2)(a).

⁴²⁴ Corporations Act s 766B(3).

⁴²⁵ The warning was also required by the Corporations Act, s 949A.

CFSIL's submissions acknowledged the risks in the branch sales model.⁴²⁶ It submitted, however, that it was 'utterly transparent with the regulator' about those risks⁴²⁷ and having identified them, it adopted a risk management process. CFSIL also submitted that it took immediate action to redress non-compliance identified by the mystery shopper exercises and to revise and strengthen compliance controls.⁴²⁸

While I accept that ASIC did not take issue with the distribution model before it was implemented, once ASIC had told CBA and CFSIL that it considered the law had been contravened, there could be no doubt that CBA and CFSIL had to reconsider their position. I think the better view of the evidence is that both CBA and CFSIL knew that selling superannuation in the branches was commercially desirable for both but that both also knew, from the outset, that it was legally difficult. But even if that is not right, utter transparency with the regulator, however much it is and must be applauded and encouraged, does not excuse non-compliance with the law. And I did not understand CBA or CFSIL to suggest that it did, whether in this case or more generally.

As I have noted above, ASIC told CBA in February 2017, that it suspected that branch staff employed by CBA had been providing personal advice giving rise to contraventions by CBA of a number of provisions of the Corporations Act, including sections 961B, 961K, 961L, 952C(1) and 912A(1). ASIC also told CBA that it suspected that CBA had contravened its general obligation under section 912A(1)(a). I have no reason to doubt ASIC's concerns. ASIC's concerns that **financial product** advice in connection with Essential Super was given in close proximity to a financial health check was acknowledged by CBA in the EU given to ASIC on 3 July 2018.⁴²⁹

⁴²⁶ CFSIL and Avanteos, Module 5 Case Study Submission, 30–1 [84].

⁴²⁷ CFSIL and Avanteos, Module 5 Case Study Submission, 30–1 [84].

⁴²⁸ CFSIL and Avanteos, Module 5 Case Study Submission, 31 [85]–[86].

⁴²⁹ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-34 [ASIC.0041.0001.4378 at .4382].

I consider that CBA might have breached the provisions set out above and set out in the undertaking.⁴³⁰ If it did, its conduct was misconduct. As ASIC has accepted an EU from CBA in respect of its concerns, there is now no reason to refer these matters to ASIC.

Counsel Assisting made a further contention in respect of the distribution arrangement between CBA and CFSIL. They submitted that the payments made pursuant to the Distribution Agreement may have contravened the conflicted remuneration provisions of the Corporations Act. The submission was that the benefit provided to CBA (an Australian financial services licensee) of 30% of the annual total net revenue earned by the trustee in relation to the fund could reasonably be expected to influence the financial product advice given by CBA to retail clients in the branches. Counsel Assisting further noted that:

- Customers of CBA who were offered the Essential Super product in branches were ‘retail clients’.⁴³¹
- CBA branch staff were providing ‘financial product advice’ to customers in the form of a recommendation intended to influence the client to make a decision in relation to a particular financial product (Essential Super).⁴³² ‘General advice’ is financial product advice that is not ‘personal advice’.⁴³³
- The distribution model involved general advice being provided by branch staff. This was acknowledged by Mr Chun in his evidence⁴³⁴ and by CBA in its response to ASIC’s position paper.⁴³⁵ Indeed, this was the reason why a general advice warning was necessary and why CBA staff underwent a course called ‘General Advice in Superannuation’.

⁴³⁰ The provisions acknowledged in the EU are Corporations Act ss 912A(1)(c), 946A, 961K and 961L.

⁴³¹ Corporations Act s 761G(6).

⁴³² Corporations Act s 766B(1).

⁴³³ Corporations Act s 766B(4).

⁴³⁴ Transcript, Peter Chun, 15 August 2018, 4989.

⁴³⁵ Exhibit 5.421, 17 March 2017, CBA Response to ASIC Position Paper [ASIC.0041.0001.5339 at .5345–.5346].

- The fee provided to CBA under the Distribution Agreement could reasonably be expected to influence the choice of the product recommended by branch staff to retail clients or the financial product advice given to retail clients. The Distribution Agreement was premised on this.

It was not apparent from the evidence that ASIC was told of the revenue-sharing arrangements underpinning CBA's branch sales model. Nor did ASIC provide any submissions to the Commission that might clarify its position on this topic.

CBA and CFSIL submitted that the fee arrangement in the Distribution Agreement could not reasonably be expected to influence either the choice of product recommended by CBA branch staff or the advice given.⁴³⁶ They submitted that branch staff were not 'directly' rewarded for sales of Essential Super and their incentives were determined on the basis of a balanced scorecard.⁴³⁷ They also said that the revenue-sharing arrangement was not designed to incentivise CBA to sell Essential Super, but to approximate its share of the costs.⁴³⁸ For these reasons, they submitted that the fee arrangement was not properly characterised as conflicted remuneration.⁴³⁹

It is to be remembered that the Distribution Agreement required CBA to use its branches to distribute Essential Super.⁴⁴⁰ In return for that service, and others, CBA was to receive 30% of the revenue earned by the trustee in relation to the fund in the relevant financial year. It follows that the greater the volume of sales of the product, the more revenue CBA would receive. In this way, it could reasonably be expected to influence which product branch staff were trained and told to recommend and the financial product advice given to retail clients. Indeed, it would be surprising if it did not have this effect.

⁴³⁶ CFSIL and Avanteos, Module 5 Case Study Submission, 33 [92].

⁴³⁷ CFSIL and Avanteos, Module 5 Case Study Submission, 33 [93].

⁴³⁸ CFSIL and Avanteos, Module 5 Case Study Submission, 33–4 [94].

⁴³⁹ CFSIL and Avanteos, Module 5 Case Study Submission, 34 [95].

⁴⁴⁰ Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-1 [CBA.0001.0398.3229 at .3239, .3258].

In my view, the payments to CBA may have contravened the conflicted remuneration provisions of the Act applicable to both CBA (section 963E) and CFSIL (section 963K). As these matters were not the subject of the EU provided by CBA to ASIC, and ASIC is the entity with primary responsibility for enforcement of the relevant provisions, it is appropriate that, pursuant to paragraph (a) of the Commission's Terms of Reference, I refer the conduct to ASIC for its consideration.⁴⁴¹

2.3.5 Cash investments

In its written submissions, CFSIL accepted that differences in cash investment returns are attributable to the differences in fee structures across different products.⁴⁴² It submitted that this was not a consequence of CFSIL having intentionally applied a preferential fee structure for CBA staff.⁴⁴³ Rather, it said a key reason for the difference was that commissions were payable on legacy products that it said are now closed and that, to the extent that grandfathered commissions are included in the fee, CFSIL continued to be contractually obliged to pay.⁴⁴⁴

CFSIL did not point to evidence showing that it had a contractual obligation to continue to pay grandfathered commission. However, even if that is assumed to be true, it would be surprising if CFSIL was unable to take steps to alter its commission arrangements with advisers or for legacy products. At the time of the Commission's inquiries, CFSIL had not taken those steps. Indeed, the evidence was that it had not turned its mind to it until June 2018. I repeat what I have said elsewhere in respect of commissions and grandfathering and the trustee's conduct in that regard. That is, the charging of grandfathered commissions was not in the best interests of members and there was no suggestion by CFSIL that it was.

⁴⁴¹ Corporations Act s 1315.

⁴⁴² CFSIL and Avanteos, Module 5 Case Study Submission, 12–13 [36].

⁴⁴³ CFSIL and Avanteos, Module 5 Case Study Submission, 12–13 [36].

⁴⁴⁴ CFSIL and Avanteos, Module 5 Case Study Submission, 12–13 [36].

2.3.6 Related parties

In its written submissions regarding the arrangements with Asset Management, CFSIL referred to the conflicts management framework that it applied in connection with related party transactions, the structure of its board, the use of separate teams, and disclosures in respect of related party transactions.⁴⁴⁵ It pointed to the ChantWest benchmarking report and said that this enhanced CFSIL's position in its negotiations and confirmed the need to take an arm's length approach.⁴⁴⁶ It also referred to evidence⁴⁴⁷ that CFSIL had decided to appoint other external investment managers, instead of Asset Management, after that company announced in 2018 the closure of its 'Australian equities core' and 'global resource investment' capabilities.⁴⁴⁸

In respect of CommInsure, CFSIL submitted that the suitability of CommInsure's product for members depended not only on the rate of premium charged, but also on other terms and conditions.⁴⁴⁹ Yet, even if management did consider more than premium rates, there was no evidence of the fruits of this consideration having been put before the board.⁴⁵⁰ CFSIL also pointed to evidence of discussions by the CFSIL Board about whether to continue to use CommInsure and referred to steps taken to ensure the arrangements in place with CommInsure were in members' best interests after the media reports concerning CommInsure's conduct in 2016.⁴⁵¹

Retention of a service provider is an exercise of the trustee's powers which the covenant in section 52(2)(c) of the SIS Act requires to be done in the best interests of members. In circumstances where third party reviews have revealed deficiencies in the services provided, the trustee has a duty to consider that information and, if necessary, to take steps to ensure those deficiencies are addressed. It is difficult to express a concluded

⁴⁴⁵ CFSIL and Avanteos, Module 5 Case Study Submission, 13 [41].

⁴⁴⁶ CFSIL and Avanteos, Module 5 Case Study Submission, 13 [39].

⁴⁴⁷ CFSIL and Avanteos, Module 5 Case Study Submission, 13 [40].

⁴⁴⁸ Exhibit 5.181, Witness statement of Linda Elkins, 30 July 2018, 28 [115]–[118].

⁴⁴⁹ CFSIL and Avanteos, Module 5 Case Study Submission, 14 [42].

⁴⁵⁰ Exhibit 5.438, 2 September 2016, 00 CFSIL Board Pack 020916.pdf, 6.

⁴⁵¹ CFSIL and Avanteos, Module 5 Case Study Submission, 14–15 [44]–[45].

view on the available evidence that CFSIL ought to have taken steps to terminate the contracts with Asset Management or CommInsure or that CFSIL breached any of its covenants.

2.3.7 Intra-fund advice

In relation to the conduct summarised regarding intra-fund advice and the financial adviser authorised by Financial Wisdom Limited, I am satisfied (as CSFIL accepts)⁴⁵² that CSFIL engaged in conduct that fell below community standards and expectations by failing to:

- bring to the attention of ADA members that their advisers may have had a relevant conflict of interest in relation to an election to a product from which they would continue to receive trail commissions;
- ask advisers to identify that conflict of interest in their communications with clients; and
- act sooner to investigate the relevant adviser's interactions regarding ADA members.

The conduct in relation to intra-fund advice and the financial adviser authorised by Financial Wisdom Limited demonstrates the potential adverse effect of a conflict between an adviser's interest in maintaining (or obtaining) a financial benefit and the duty to his or her client. Here, it may have led to adverse outcomes for some 1,380 clients of the relevant financial adviser. Other case studies demonstrate similar conflicts and their potential for harm. I return to this issue later in the Report.

2.3.8 Conclusion

One broad theme ran throughout each part of this case study: for each way in which the trustees' conduct was examined, their conduct appeared to be calculated to generate or retain, or weighted in favour of generating or retaining, fees from members, for the trustee's or a related party's own use, in circumstances where that generation or retention was not in members' best interests.

⁴⁵² CBA, Module 5 Case Study Submission, 41 [126]; see also, Exhibit 5.234, Witness statement of Peter Chun, 12 August 2018, 28–9 [115]–[116].

Within this theme, two points can be made.

First, the trustees' conduct points to a lack of willingness to intervene to prevent or cease conduct that is not in their members' best interests. It points to an unwillingness to recognise the seriousness of the conduct and its effects on the members of their funds. This is particularly stark when considering that consumers are unlikely to identify the conduct, or the harm that it may have caused them. In the case of those members whose contributions were not directed to a MySuper product, those members may not have been aware of that statutory requirement. And they would not know, or expect, that what they were told – by their trustee – about why they should give an investment direction was potentially inaccurate and might disadvantage them, but would advantage the financial advisers who would continue to receive commissions. And, in the case of deceased members who continued to be charged fees, the families of those members were unlikely to be in a position to realise that fees for advice to their deceased relative continued to be deducted.

Second, the regulator's response to the conduct engaged in by the trustees did not seek to address the underlying causes of the problem. Although APRA engaged with the trustees to varying degrees about their conduct, that engagement could be understood as APRA simply managing the conduct, and, in doing so, managing it on the trustees' terms, rather than requiring compliance with the standards and obligations that are imposed on those trustees under statute. The consequences of harm to members flowing from such a regulatory response are seen when considering APRA's regulatory response to the MySuper transition – a response that did not deal directly with the interests of vulnerable members: the default members.

These two points suggest that conflicts for retail trustees, and the resolution of those conflicts in favour of the interests of the retail group rather than the consumer, may be treated by trustees and regulators as unexceptional and, when they are discovered, are treated as part of the ordinary machinery of business. If that is right, it must change. Both retail trustees and regulators must regard, and demonstrate that they regard these failures as unacceptable – as reflecting a fundamental failure of the trustee to carry out its fiduciary duty to the members. If there is such a failure it must bring serious consequences for the trustees and those involved in the contraventions.

3 AMP

3.1 Background

AMP Superannuation Limited (ASL) and NM Superannuation Proprietary Limited (NM) are both within the group of companies for which AMP Limited is the ultimate holding company. The case study examined the way in which, and extent to which, ASL and NM were able to discharge their duties as trustees of their respective funds in light of their arrangements with, and membership of, the AMP Group.

3.2 Evidence

3.2.1 AMP superannuation funds

ASL and NM have common boards of directors, and the boards operate concurrently.⁴⁵³

Between them, ASL and NM are responsible for eight superannuation funds.⁴⁵⁴ At August 2018, those funds had approximately \$120 billion in funds under management.⁴⁵⁵ At the date of the hearings, this was the second largest pool of superannuation funds under management in Australia.

⁴⁵³ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 6 [25].

⁴⁵⁴ AMP, Module 5 Case Study Submission, 1 [2]. ASL is the trustee of AMP Superannuation Savings Trust (SST), AMP Retirement Trust (ART) and AMP Eligible Rollover Fund. The AMP Eligible Rollover Fund was not relevant to the case study. NM is the trustee of National Mutual Pro-Super Fund (PSD), National Mutual Retirement Fund (NMRF), Super Directions Fund (SDF), Wealth Personal Superannuation and Pension Fund (Wealth) and The Retirement Plan (TRP): Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 4 [17]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 4 [17]. The members and assets of TRP were transferred by SFT to Wealth by 30 June 2018: Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 5 [18].

⁴⁵⁵ AMP, Module 5 Case Study Submission, 1 [2].

Mr Richard Allert, the Chairman and a non-executive director of both ASL and NM,⁴⁵⁶ gave evidence to the Commission. The Commission also heard evidence from Ms Rachel Sansom, the Director of Regulatory Governance within the AMP Group. Regulatory Governance was described as the part of the AMP Group that provides trustee services to ASL and NM.⁴⁵⁷

3.2.2 Outsourcing arrangements

The trust deed of each AMP superannuation fund permits the trustee (ASL or NM) to delegate any of its powers, duties and discretions to any person.⁴⁵⁸

Both ASL and NM have made arrangements by which they delegate the day-to-day operation and administration of their funds to related parties within the AMP Group.⁴⁵⁹

⁴⁵⁶ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 2 [1]–[2]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 2 [1]–[2].

⁴⁵⁷ Regulatory Governance assists the AMP trustees to operate in compliance with their regulatory, fiduciary and licensing obligations, and also assists the Group Investment Committee: Transcript, Rachel Sansom, 16 August 2018, 5108–10; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 2 [1], 4 [15].

⁴⁵⁸ For ASL, see Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0139.0071 at .0103, cl 10.7]; Exhibit 5.268, Witness statement of Richard Allert (5-34), 1 August 2018, Exhibit RHA-3 [AMP.6000.0174.0044 at .0079, cl 10.8]. For NM, see Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0145.3402 at .3414, cl 6(e)]; [AMP.6000.0145.1891 at .1960, cl 28]; [AMP.6000.0145.2623 at .2716, cl 21.3]; [AMP.6000.0145.2998 at .3030–.3031, cl 20]; [AMP.6000.0145.3070 at .3107, cl 15].

⁴⁵⁹ AMP, Module 5 Case Study Submission, 1 [6]; Transcript, Richard Allert, 16 August 2018, 5071–2; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 5 [22]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 5 [20].

The arrangements encompass all functions and powers of the relevant trustee, from the collection of funds and the administration of the trusts, to decisions about making investment management agreements.⁴⁶⁰

ASL outsources its functions to AMP Life Limited (AMP Life).⁴⁶¹ AMP Life owns 100% of the shares in ASL.⁴⁶² In practical terms, AMP Life operates the two⁴⁶³ superannuation funds of which ASL is the trustee.

AMP Life provides, among other things, administration services,⁴⁶⁴ internal audit services,⁴⁶⁵ insurance administration services⁴⁶⁶ and investment management services.⁴⁶⁷ AMP Life is responsible for preparing product disclosure statements (PDSs) for all of the products offered through the funds of which ASL is the trustee. AMP Life prepares and distributes all new products offered by ASL. It prepares and maintains the product dashboards and other online disclosure material required to be provided by ASL.⁴⁶⁸

⁴⁶⁰ Transcript, Richard Allert, 16 August 2018, 5075; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472]; Exhibit 5.265, Witness statement of Richard Allert (5-06), Exhibit RHA-1 [AMP.6000.0125.0272]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0283]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0125.0100].

⁴⁶¹ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0156.1605].

⁴⁶² Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 6 [24(b)].

⁴⁶³ ASL is also trustee of another fund that was not relevant to the case study, the AMP Eligible Rollover Fund, which AMP Life also administers. The case study was concerned only with the trustees' regulated superannuation funds, as defined in SIS Act s 19.

⁴⁶⁴ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6515 Sched 1 cl 1.1].

⁴⁶⁵ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6521 Sched 1 cl 1.8].

⁴⁶⁶ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6523 Sched 1 cl 1.9].

⁴⁶⁷ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6493 cl 8, .6526 Sched 1 cl 2.1].

⁴⁶⁸ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6515 Sched 1 cl 1.1].

AMP Life (not ASL) is identified as the entity to be contacted on the PDS.⁴⁶⁹ AMP Life prepares any breach reports that ASL submits to the regulator.⁴⁷⁰

AMP Life has outsourced its provision of investment management services to AMP Capital Investors Limited (AMP Capital)⁴⁷¹ and some administration services to AMP Services Limited (AMP Services).⁴⁷² Both AMP Capital and AMP Services are companies within the AMP Group.

NM is the trustee of five funds. For three of those funds, NM has outsourced its functions to AMP Life.⁴⁷³ AMP Life holds 100% of the shares in NM.⁴⁷⁴

⁴⁶⁹ See, eg, the PDS of the AMP Flexible Super product of ART, a fund for which ASL is trustee: Exhibit 5.433, 8 March 2018, AFS-Fact-Sheet-Getting-to-know-your-AFS.pdf, 60.

⁴⁷⁰ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6520 Sched 1 cl 1.5(b)].

⁴⁷¹ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 42 [192]; Exhibit 5.268, Witness statement of Richard Allert (5-34), 1 August 2018, 47 [200]. This arrangement is, relevantly in respect of the MySuper products offered through the ASL funds, governed by an investment management agreement: Transcript, Richard Allert, 16 August 2018, 5072; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 27 [93]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0178.3313]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0283].

⁴⁷² Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 5 [20]. This arrangement is contained in the Master Outsourcing Agreement, and ASL also receives resources from AMP Services pursuant to the Master Resourcing Agreement: Exhibit 5.268, Witness statement of Richard Allert (5-34), 25 July 2018, Exhibit RHA-3 [AMP.6000.0125.0252].

⁴⁷³ These are SDF, NMRF and PSD. The arrangement is governed by an Administration Deed: Exhibit 5.265, Witness statement of Richard Allert (5-06), 5 [22]; Exhibit 5.265, Witness statement of Richard Allert (5-06), Exhibit RHA-1 [AMP.6000.0125.0272].

⁴⁷⁴ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 6 [26].

AMP Life has, again, in turn outsourced the investment management services for these funds to AMP Capital.⁴⁷⁵

For its two other funds, NM has outsourced its functions to NMMT Limited (NMMT).⁴⁷⁶ NMMT is another entity within the AMP Group.

The arrangements that have been described are recorded in various agreements between ASL and NM and the relevant AMP entities. But AMP's submissions proceeded from the premise that the apparent generality of those agreements must be understood in the light of the 'Fund Governance Charter' tendered in evidence.⁴⁷⁷ The legal character of this document was not explored during the hearings but, in general terms, it describes how ASL and NM are to act as trustees of their respective funds. Its overall tenor is that ASL and NM remain ultimately responsible for the sound and prudent management of their funds, and that the primary role of each is to ensure that there are appropriate governance practices in place for each fund.⁴⁷⁸

The Fund Governance Charter does no more than state what would otherwise be the legal position – that is, it adds nothing to the effect of the trustees' agreements and their obligations under legislation and the general law. Given that all of ASL's and NM's outsourcing arrangements are made only with other entities within the AMP Group, the Charter may be taken

⁴⁷⁵ Transcript, Richard Allert, 16 August 2018, 5072; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 27 [93]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0178.3313]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0283].

⁴⁷⁶ Being Wealth and TRP (before 30 June 2018). The arrangement is governed by an Agency Agreement: Transcript, Richard Allert, 16 August 2018, 5072–3; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0283]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0125.0100].

⁴⁷⁷ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0212.0001].

⁴⁷⁸ AMP, Module 5 Case Study Submission, 1–2 [6]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0212.0001 at .0005, cl 1.1]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553].

as recognition, within the AMP Group, that ASL's and NM's outsourcing arrangements do not change the position that both are ultimately responsible for their respective funds.

The Fund Governance Charter lists some matters that are reserved to the boards of ASL and NM that cannot be delegated. They include approval of the trustee's business plan, approval of amendments to the trust deeds and policies, approval of the trustee's investment policies and financial statements, and the approval of new financial products to be issued from a fund.⁴⁷⁹ But the Charter does not reserve to the boards of ASL or NM decisions about pricing of the products offered by the trustees.

3.2.3 Products offered and fees charged to members

ASL and NM each offer, or have offered, within their funds a large number of 'choice' products – as noted earlier, these are products in respect of which the member has made a choice as to their superannuation investment. Those products are variously open or closed to new members, or open to new members but restricted to employees of existing corporate plans.⁴⁸⁰

Members of ASL's and NM's respective funds are charged various fees.

A member invested in a choice product is charged direct fees against the cash balance in the member's account. Those fees appear on the member's statement as contribution fees, member fees and insurance premiums.⁴⁸¹

Choice members are also charged indirect fees, by deduction from the member's investment return before that return is credited to their account. Those indirect fees include what are described as 'other' fees – such as investment fees, administration fees and transaction cost fees (or buy–sell

⁴⁷⁹ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0212.0001 at .0022, Sched 1].

⁴⁸⁰ For a full list of the products offered by the trustees as at December 2017, see the table in Appendix 1 in Exhibit 5.289, 22 November 2017, ASL and NM Board Papers 6 December 2017, 99.

⁴⁸¹ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0213.0016 at .0021–.0022].

spread fees)⁴⁸² – as well as other indirect fees that reduce the return on the investment but are not specifically identified in the member’s statement.⁴⁸³ Some members are also charged ongoing advice fees.⁴⁸⁴

In addition to the choice products, ASL also offers two MySuper products⁴⁸⁵ and NM offers one.⁴⁸⁶ Like choice members, MySuper members are also charged direct and indirect costs. The direct costs may appear on the member’s statement as a MySuper member fee and as insurance premiums.⁴⁸⁷ Members who hold a MySuper product and a choice product are charged both a MySuper member fee, and a choice member fee.⁴⁸⁸

3.2.4 Fees under outsourcing arrangements

In general terms, the related company to which the trustee has outsourced the day-to-day administration of the fund (either AMP Life or NMMT) receives all of the amounts charged to members as fees and retains the balance after expenses. That is, AMP Life and NMMT retain the margins of ASL’s and NM’s superannuation businesses.⁴⁸⁹

⁴⁸² Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0204.2380 at .2383].

⁴⁸³ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0213.0016 at .0021–.0022].

⁴⁸⁴ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0214.0018 at .0019], [AMP.6000.0162.0225 at .0226].

⁴⁸⁵ Through ART and SST: see Exhibit 5.407, 8 June 2018, ASL NM Super Board Papers, 129.

⁴⁸⁶ Through SDF: see Exhibit 5.407, 8 June 2018, ASL NM Super Board Papers, 129.

⁴⁸⁷ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0188.0065 at .0067].

⁴⁸⁸ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0188.0065 at .0067].

⁴⁸⁹ Transcript, Richard Allert, 16 August 2018, 5079; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 104.

AMP Life receives all fees charged to members of the ASL funds in exchange for its administration services.⁴⁹⁰ For the financial year ended 30 June 2017, the fees paid to AMP Life across ASL's (relevant) funds were approximately \$253 million.⁴⁹¹

Similarly, AMP Life collects all of the fees charged to members of the three NM funds of which AMP Life is the administrator,⁴⁹² and NMMT collects the fees and charges owed by members of the two funds of which it is administrator.⁴⁹³

AMP Life pays fees to ASL and NM in consideration for them acting as trustees of their respective funds.

Under the outsourcing arrangements, AMP Life must pay ASL a 'Trustee Services Fee' in 'consideration for ASL acting as trustee' of ASL's funds.⁴⁹⁴

⁴⁹⁰ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0156.1605, cl 7.1].

⁴⁹¹ For ART, it was \$111,525,000: see Exhibit 6.486, 3 October 2017, [SIGNED] ART Financial Report 30 June 2017 Final 20170927.pdf, 15. For SST, it was \$141,390,000: see Exhibit 5.434, 3 October 2017, [SIGNED] SST Financial Report 30 June 2017 Final 20170927.pdf, 21.

⁴⁹² See the Administration Deed between NMLA and NM: Exhibit 5.265, Witness statement of Richard Allert (5-06), Exhibit RHA-1 [AMP.6000.0125.0272 at .0293, cl 8.1]. NMLA novated its rights under the Administration Deed to AMP Life on 1 January 2017: see Exhibit 5.435, 3 October 2017, [SIGNED] SDF Financial Report 30 June 2017 Final 20170927.pdf, 16.

⁴⁹³ Transcript, Richard Allert, 16 August 2018, 5076, 5080–1; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 106; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0125.0100, Annexure C, cl 1].

⁴⁹⁴ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 41 [188]; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 104–5; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6492 cl 7.1(b)]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0125.0252 at .0261, cl 5].

ASL then pays that fee to AMP Services for providing services to ASL.⁴⁹⁵ That fee is paid to AMP Services ‘to cover the costs of providing trustee services and to enable Trustee Services to execute its obligations under the trust deeds’.⁴⁹⁶ The same arrangements exist between NM and AMP Life and AMP Services.⁴⁹⁷

For the year ended 31 December 2017, AMP Life paid ASL trustee services fees of \$5.878 million, and ASL paid AMP Services fees of \$5.331 million.⁴⁹⁸ For the year ended 31 December 2017, AMP Life paid NM trustee services fees of \$1.187 million,⁴⁹⁹ and NM paid AMP Services fees of \$1.065 million.⁵⁰⁰

⁴⁹⁵ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 41 [188]; Exhibit 5.269, August 2017, Board Pack of Meeting Held on 16 August 2017, 104–5; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0125.0252 at .0262, cl 7].

⁴⁹⁶ See Exhibit 5.269, Board pack of meeting held on 16 August 2017, 4.

⁴⁹⁷ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 52 [227]; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 105–6; Exhibit 5.361, 11 December 2017, Side Letter – Fee Arrangements.

⁴⁹⁸ Exhibit 5.268, Witness statement of Richard Allert (5-15), 25 July 2018, 41 [188]. The trustee services fee paid by AMP Life to ASL is calculated on the basis of \$2.17 per member per annum, and the fee paid by ASL to AMP Services is calculated on the basis of \$1.96 per member per annum: Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 104–5; Exhibit 5.268, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0125.0252 at .0269, Sched A].

⁴⁹⁹ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 52 [227]. This fee was previously a fixed amount of \$1 million per annum, but since 1 January 2017, the amount paid by AMP Life to NM has been \$2.16 per member per annum in line with ASL: see Exhibit 5.361, 11 December 2017, Side Letter – Fee Arrangements; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 106.

⁵⁰⁰ Exhibit 5.265, Witness statement of Richard Allert (5-06), 53 [227]. This fee was previously a fixed amount of \$1.32 million per annum, but since 1 January 2017, it has been \$1.96 per member per annum in line with ASL: see Exhibit 5.361, 11 December 2017, Side Letter – Fee Arrangements; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 106.

3.2.5 Consequences of outsourcing arrangements

What were the consequences of ASL and NM delegating the day-to-day administration of their funds to other entities in the AMP Group? How did the trustees monitor what was done? How did they decide whether the members of their respective funds received value for what was paid to the other entities?

It is useful to answer those questions by first describing the general arrangements in place to monitor performance by the related entity and then considering some particular issues that emerged in connection with: performance of cash investments, performance of MySuper products, the trustees' arrangements in relation to distribution of their products, indirect costs, transition to MySuper, decisions as to pricing of the trustees' products and termination of the trustees' outsourcing arrangements.

3.2.6 Monitoring of outsourcing arrangements

The formal, and primary, way in which the trustees monitor their outsourcing arrangements is through the Business Monitoring Model (BMM).⁵⁰¹

Trustee Services

Trustee Services, an administrative and governance function within the AMP Group, is responsible for assisting the trustee boards with the day-to-day monitoring and oversight set out in the BMM.⁵⁰²

The BMM approved on 15 March 2018 said that the trustee boards' successful discharge of their obligations in relation to 'monitoring and oversight of each Trustee's business operations [relied] on successful implementation of the BMM by *Trustee Services*'.⁵⁰³

⁵⁰¹ AMP, Module 5 Case Study Submission, 3 [14]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 5 [23]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552].

⁵⁰² Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 5 [23]; Transcript, Rachel Sansom, 16 August 2018, 5109.

⁵⁰³ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553] (emphasis added).

Operation of the Business Monitoring Model

The BMM framework has a number of parts: preparation of quarterly reports, stakeholder meetings – being meetings between Trustee Services (or Regulatory Governance) and senior staff such as directors or the heads of particular departments or teams within AMP – and reporting to the board.⁵⁰⁴ More specifically, the BMM has operated as follows.

First, Trustee Services receives quarterly reports from six areas of the trustees' business operations: finance, product management, risk management and compliance, operations, investment management and insurance.⁵⁰⁵

The reports are designed so that Trustee Services receives reporting from the heads of the relevant business area on that business area's compliance with the trustees' legal and regulatory obligations and performance of contractual obligations.⁵⁰⁶ Any incidents of non-compliance are identified as 'exceptions' in the report.⁵⁰⁷ Exceptions are identified according to an exceptions framework, which contains criteria that are developed by reference to the trustees' legal and regulatory obligations, the contractual obligations of the trustees' outsourced service providers and the performance metrics under the outsourcing arrangements.⁵⁰⁸

Second, Trustee Services reviews the reports and meets with the directors or heads of the relevant business area at 'stakeholder' meetings.⁵⁰⁹

⁵⁰⁴ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 56 [247].

⁵⁰⁵ AMP, Module 5 Case Study Submission, 3 [14(a)]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0554].

⁵⁰⁶ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553–.0555].

⁵⁰⁷ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553].

⁵⁰⁸ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0556].

⁵⁰⁹ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 56 [247]; AMP, Module 5 Case Study Submission, 3 [14(b)-(c)]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

Any identified exceptions that require escalation to the trustee boards are discussed at those meetings.⁵¹⁰ The BMM does not require all exceptions to be reported to the trustee boards – only those that are agreed at the meeting as those that should be brought to their attention.⁵¹¹ The reports contain the exceptions criteria that identify an exception, and the circumstances in which an exceptions report is prepared.⁵¹²

Third, Trustee Services prepares reports for the trustee boards that, among other things, detail any exceptions that are required to be reported and any other material information that Trustee Services considers should be brought to the attention of the board.⁵¹³

Last, Trustee Services presents the report to the trustee boards.⁵¹⁴ Mr Allert said that, where an exception is identified, the ‘part of the business [responsible for the exception] comes to the board meeting and explains what has happened and what they’re doing about it’.⁵¹⁵

The BMM recognises that the AMP trustee boards need to remain ‘properly informed about the [trustees’] activities and monitor the [trustees’] affairs and policies’ to ensure that they discharge their trustee and individual director duties.⁵¹⁶ The BMM says that it is important that the reporting

⁵¹⁰ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

⁵¹¹ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

⁵¹² Exhibit 5.270, 12 August 2016, Trustee Quarterly Investment Management Report, 3; Transcript, Richard Allert, 16 August 2018, 5084.

⁵¹³ AMP, Module 5 Case Study Submission, 4 [14(e)].

⁵¹⁴ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

⁵¹⁵ Transcript, Richard Allert, 16 August 2018, 5082; see also AMP, Module 5 Case Study Submission, 4 [14(e)].

⁵¹⁶ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

structure and exceptions criteria for each business report ensure that this can be achieved.⁵¹⁷

Exceptions criteria for underperformance

One example of the exceptions criteria relevant to underperformance of the investments of the trustees was put to Mr Allert. These criteria were set out in the quarterly investment management report prepared by the AMP Investment Committee under the BMM in August 2016.⁵¹⁸

The report explained that the ‘Trustee Exceptions Criteria’ proceeded by three steps or ‘phases’: identification, further investigation of investments identified, and creation of an exceptions list. For underperformance, identification of the investment required ‘[s]ignificant underperformance against peers/benchmarks over [a] rolling 36 month period’, and the report said that an exceptions report would be issued where ‘[a]n investment option remains under investigation or on the Exceptions List for a period of 8 or more quarters’.⁵¹⁹ That is, on the face of the statement of the Exceptions Criteria, underperformance of a product could continue for five years before it would be reported to the directors of the trustees.

Mr Allert did not accept that this was the position – he said that ‘if there was something that was *really bothering* the Group Investment Committee [of AMP] ... or was bothering our trustee services representative on the [Group Investment Committee], they would alert the board to that fact’.⁵²⁰ And an exception report could be issued for ‘[a]ny matter’ regarding investment reporting that Trustee Services thought ‘should be brought to the attention of the Boards’.⁵²¹

⁵¹⁷ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

⁵¹⁸ Exhibit 5.270, 12 August 2016, Trustee Quarterly Investment Management Report, 3; Transcript, Richard Allert, 16 August 2018, 5084.

⁵¹⁹ Exhibit 5.270, 12 August 2016, Trustee Quarterly Investment Management Report, 3; Transcript, Richard Allert, 16 August 2018, 5084.

⁵²⁰ Transcript, Richard Allert, 16 August 2018, 5086–7 (emphasis added).

⁵²¹ Exhibit 5.270, 12 August 2016, Trustee Quarterly Investment Management Report, 3; Transcript, Richard Allert, 16 August 2018, 5084, 5087.

But the relevant question, not answered by what Mr Allert said about how *other* elements within AMP might respond, was whether the trustees were in a position to know whether they in fact should be ‘really bothered’ by what was happening. On the face of the exceptions reporting framework, the board would not be informed of the matter until there had been five years of significant underperformance.

3.2.7 Performance of cash investments

Evidence

In May 2018, Trustee Services reported an issue to NM’s board outside the BMM reporting framework.⁵²² Trustee Services told the board that members in the Super Directions Cash Management Trust investment option (a product offered through one of NM’s funds, the Super Directions Fund [SDF]) had received negative net returns over a three year period.⁵²³

On 1 March 2018, APRA had requested information from NM about its Super Directions Cash Management Trust investment option, as part of its targeted review of cash options to assess whether trustees were complying with the ‘reasonable expectations’ principles in Prudential Standard SPS 530: Investment Governance with respect to cash investment options.⁵²⁴ AMP discovered the negative net returns for members invested in cash when it was preparing its response to APRA’s targeted review.⁵²⁵

Member statements of members invested 90% or more in cash through the Super Directions Cash Management Trust were tendered in evidence. One statement showed that, as at 28 February 2015, a member, born in May 1960 and invested 100% in cash, received a net rate of return of 0.47%, amounting to \$381.59 after total fees of \$1,723.47 were deducted

⁵²² Transcript, Richard Allert, 16 August 2018, 5086–7, 5091.

⁵²³ AMP, Module 5 Case Study Submission, 9 [37], 10 [43]–[44]; Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 40; Transcript, Richard Allert, 16 August 2018, 5089–91.

⁵²⁴ Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

⁵²⁵ Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 40; Transcript, Richard Allert, 16 August 2018, 5090.

from the return.⁵²⁶ A further statement for that member showed that as at 28 February 2018, the member had an account balance of \$105,304.69 and after investment fees and administration fees were deducted, ended the period with an account balance reduced by \$451.12 – a net return of -0.39%.⁵²⁷

Mr Allert accepted that the member had received a negative net return.⁵²⁸ Mr Allert also accepted that a member invested in an interest bearing account with AMP Bank would have received a higher return than they would through this cash investment.⁵²⁹ When asked why a member who invests their retirement savings 100% in cash with NM achieved a substantially lower return than they would had they invested their retirement savings in an interest bearing account with AMP Bank, Mr Allert's response was that '[y]ou would have to ask the client' why they would do that; '[t]hey left the cash there knowing the return [they were] getting'.⁵³⁰ That is, the Chair of the board of the trustees treated *charging* the member for retaining the member's account wholly in cash (which was the effect of providing a negative return) as a matter wholly for the member and not a matter of concern to the trustee.

A statement from a different member, born in October 1948, showed that the member received net investment earnings of \$3.23, or an investment return of 0.02%, for the year ending 30 June 2016.⁵³¹ This member had a financial adviser, and had adviser service fees (ASFs) automatically deducted from their account each month.⁵³² Because the AMP trustees do not monitor the provision of services by the adviser to the member, the trustee could not say

⁵²⁶ Transcript, Richard Allert, 16 August 2018, 5092; Exhibit 5.272, 11 April 2015, Member Statement Super Directions for Business for Year Ended 28 February 2015.

⁵²⁷ Transcript, Richard Allert, 16 August 2018, 5093; Exhibit 5.273, 8 June 2018, Member Statement Super Directions for Business for Year Ended 28 February 2018.

⁵²⁸ Transcript, Richard Allert, 16 August 2018, 5093.

⁵²⁹ Transcript, Richard Allert, 16 August 2018, 5095.

⁵³⁰ Transcript, Richard Allert, 16 August 2018, 5095.

⁵³¹ Transcript, Rachel Sansom, 16 August 2018, 5148; Exhibit 5.294, 13 August 2018, Member Statement Super Directions for Business Year Ended 30 June 2016].

⁵³² Transcript, Rachel Sansom, 16 August 2018, 5148; Exhibit 5.294, 14 October 2016, Member Statement Super Directions for Business Year Ended 30 June 2016.

what services the adviser had provided.⁵³³ It is enough to observe that, whatever the services were, they did not yield any immediate real return to the member for this aspect of the member's investments.

AMP submitted that the issue of negative net returns affected a minority of the cash options offered by the AMP trustees, and was restricted to some cash options within two of NM's funds.⁵³⁴ But observing that the issue was confined does not mean it is unimportant to those affected or unimportant when considering the trustee's performance of duties.

In any event, the issue was not as confined as AMP had sought to characterise it. At the meeting of the trustees' boards on 25 July 2018, the boards were told that nine products across two of NM's funds had instances of negative net returns.⁵³⁵ In total, approximately 12,000 current members, with \$43,367,658 funds under management, were affected, and a total amount of approximately \$5 million was to be paid as remediation.⁵³⁶ Over the relevant period, the total number of members affected (both existing and exited members) was estimated to be 47,000.⁵³⁷ Ms Sansom said that she thought that the current members were to be remediated by reducing the administration fee 'across all cash options' applied retrospectively for three years.⁵³⁸

NM notified APRA and ASIC on 15 May 2018 that it had breached section 52(2)(b) of the SIS Act and section 912A(1)(a) of the Corporations Act by generating negative net returns to members invested in cash through the Super Directions Cash Management Trust investment option over the

⁵³³ Transcript, Rachel Sansom, 16 August 2018, 5149.

⁵³⁴ AMP, Module 5 Case Study Submission, 10–11 [45].

⁵³⁵ Transcript, Richard Allert, 16 August 2018, 5103; Exhibit 5.290, 25 July 2018, ASL and NM Board Papers, 19.

⁵³⁶ Transcript, Richard Allert, 16 August 2018, 5103; Exhibit 5.290, 25 July 2018, ASL and NM Board Papers, 19.

⁵³⁷ Exhibit 5.290, 25 July 2018, ASL and NM Board Papers, 19.

⁵³⁸ Transcript, Rachel Sansom, 16 August 2018, 5148; see also Exhibit 5.290, 25 July 2018, ASL and NM Board Papers, 19.

previous three years.⁵³⁹ As noted above, NM said in that breach report that it had identified the negative net returns while preparing its response to a request for information made by APRA on 1 March 2018 as part of APRA's targeted review of cash options.⁵⁴⁰

Since reporting the breach in relation to cash investments, NM has lowered the administration fees on products affected by the negative returns to 0.5% per annum for open products, reducing the fee from as high as 1.72% per annum, and to 0.7% per annum for mature products, reducing the fee from as high as 2.70% per annum.⁵⁴¹ Why fees had been set at the rates they were for investment in cash or cash equivalents is not immediately apparent. At least on the face of it, investment in cash or cash equivalents, when interest rates are as low and as steady as they have been in recent years, seems unlikely to need as much skill and work as some other forms of investment.

The evidence demonstrated that the poor performance of the Super Directions Cash Management Trust investment option went unnoticed by NM due to a 'gap' in reporting on investments to the trustees – that was that the reporting reflected an investment management view of performance of the investment, rather than performance of the investment from the member's perspective, net fees and costs.⁵⁴² This was explained in a report to the trustee boards in June 2018, which said 'the SDF Cash breach highlighted the broader monitoring gap that performance of the SDF cash option was not reviewed on a net return to member basis (after application of all investment, AMP product/platform and administration fees)' and the Group Investment Committee said that 'enhanced oversight of performance after product fees would be required'.⁵⁴³ I deal with the adequacy of the

⁵³⁹ AMP, Module 5 Case Study Submission, 11 [47]; Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

⁵⁴⁰ AMP, Module 5 Case Study Submission, 11 [47]; Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

⁵⁴¹ AMP, Module 5 Case Study Submission, 11 [49]; Exhibit 5.290, 25 July 2018, ASL and NM Board Papers, 22; Transcript, Richard Allert, 16 August 2018, 5094, 5096.

⁵⁴² Transcript, Richard Allert, 16 August 2018, 5089–90, 5104; Exhibit 5.407, 2 July 2018, ASL NM Super Board Papers, 107; Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 40.

⁵⁴³ Exhibit 5.407, 2 July 2018, ASL NM Super Board Papers, 107–8.

reporting on investment performance to the trustees below. It is enough to note at this point that AMP identified a 'gap' in reporting that required remedying, and a result of that gap caused NM to significantly reduce the administration fees charged to members and to lodge a breach notification with APRA and ASIC.

One other aspect of investment in cash or cash equivalents was briefly examined in evidence. It focused on the elasticity of the notion of 'cash equivalents'. Ms Sansom said in her witness statement that AMP Cash Plus and AMP Secure Cash, products of an ASL fund, were investments that comprised 'Cash/Cash Equivalent with Other Guarantee', and for which the lowest credit rating was BBB+. ⁵⁴⁴ Ms Sansom also said that AMP Capital Wholesale Cash Management Trust, which comprised 'Cash/Cash Equivalent', had a lowest credit rating of BBB-. ⁵⁴⁵ Ms Sansom explained in her statement that Cash/Cash Equivalent investment options 'will have exposures to cash/cash-like investments ... and may also hold other fixed interests securities (eg mortgage-backed securities and corporate debt)' and that 'Cash/Cash Equivalents and Other with Guarantee' comprised the same investments, but also had a guarantee. ⁵⁴⁶

Credit ratings of BBB+ and BBB- point to a level of credit risk not associated with investing in cash. They are ratings that suggest to me that the investment is not being made in cash or an instrument or asset properly described as the equivalent of cash. They are investments of a kind that may not readily be reflected by product names such as 'Cash Plus' or 'Secure Cash'.

When Ms Sansom was asked if she knew whether any decision had been made by AMP about whether it would continue to describe as 'cash' things that are not cash, her evidence was that she believed there is 'analysis and a project underway at the moment to review that', which analysis was being undertaken by AMP Capital. ⁵⁴⁷

⁵⁴⁴ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 45 [165].

⁵⁴⁵ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 45 [165].

⁵⁴⁶ Transcript, Rachel Sansom, 16 August 2018, 5147.

⁵⁴⁷ Transcript, Rachel Sansom, 16 August 2018, 5147.

It should go without saying that expressions like ‘cash equivalents’ might be used in ways that are likely to mislead or deceive. I do not say that AMP has done this. But the use of expressions such as ‘cash’ and ‘cash equivalents’ is a matter to which ASIC should consider giving close attention.

What this part of the case study showed

The 15 May 2018 breach report, in which NM notified APRA and ASIC that it had breached section 912A(1)(a) of the Corporations Act and section 52(2)(b) of the SIS Act, recorded that members in Super Directions products had received negative net returns over the preceding three years.⁵⁴⁸ The report said that APRA’s targeted review of cash options had ‘highlighted that the current monitoring processes and framework did not provide the Trustee with an adequate level of information to effectively monitor performance of the investment options at a net of fees and taxes level’.⁵⁴⁹

In its submissions AMP accepted that NM had breached section 912A(1)(a) of the Corporations Act and section 52(2)(b) of the SIS Act in relation to its monitoring of the performance of the cash investment options offered by NM.⁵⁵⁰ I see no reason to doubt that this is so. It follows, of course, that NM’s conduct amounted to misconduct as defined in the Commission’s Terms of Reference.

Counsel Assisting submitted that it was open to me to find that NM’s conduct might amount to other forms of misconduct – in particular, that NM may have breached its duty under section 52(6) of the SIS Act and obligations under SPS 530. AMP disagreed.⁵⁵¹

⁵⁴⁸ AMP, Module 5 Case Study Submission, 11 [47]; Exhibit 5.406, 15 May 2018, Breach Report.

⁵⁴⁹ Exhibit 5.406, 15 May 2018, Breach Report.

⁵⁵⁰ AMP, Module 5 Case Study Submission, 11 [47], 17 [81], 20 [91].

⁵⁵¹ AMP, Module 5 Case Study Submission, 20 [92].

Trustees have particular obligations under the SIS Act and Prudential Standards⁵⁵² with respect to investments. Section 52(6)(a) of the SIS Act requires trustees, among other things, to regularly review an investment strategy for *each investment option* offered by the trustee, having regard to the likely return from the investments,⁵⁵³ and any other relevant matters.⁵⁵⁴ Section 52(6)(b) requires trustees to exercise due diligence in developing, offering and reviewing regularly each investment option. As noted above, the breach report identified deficiencies in providing the trustee with ‘an adequate level of information to effectively monitor *performance of the investment options* at a net of fee and taxes level’.⁵⁵⁵

SPS 530 requires the board of an RSE licensee⁵⁵⁶ to monitor and assess regularly whether the investment objectives are being met,⁵⁵⁷ and to have an investment governance framework⁵⁵⁸ to manage investments so that they meet the RSE licensee’s obligations to beneficiaries.⁵⁵⁹ SPS 530 also requires an RSE licensee to determine appropriate measures, approved by the board, to monitor the performance of each investment in each investment option, and each MySuper product, on an ongoing basis.⁵⁶⁰

⁵⁵² Prudential Standards are made by APRA pursuant to SIS Act s 34C(1), and are part of the RSE licensee law: see the par (aa) of the definition of ‘RSE licensee law’ in SIS Act s 10(1). Section 29E(1)(a) imposes a condition on all RSE licensees that they must comply with the RSE licensee law.

⁵⁵³ See SIS Act s 52(6)(a)(i).

⁵⁵⁴ See SIS Act s 52(6)(a)(viii).

⁵⁵⁵ Exhibit 5.406, 15 May 2018, Breach Report (emphasis added).

⁵⁵⁶ For the purposes of Prudential Standard SPS 530, ‘RSE licensee’ has the meaning given in SIS Act s 10(1).

⁵⁵⁷ APRA, Prudential Standard SPS 530, 15 November 2012, [6(c)].

⁵⁵⁸ SPS 530 describes an investment governance framework as the totality of systems, structures, policies, processes and people to address the RSE licensee’s responsibilities with regard to investments of each RSE (fund) within the RSE licensee’s business operations, which includes generating returns to meet investment objectives while managing and monitoring all identified sources of investment risk: see APRA, Prudential Standard SPS 530, 15 November 2012 [9].

⁵⁵⁹ APRA, Prudential Standard SPS 530, 15 November 2012, [8].

⁵⁶⁰ APRA, Prudential Standard, SPS 530, 15 November 2012, [24].

AMP submitted that it was not open to me to find that NM may have breached section 52(6) of the SIS Act or SPS 530 in generating a negative return on cash investments.⁵⁶¹ AMP submitted that there was no evidence that the AMP trustees failed to formulate, review regularly and give effect to an appropriate investment strategy for their *funds*.⁵⁶²

I am unpersuaded by AMP's submissions for the following reasons.

First, as has been noted above, NM's report identified that the monitoring processes and framework of NM did not provide it with an adequate level of information to effectively monitor performance of the investment options at a net of fee and taxes level.⁵⁶³ It said that 'reporting and monitoring at the member level at a net of fees and taxes position was not being performed'.⁵⁶⁴ Mr Allert⁵⁶⁵ and Ms Sansom⁵⁶⁶ reiterated this in their evidence. So did AMP in its submissions.⁵⁶⁷

Second, the breach report proposed that, as part of the rectification of the incident, 'more appropriate reporting and processes in respect of all investment options available to all members will be established to ensure that the requirements of SPS 530 will be met going forward'.⁵⁶⁸ This was consistent with information considered by the board on 14 May 2018,⁵⁶⁹ and the change to the reporting was confirmed by Mr Allert in his evidence.⁵⁷⁰

Third, AMP's submission directs attention to the investment strategy of the fund as a whole. But section 52(6)(a) expressly distinguishes between the investment strategy 'for the whole of the entity' and the investment strategy

⁵⁶¹ AMP, Module 5 Case Study Submission, 20 [92].

⁵⁶² AMP, Module 5 Case Study Submission, 20 [92]; see also 8 [30].

⁵⁶³ Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

⁵⁶⁴ Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

⁵⁶⁵ Transcript, Richard Allert, 16 August 2018, 5089–90.

⁵⁶⁶ Transcript, Rachel Sansom, 16 August 2018, 5132.

⁵⁶⁷ AMP, Module 5 Case Study Submission, 11 [46], 17 [81].

⁵⁶⁸ Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

⁵⁶⁹ Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 41.

⁵⁷⁰ Transcript, Richard Allert, 16 August 2018, 5090–1.

‘for each investment option offered by the trustee in the entity’ and section 52(6)(b) expressly requires regular review of ‘each investment option’.

SPS 530 complements the obligation in section 52(6) by requiring measures to be established for ongoing monitoring of the performance of the investment.

Contrary to AMP’s submissions, I consider that NM may have breached its obligations under section 52(6)(a) and (b) and SPS 530. The matter having already been reported to the regulators, it is a matter for them to decide what, if any, further action should be taken.

3.2.8 Performance of MySuper products

Evidence

NM’s decision to reduce the administration fees in respect of its cash investments was not prompted solely by the negative net returns on cash investments. The decision was also a result of APRA identifying in October 2017 that MySuper products offered by ASL and NM had high costs per member relative to other MySuper products, as well as continued net cash outflows.⁵⁷¹

On 25 July 2018, the administration fees of the AMP trustees’ generic MySuper products⁵⁷² were halved to 0.29%.⁵⁷³ In its submission AMP described these reductions as ‘very significant’.⁵⁷⁴ A memorandum considered by the AMP trustee boards on 25 July 2018 said that the proposed changes would move the pricing from Quartile 4 to Quartile 3, and that ‘the proposed pricing change [would] deliver an immediate and ongoing improvement in outcomes for ~700k members’, with the price reductions

⁵⁷¹ Transcript, Richard Allert, 16 August 2018, 5097; Exhibit 5.274, 16 October 2017, Letter from APRA to Sansom and Allert.

⁵⁷² For the SDF and SST generic options, and the choice lifecycle option in ART: AMP, Module 5 Case Study Submission, 13 [59].

⁵⁷³ AMP, Module 5 Case Study Submission, 13 [59].

⁵⁷⁴ AMP, Module 5 Case Study Submission, 13 [59].

being ‘borne by the AMP Shareholder in the form of reduced revenue from fees’.⁵⁷⁵

The fee reductions in July 2018 were the first time that changes had been made to the pricing of the AMP trustees’ MySuper products since they were initially approved by APRA in 2013.⁵⁷⁶ However, Ms Sansom said that she had held the view for ‘[q]uite some time’ that fees should be reduced.⁵⁷⁷ Ms Sansom said that she had advocated for the change to pricing throughout 2017, but that any change in fees was dependent on the AMP Product Team’s view.⁵⁷⁸

Ms Sansom had noticed poor performance in the AMP trustees’ MySuper products in September 2016, and the issue was raised then with the AMP trustee boards.⁵⁷⁹ At that time, two of the AMP trustees’ MySuper products were reported in a news article as being the second and third poorest performing products for the 2016 financial year.⁵⁸⁰

The same ‘gap’ in reporting of investment performance identified above (in connection with the negative net returns on cash investments) was identified by AMP Investment Regulatory Governance in April 2017 in respect of reporting of investment performance of the AMP trustees’ MySuper products.⁵⁸¹

⁵⁷⁵ Exhibit 5.275, 8 July 2018, ASL and NM Super Board Papers for meeting of 25 July 2018, 14.

⁵⁷⁶ Exhibit 5.275, 8 July 2018, ASL and NM Super Board Papers for meeting of 25 July 2018, 9; Transcript, Rachel Sansom, 16 August 2018, 5113.

⁵⁷⁷ Transcript, Rachel Sansom, 16 August 2018, 5140.

⁵⁷⁸ Transcript, Rachel Sansom, 16 August 2018, 5140.

⁵⁷⁹ Transcript, Richard Allert, 16 August 2018, 5088; Transcript, Rachel Sansom, 16 August 2018, 5131–2; Exhibit 5.286, 19 September 2016, Board Papers AMP Super and NM Super for Meeting of 20 September 2016, 359.

⁵⁸⁰ Transcript, Richard Allert, 16 August 2018, 5088; Transcript, Rachel Sansom, 16 August 2018, 5131–2; Exhibit 5.286, 19 September 2016, Board Papers AMP Super and NM Super for Meeting of 20 September 2016, 359.

⁵⁸¹ Transcript, Rachel Sansom, 16 August 2018, 5132.

This was recorded in a memorandum prepared by AMP Investment Regulatory Governance for Trustee Services (along with Superannuation Retirement and Investment Platforms, Corporate Super, and AMP Capital) dated 3 April 2017.⁵⁸² The memorandum contrasted APRA's reporting methodology, which 'focuse[d] on the *net* member experience by incorporating all fees and taxes that apply', with AMP Capital's reporting, which reported performance 'on a *gross* basis (before fees and taxes)'.⁵⁸³ The memorandum said that, given the 'gross investment performance lens ... ignores the impact of fees, costs and taxes, the investment updates have not addressed the "net member experience" aspect of MySuper performance'.⁵⁸⁴ The memorandum ranked the AMP trustees' products in comparison to those of their competitors, recording that, for example, one product ranked 26 out of 29 for administration fees and costs and 23 out of 29 for net returns to members, and another ranked 59 out of 63 on administration fees and costs and 49 out of 63 for net returns to members.⁵⁸⁵

Neither Ms Sansom, nor anyone else, reported the results of the April 2017 memorandum to the AMP trustee boards.⁵⁸⁶ There was no evidence that any changes were made to investment performance reporting to the AMP trustee boards at this time.

The third and fourth annual MySuper scale assessments, performed in November 2016 and November 2017 respectively, identified that the AMP

⁵⁸² Exhibit 5.287, 3 April 2017, Memorandum 3 April 2017 from AMP Investment Regulatory Governance Concerning MySuper Performance Measurement.

⁵⁸³ Exhibit 5.287, 3 April 2017, Memorandum 3 April 2017 from AMP Investment Regulatory Governance Concerning MySuper Performance Measurement, 2 (emphasis in original).

⁵⁸⁴ Exhibit 5.287, 3 April 2017, Memorandum 3 April 2017 from AMP Investment Regulatory Governance Concerning MySuper Performance Measurement, 2.

⁵⁸⁵ Transcript, Rachel Sansom, 16 August 2018, 5134; Exhibit 5.287, 3 April 2017, Memorandum 3 April 2017 from AMP Investment Regulatory Governance Concerning MySuper Performance Measurement, 7.

⁵⁸⁶ Transcript, Rachel Sansom, 16 August 2018, 5135.

trustees' generic MySuper products were 'below median' or in the 'bottom quartile' when fees were considered.⁵⁸⁷

What this part of the case study showed

Section 29VN(a) of the SIS Act obliges the trustee of a regulated superannuation fund that includes a MySuper product to promote the financial interests of the beneficiaries of the fund who hold the MySuper product, in particular the returns to those beneficiaries (after the deduction of fees, cost and taxes).

The Explanatory Memorandum to the Bill for the Act that inserted section 29VN said that the requirement to promote the financial interests of MySuper members:⁵⁸⁸

heightens the obligations trustees owe to members of a MySuper product reflecting that members of a MySuper product have effectively delegated the responsibility for making decisions regarding their superannuation to the trustee. This requires a trustee to make informed judgments regarding the MySuper product, for example in relation to the composition of assets in the investment strategy, so that it secures the best financial outcome for these beneficiaries.

The Memorandum expected that section 29VN would 'lift the standard required of trustees'.⁵⁸⁹

Counsel Assisting submitted that it was open to me to find that ASL and NM may each have breached section 29VN(a) to promote the financial interests of their MySuper members. AMP submitted that such a finding was not open. AMP said that the evidence showed that the AMP trustees have consistently advocated for the financial interests of the MySuper members,

⁵⁸⁷ Exhibit 5.408, 6 December 2016, ASL and NM Super Board Papers, 128–36; Transcript, Rachel Sansom, 16 August 2018, 5138; Exhibit 5.289, 30 November 2017, ASL and NM Board Papers 6 December 2017, 67, 69.

⁵⁸⁸ Explanatory Memorandum, Superannuation Legislation Amendment (Trustees Obligations and Prudential Standards) Bill 2012 (Cth), 13 [1.16].

⁵⁸⁹ Explanatory Memorandum, Superannuation Legislation Amendment (Trustees Obligations and Prudential Standards) Bill 2012 (Cth) at 13 [1.17].

including to improve the outcomes of members in the generic MySuper products 'by securing a significant reduction in fees'.⁵⁹⁰

There are two problems with AMP's submission.

First, the evidence did not support AMP's submission. There was no evidence that, before the MySuper fees were reduced in July 2018, the *boards* of either ASL or NM had ever advocated for the financial interests of *MySuper members*.⁵⁹¹ The highest that AMP's evidence rose was Ms Sansom's. She said that *she* had held the view that fees were too high and that *she* had advocated since 2017 for lower fees but that lowering the fees was ultimately a matter for the AMP Product Team.⁵⁹²

AMP relied on the July 2018 reduction in fees as supporting its position. That reduction was made after APRA had identified, in October 2017, the high costs to members of AMP superannuation funds who held MySuper products. And the reduction pertained to the reduction in fees brought about by the negative net returns over a three year period to members who were invested in NM's Super Directions Cash Management Trust cash investment option.

The third and fourth annual MySuper scale assessments, performed in 2016 and 2017 to satisfy the trustees' obligations under section 29VN(b) of the SIS Act, had identified that ASL's and NM's MySuper products were 'below median' or in the 'bottom quartile' of fund performance when fees were taken into account.⁵⁹³ There is no evidence that any step was taken by the AMP trustees at or around those times to inquire into, or to address, the effect of fees on net performance.

⁵⁹⁰ AMP, Module 5 Case Study Submission, 20 [93].

⁵⁹¹ AMP, Module 5 Case Study Submission, 13 [58], 18 [80]. In respect of the trustee boards, AMP references Transcript, Richard Allert, 16 August 2018, 5103 as evidence that the 'Trustees continued to advocate for the fees to be lowered in the interests of members'. This is a reference to Mr Allert's evidence that he had advocated for the fees to be reduced and compensation to be paid to those members invested in cash who received a negative net return over the last three years – not MySuper members.

⁵⁹² Transcript, Rachel Sansom, 16 August 2018, 5140.

⁵⁹³ Exhibit 5.408, 6 December 2016, ASL and NM Super Board Papers, 128–36; Transcript, Rachel Sansom, 16 August 2018, 5138; Exhibit 5.289, 30 November 2017, ASL and NM Board Papers 6 December 2017, 67, 69.

No step was taken by the AMP trustees to address the effect of fees on performance until, following the identification of the negative net returns on cash investments, Trustee Services brought to the boards' attention, in May 2018, the gap in reporting that underpinned the later breach reports to APRA and ASIC.⁵⁹⁴ As I noted earlier, the trustees identified this issue because they were prompted by APRA and the work required by APRA's targeted review.

The second problem with AMP's submission is that it reduces to meaningless the obligation imposed upon the AMP trustees by section 29VN(a) to promote the financial interests of the MySuper members. On AMP's approach, the AMP trustees satisfied their obligations by Ms Sansom advocating for reduced fees in 2017. But, as Ms Sansom acknowledged, changes to fees were out of her (and the trustees') hands. Any changes were a matter for AMP's Product team. It was only in July 2018, in response to APRA's enquiries and in the midst of this Royal Commission, that fees were lowered to competitive levels. Yet AMP says that the response was sufficient for the AMP trustees to have discharged their duties. That cannot be correct. If anything, the lowering of fees in the circumstances described points to the trustees having failed, until then, to promote the financial interests of its members in satisfaction of section 29VN(a).

Ms Sansom said that the reporting to the AMP trustees about the 'net member experience' through the MySuper scale assessments is currently being strengthened.⁵⁹⁵ AMP submitted that Trustee Services and the Group Investment Committee are working with the Product Management team to establish investment reporting to the AMP trustees that is net of fees and taxes.⁵⁹⁶ If this is right, and I have no reason to doubt it, it follows that at the time the Commission took evidence about these matters, and at the time of AMP's submissions to the Commission in August 2018, investment performance reporting to the AMP trustees still did not sufficiently report investment performance net of fees and taxes.

⁵⁹⁴ Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 41; see also Exhibit 5.407, 8 June 2018, ASL and NM Super Board Papers, 107–8.

⁵⁹⁵ Transcript, Rachel Sansom, 16 August 2018, 5141–2.

⁵⁹⁶ AMP, Module 5 Case Study Submission, 11 [51].

It follows that since at least the third MySuper scale determination performed in 2016, ASL and NM may not have complied with section 29VN(a). And failing to comply with that obligation would evidently be misconduct. Under section 29VP of the SIS Act, contravention of section 29VN, though prohibited by section 29VP(1), is not an offence⁵⁹⁷ but persons who suffer loss or damage as a result of the contravention may recover that loss or damage from the contravener and from any person involved in the contravention.⁵⁹⁸

3.2.9 Distribution of trustees' products

Evidence

The BMM approved on 15 March 2018 stated that '[n]o standalone BMM is required from any Advice/Distribution area as financial planners do not directly undertake activities on behalf of' the AMP trustees.⁵⁹⁹ The BMM also said that, given the 'nature of the services that advisers provide to members as well as the importance of effective distribution of the [AMP trustees'] products', the AMP trustees were to receive reporting about advice and distribution through Product and Risk and Compliance reports.⁶⁰⁰

Ms Sansom said that, because of the trustees' outsourcing arrangements, effective distribution of superannuation products is a responsibility of AMP Life: the AMP trustees rely on the terms of their outsourcing arrangements and the measures in place within AMP to oversee distribution.⁶⁰¹

⁵⁹⁷ SIS Act s 29VP(2).

⁵⁹⁸ SIS Act s 29VP(3).

⁵⁹⁹ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53 [207]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0554].

⁶⁰⁰ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53 [207]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0554].

⁶⁰¹ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53–4 [208].

APRA undertook a review of the BMM in March 2017.⁶⁰² APRA identified as part of that review that the BMM does not provide the AMP trustees with ‘visibility of the advisers who direct members to invest in their superannuation products or [advise] whether the strategies for members are appropriate’.⁶⁰³ Ms Sansom’s evidence was that, in response to that review, the AMP Advice licensees ensured that AMP ‘Enterprise Risk Management’ (ERM) distribution reports, and risk reporting by AMP Advice, would be made available to Trustee Services, and that commentary related to distribution risk would be included in ERM’s regular BMM reporting to Trustee Services.⁶⁰⁴

APRA considered the issue of the trustees’ visibility over distribution closed on 30 January 2018.⁶⁰⁵ However, Ms Sansom’s evidence was that the AMP trustees considered that further improvements could be made.⁶⁰⁶ A review of the BMM completed in June 2018 showed that there was a need for more direct oversight of advice related activities.⁶⁰⁷ AMP acknowledged in its submissions that the AMP trustees’ monitoring through the BMM of distribution of their products through financial advisers was being, and had recently been, strengthened.⁶⁰⁸

In particular, as noted above, Trustee Services now receives risk reporting about the AMP Advice business through the BMM.⁶⁰⁹ Further, in May 2018, the trustee boards requested that a senior executive in AMP Advice provide them with direct reporting, and the reporting model for this is being

⁶⁰² Exhibit 5.291, 7 April 2017, Letter from APRA to Sansom, 3, 5.

⁶⁰³ Transcript, Rachel Sansom, 16 August 2018, 5142; Exhibit 5.291, 7 April 2017, Letter from APRA to Sansom.

⁶⁰⁴ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [209].

⁶⁰⁵ Exhibit 5.410, 30 January 2018, Email from APRA to AMP; Exhibit 5.411, 30 January 2018, Letter from APRA to AMP.

⁶⁰⁶ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53 [205].

⁶⁰⁷ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [211].

⁶⁰⁸ AMP, Module 5 Case Study Submission, 5 [15].

⁶⁰⁹ AMP, Module 5 Case Study Submission, 2 [9]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [209].

developed.⁶¹⁰ The trustees also requested more oversight through the BMM of open incidents and reported breaches.⁶¹¹

The timing of these requests should be noted. They followed evidence heard in the second round of the Commission's hearings.⁶¹² During those hearings, the Commission heard evidence that the conduct within the AMP Advice business of charging ongoing service fees to members in circumstances where those services could not be provided appeared, to at least some extent, to have been intentional.

ASL and NM had not been aware of, or told by AMP about, any *intentional* aspect of the conduct until they heard AMP's evidence during the Round 2 hearings.⁶¹³ Until then, the AMP trustees had been aware of the conduct to the extent that ASIC and APRA had been told it was due to an 'administration error'.⁶¹⁴ The AMP trustees were named as the 'AMP Product Issuers' on the breach notification given to APRA and ASIC on 27 May 2015.⁶¹⁵

On 8 June 2018, in response to the trustee boards' request in May 2018, ASL and NM were provided with information about the current open incidents recorded in the incident management system that affected the trustees.⁶¹⁶ One of those incidents was the charging of planner servicing

⁶¹⁰ AMP, Module 5 Case Study Submission, 5 [15]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [210].

⁶¹¹ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [210].

⁶¹² Transcript, Rachel Sansom, 16 August 2018, 5143.

⁶¹³ Transcript, Rachel Sansom, 16 August 2018, 5143.

⁶¹⁴ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [212]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0051.0612].

⁶¹⁵ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [212]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0051.0612].

⁶¹⁶ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53 [204]; Exhibit 5.407, 8 June 2018, ASL NM Super Board Papers, 220–1.

fees where they should not have been charged.⁶¹⁷ This incident was discovered within the AMP Advice business on 26 July 2017, and at that time it was thought to have affected 553 members with total fees of \$76,113.50.⁶¹⁸ The Advice Breach Committee did not determine the incident to be a reportable breach.⁶¹⁹ This incident would not have otherwise been brought to the attention of the trustee boards as it did not qualify as an exception under the BMM – to do so, the compensation would have had to have exceeded \$100,000.⁶²⁰ The information provided to the trustee boards in June 2018 indicates that, as at 17 May 2018, the incident had not been resolved, nor had the number of members affected been ascertained.⁶²¹

Separate from, but similar to, this incident, ASL notified APRA and ASIC on 26 June 2018 that it had breached sections 912A(1)(a) and 1017D of the Corporations Act by continuing to charge PSFs in circumstances where they should not have been charged.⁶²² ASL provided an estimate that approximately 6,300 members were affected with an ‘initial financial impact’ of approximately \$1 million.⁶²³

What this part of the case study showed

The ASL and NM Boards have had little reporting and monitoring through the BMM about issues with the distribution of their products. That is because, as Ms Sansom said, AMP Life is responsible for the distribution

⁶¹⁷ Transcript, Rachel Sansom, 16 August 2018, 5145; Exhibit 5.293, 28 August 2017, Licensee Incidents Panel Agenda.

⁶¹⁸ Exhibit 5.412, 9 November 2017, Licensee Incidents Panel – Meeting Agenda, 4; Exhibit 5.413, 9 November 2017, Licensee Incidents Panel – Meeting Minutes.

⁶¹⁹ Exhibit 5.412, 9 November 2017, Licensee Incidents Panel – Meeting Agenda, 4; Exhibit 5.413, 9 November 2017, Licensee Incidents Panel – Meeting Minutes.

⁶²⁰ Exhibit 5.407, 8 June 2018, ASL and NM Super Board Papers, 221; Transcript, Rachel Sansom, 16 August 2018, 5145.

⁶²¹ Exhibit 5.407, 8 June 2018, ASL and NM Super Board Papers, 215.

⁶²² Exhibit 5.292, 26 June 2018, AMP Superannuation Breach Report.

⁶²³ Exhibit 5.292, 26 June 2018, AMP Superannuation Breach Report.

of the trustees' products, and the trustees rely on their outsourcing arrangements and the measures within AMP to oversee distribution.⁶²⁴

However, following the second round of the Commission's hearings, the trustee boards requested that they be provided with a list of the open incidents within AMP that affected the trustees.⁶²⁵ The list provided to the trustees, at their June 2018 board meeting, revealed that there were many open incidents that had not been reported as an exception to the boards including, in some cases, where the incident had been reported to the regulator. Presumably it was possible for an incident to be reported to the regulator without it also being reported to the trustees because under the outsourcing arrangements, AMP Life prepares breach reports to the regulator.⁶²⁶

An example provided in the list at the June 2018 meeting, which had not been reported to the trustees through the BMM, was an open incident where MySuper members had been charged PSFs after 1 January 2014 contrary to legislative requirements.⁶²⁷ AMP Advice attributed this to a systems error in that 'the appropriate systems did not correctly reflect the rules following FoFA changes as at 1 July 2014'.⁶²⁸ AMP Advice identified in July 2017 that this incident affected approximately 553 members with total fees charged of \$76,113.⁶²⁹ AMP Advice considered that this incident was a breach, but not a significant or reportable breach, based on the circumstances including the number of affected members.⁶³⁰ However, by the time the trustees were

⁶²⁴ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53–4 [208].

⁶²⁵ Exhibit 5.407, 8 June 2018, ASL and NM Super Board Papers, 221.

⁶²⁶ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6520, Sched 1 cl 1.5(b)].

⁶²⁷ SIS Act s 29SAC charging fees deemed to be conflicted remuneration on MySuper products.

⁶²⁸ Exhibit 5.412, 9 November 2017, Licensee Incidents Panel – Meeting Agenda, 3.

⁶²⁹ Exhibit 5.412, 9 November 2017, Licensee Incidents Panel – Meeting Agenda, 3; Exhibit 5.413, 9 November 2017, Licensee Incidents Panel – Meeting Minutes.

⁶³⁰ Exhibit 5.412, 9 November 2017, Licensee Incidents Panel – Meeting Agenda, 4; Exhibit 5.413, 9 November 2017, Licensee Incidents Panel – Meeting Minutes.

given information about this incident, based on information as at May 2018, the number of customers affected by this incident was still ‘TBC’.⁶³¹

This incident was similar to a separate incident that was reported to APRA and ASIC on 26 June 2018 – ASL told the regulators that it had breached sections 912A(1)(a) and 1017D of the Corporations Act by continuing to charge PSFs to employees who had ‘delinked’ from their employer plan post-1 January 2014.⁶³² But just like the incident described above, those members were being charged PSFs contrary to legislative requirements. AMP also attributed the incident to a systems issue – it said in the breach report that ‘the product administration system has continued to charge the [fee] to delinked members ... contrary to product rules set in place in June 2014’.⁶³³ The breach report estimated about 6,300 AMP Flexible Super members were affected, and that the amount involved was \$1 million.⁶³⁴ This incident had not been reported to the trustees through the BMM by the time the breach report was made.

These incidents show three ways in which the trustees’ visibility and monitoring of distribution of their products was inadequate.

First, even at May 2018, the level of reporting that the trustees received through the BMM did not capture all incidents in which members were being charged fees incorrectly and contrary to the law.

Second, the two incidents were both cases where AMP Advice charged or allowed the charging of fees to the trustees’ members in circumstances where they should not have been charged. Yet the trustees were not aware of this and apparently had no way of monitoring the charging of fees to members.

Third, the trustees only asked to be provided with information about the open incidents after the evidence given at to the Commission in April 2018.

⁶³¹ Exhibit 5.407, 8 June 2018, ASL and NM Super Board Papers, 222.

⁶³² Exhibit 5.292, 26 June 2018, AMP Superannuation Breach Report.

⁶³³ Exhibit 5.292, 26 June 2018, AMP Superannuation Breach Report.

⁶³⁴ Exhibit 5.292, 26 June 2018, AMP Superannuation Breach Report.

This is so even though APRA identified as early as April 2017 that the trustees did not have adequate oversight of distribution of their products.⁶³⁵

The trustees accepted there were ‘opportunities for enhancement of their oversight of distribution of their products’ and said that they were ‘taking steps to do so’.⁶³⁶ I agree that the trustee boards do not have a level of oversight over distribution of their products that would be reasonably expected of trustees with the number of members and funds under management as the AMP trustees. But this is not a recent revelation to the trustee boards. APRA alerted them to the danger last year but they had not recognised it themselves and did not move swiftly to address it.

3.2.10 Performance of investments and indirect costs

Evidence

AMP trustees do not know the indirect costs charged to members beyond what they are told by AMP Life or AMP Capital.⁶³⁷ Ms Sansom said that ‘the level of monitoring [done by Trustee Services] would not pick up’ those costs.⁶³⁸

Two recent ‘incidents’ highlighted the trustees’ lack of knowledge of the indirect fees charged to members.

AMP referred to the first incident as the ‘Expense Recovery Incident’. It happened because AMP Capital recovered expenses, such as fund services expenses, at a fund level and charged fees on a pro-rata basis, rather than recovering fees from the relevant members’ investment options.⁶³⁹ AMP Capital had been recovering these expenses pursuant to an

⁶³⁵ Transcript, Rachel Sansom, 16 August 2018, 5142; Exhibit 5.291, 7 April 2017, Letter from APRA to Sansom.

⁶³⁶ AMP, Module 5 Case Study Submission, 19 [88].

⁶³⁷ Transcript, Rachel Sansom, 16 August 2018, 5151.

⁶³⁸ Transcript, Rachel Sansom, 16 August 2018, 5152.

⁶³⁹ Transcript, Rachel Sansom, 16 August 2018, 5150; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 57 [220].

‘expense recovery project’, clarifying which expenses it was permitted charge under the terms of the relevant agreements with AMP Life.⁶⁴⁰

Ms Sansom said that the expense recovery project was not intended to affect other AMP Group entities, and so there was no report to the AMP trustees in respect of it.⁶⁴¹ This is so even though the Expense Recovery Incident ultimately affected 31 of the trustees’ products (being products offered through one fund of NM, and each of the funds of ASL).⁶⁴² Nor was any report made about the project to the board of AMP Capital or any other AMP Group entity.⁶⁴³

The second incident was referred to by AMP as the ‘Fee Rebate Incident’. It happened because AMP Capital charged its investment management fee in respect of external direct property and infrastructure funds in circumstances where the fees should have been rebated to the member.⁶⁴⁴

The trustees’ members were among those affected by the incorrect fees charged by AMP Capital in respect of both the Expense Recovery Incident and the Fee Rebate Incident.⁶⁴⁵ Ms Sansom estimated that the value of the fees incorrectly deducted for the Expense Recovery Incident is approximately \$1 per member, and an aggregate amount of \$3 million to \$3.5 million.⁶⁴⁶ For the Fee Rebate Incident, Ms Sansom estimated that the value of the fees incorrectly charged is approximately \$6 to \$8 per member, with approximately 3 million to 4 million members affected,

⁶⁴⁰ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 58 [222].

⁶⁴¹ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 58 [222].

⁶⁴² Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 58 [221].

⁶⁴³ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 58 [222].

⁶⁴⁴ Transcript, Rachel Sansom, 16 August 2018, 5150; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 60 [236].

⁶⁴⁵ Note that not all of the products affected were the AMP trustees’ super products – AMP Life products, which were not held by the AMP trustees’ members, were also affected: see Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 59 [228], 60 [238].

⁶⁴⁶ Transcript, Rachel Sansom, 16 August 2018, 5150; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 59 [228].

and an aggregate amount of more than \$23 million provisioned for remediation.⁶⁴⁷ The amounts to be remediated include the ‘amount wrongly charged plus the impact on performance’.⁶⁴⁸

The Expense Recovery Incident could be traced back to 2014.⁶⁴⁹ AMP Capital became aware of the Incident in August 2017 and reported it to ASIC⁶⁵⁰ – at that time, AMP Capital had understood that it did not affect superannuation members.⁶⁵¹ It was not clear when the issue was subsequently identified by AMP Capital as extending to superannuation products.⁶⁵² The Fee Rebate Incident likely existed since fund inception or when the funds held direct property or infrastructure funds for the first time, which was estimated to be between four and at least 10 years, depending on the fund.⁶⁵³ AMP Capital reported the Fee Rebate Incident to ASIC as a potentially significant breach on 22 March 2018.⁶⁵⁴

The two incidents were revealed to ASL and NM only because of analysis done so that they could comply with ASIC’s new Regulatory Guide 97. ASL and NM were required by the new Regulatory Guide to disclose those fees, which had previously been undisclosed, charged to the return on the investment.⁶⁵⁵

What this part of the case study showed

Where a trustee engages an investment manager to manage the investments of the fund, section 102(1) of the SIS Act obliges the trustee, among other things, to have in place an agreement that enables the trustee

⁶⁴⁷ Transcript, Rachel Sansom, 16 August 2018, 5150; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 60 [237], 61 [239].

⁶⁴⁸ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 59 [228], 60 [237].

⁶⁴⁹ Transcript, Rachel Sansom, 16 August 2018, 5152.

⁶⁵⁰ Transcript, Rachel Sansom, 16 August 2018, 5151; Exhibit 5.295, 3 August 2017, AMP Capital Breach Notice to ASIC.

⁶⁵¹ Transcript, Rachel Sansom, 16 August 2018, 5151.

⁶⁵² Transcript, Rachel Sansom, 16 August 2018, 5151.

⁶⁵³ Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 36.

⁶⁵⁴ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 62 [241].

⁶⁵⁵ Transcript, Rachel Sansom, 16 August 2018, 5151–2.

to require the investment manager to provide information wherever it is necessary or desirable to do so.⁶⁵⁶ Such information may include that related to the making of, and return on, the investments.⁶⁵⁷

The directors of the AMP trustees use a ‘directors’ roadmap’ to assist them to monitor their obligations, including their obligations under the SIS Act.⁶⁵⁸ The roadmap says that the duty imposed under section 102 does not apply, as the AMP trustees do not ‘directly engage Investment Managers’.⁶⁵⁹ This is because AMP Life has engaged AMP Capital to provide investment management services on behalf of the AMP trustees.

Counsel Assisting submitted that, by entering into the outsourcing arrangements, the trustees owed no duties to their members under section 102(1) of the SIS Act to seek information in accordance with that section from AMP Capital.

AMP submitted that the trustees’ ‘outsourcing arrangements are in full compliance with [section] 102(1) – the agreement with AMP Life requires it to comply with this obligation’.⁶⁶⁰ It is not clear what AMP means by this. The obligation in section 102(1) is on the *trustee*.

In any case, AMP did not identify the agreement, or the provision within that agreement, upon which it relies in making this assertion of compliance. Neither of the trustees’ agreements with AMP Life (the Master Outsourcing Agreement⁶⁶¹ for ASL, and the Administration Deed⁶⁶² for NM) refer to section 102(1) of the SIS Act. Nor do they impose obligations identical to those that would lie under section 102(1) on a trustee that has directly engaged an investment manager, though the agreements with AMP Life

⁶⁵⁶ See SIS Act s 102(1)(b).

⁶⁵⁷ See SIS Act s 102(a)(i).

⁶⁵⁸ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0190.6646].

⁶⁵⁹ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0190.6646].

⁶⁶⁰ AMP, Module 5 Case Study Submission, 19 [89].

⁶⁶¹ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472].

⁶⁶² Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0125.0272].

do impose a general obligation on AMP Life to monitor the performance of each investment on an ongoing basis.

As I have explained, the trustees' 'directors' roadmap' said only that the obligations under section 102(1) are not applicable – it did not say that AMP Life has been required to cause the trustees to comply with the obligation imposed by section 102(1). The point made by the 'directors' roadmap' is that because the trustees do not directly hold the contracts with investment managers, they have no obligations under section 102(1). That is correct. I do not accept the submission that AMP made to the contrary.

AMP also said that information is sought from the investment manager whenever the Group Investment Committee, to which investment performance monitoring had been delegated, thought it necessary or desirable to seek information.⁶⁶³ The only reference given by AMP to support this submission was to the Terms of Reference for the AMP Group Investment Committee. AMP did not point to a specific obligation in the Terms of Reference. AMP did not identify any evidence of the Group Investment Committee requesting information to assist the trustees or AMP Life to discharge their investment-related obligations.

The weakness in the trustees' monitoring of performance is demonstrated by the Expense Recovery Incident and the Fee Rebate Incident. As a result of these incidents, AMP is paying customers approximately \$26.5 million in fees incorrectly charged or withheld by AMP Capital.⁶⁶⁴ The customers who are being compensated include members of ASL's and NM's funds and include some of their MySuper members.⁶⁶⁵

The conduct referred to as the Expense Recovery Incident occurred over about three years from 2014; the conduct referred to as the Fee Rebate Incident may have occurred over as many as 10 years. This overcharging of fees was not discovered by AMP Life monitoring the performance of

⁶⁶³ AMP, Module 5 Case Study Submission, 19 [89].

⁶⁶⁴ Transcript, Rachel Sansom, 16 August 2018, 5150; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 59 [228], 60 [237], 61 [239]. Note that not all of the products affected were the AMP trustees' super products – AMP Life products, which were not held by the AMP trustees' members, were also affected: see Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 59 [228], 60 [238].

⁶⁶⁵ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 57 [221], 60 [238].

investments in accordance with its agreements with the trustees. Whatever information was being provided by AMP Capital to AMP Life (or the Group Investment Committee), it was apparently insufficient to show that fees were being incorrectly charged to members.

Nor was the overcharging of fees discovered by the Group Investment Committee requesting information to assist AMP Life or the trustees to discharge their respective investment-related obligations. There was no evidence of the Group Investment Committee requesting, on behalf of AMP Life, information with a level of detail that would enable it to identify the incorrect charging of fees (and therefore the reduction in net returns).

The overcharging of fees was only revealed to ASL and NM because the new version of Regulatory Guide 97 required the trustees to disclose indirect costs of investments and so those costs needed to be identified.⁶⁶⁶

The evident purpose of the Regulatory Guide was to require trustees to make disclosure so that consumers could be informed of the costs of investment. It says little for the merits of AMP's outsourcing arrangements that in order to comply with the guide it was first necessary to inform the Group Investment Committee, AMP Life, ASL and NM about these costs.

3.2.11 Transition to MySuper

Evidence

The transition plan prepared for moving members' accrued default amounts (ADAs) into a MySuper product was not designed by the AMP trustees, but by a special-purpose team within AMP known as the 'FoFA and Stronger Super program'.⁶⁶⁷ Ms Sansom said that it was not unusual for a special purpose team to be set up for such a large program.⁶⁶⁸

⁶⁶⁶ Transcript, Rachel Sansom, 16 August 2018, 5151–2.

⁶⁶⁷ Transcript, Rachel Sansom, 16 August 2018, 5112–3, 5124.

⁶⁶⁸ Transcript, Rachel Sansom, 16 August 2018, 5116.

The transition plan for one of ASL's funds showed that the transfer of members' ADAs to MySuper products was done in tranches.⁶⁶⁹ All tranches were to be completed by 30 June 2017.⁶⁷⁰ That was the last day by which trustees had to attribute ADAs to MySuper products.⁶⁷¹ AMP Life, as administrator of the fund, was responsible for ensuring that each tranche of transfers occurred at the determined time.⁶⁷²

From the trustees' perspectives, the timing of the transitions was designed to manage the operational risk of the transitions.⁶⁷³ An update given to the trustees in March 2015 regarding the transitions said that the 'ADA transitions have been spread over a few years due to the large volume required to be transferred (over \$10bn in assets) and complexity involved in asset movements of this size'.⁶⁷⁴ That update did not record any commercial considerations that affected others in, or aligned with, the AMP Group.⁶⁷⁵

Since commencing in her role in 2015, Ms Sansom could not recall anyone discussing with her or the trustees any assessment AMP had made about the effect the timing of the ADA transfers may have on revenue.⁶⁷⁶

There were documents in evidence before the Commission, however, that did consider the effect of the timing of the ADA transfers on the AMP Group's profits.

A pricing paper prepared by actuaries for the consideration of AMP's Product and Insurance Risk Committee (PIRC), at a meeting on 29 May 2013 (PIRC Pricing Paper), set out a proposed schedule for the timing of

⁶⁶⁹ Exhibit 5.280, 3 May 2013, Trustees MySuper Transition Plan, 8, 10.

⁶⁷⁰ Exhibit 5.280, 3 May 2013, Trustees MySuper Transition Plan, 8, 10.

⁶⁷¹ See SIS Act Pt 33.

⁶⁷² Exhibit 5.280, 3 May 2013, Trustees MySuper Transition Plan, 8, 10.

⁶⁷³ Transcript, Rachel Sansom, 16 August 2018, 5123.

⁶⁷⁴ Transcript, Rachel Sansom, 16 August 2018, 5153; Exhibit 5.296, 24 March 2015, AMP Super and NM Super Board Papers, 73.

⁶⁷⁵ Transcript, Rachel Sansom, 16 August 2018, 5154.

⁶⁷⁶ Transcript, Rachel Sansom, 16 August 2018, 5118.

transfer of ADAs to MySuper products.⁶⁷⁷ One section of the PIRC Pricing Paper dealing with 'Risks and sensitivities' considered how profits would be affected by the transfer patterns of the ADAs. It said that there would be a \$3 million or 0.2% reduction of inforce profits if a higher proportion of ADAs were to be transferred in 2017, whereas there would be a \$86.5 million or 7.5% reduction of inforce profits if 100% of ADAs were to be transferred in 2014.⁶⁷⁸

The PIRC Pricing Paper also considered the effect that MySuper would have on distribution. It said that PwC had been engaged to build an economic model and 'planner heat maps' to identify planners affected by the introduction of MySuper.⁶⁷⁹ The financial planners or advisers who were affected by the transition to MySuper products were referred to as being 'MySuper exposed', in that the advisers would have been receiving revenue from clients' ADAs and would lose that revenue if those clients were transferred to a MySuper product.⁶⁸⁰ The modelling to be done by PwC would, among other things, allow AMP to build 'comprehensive value propositions for the financial planners, employers and members' to help 'minimise impacts on AMP's net cash flow and operating earnings arising from the introduction of MySuper products'.⁶⁸¹

The PIRC Pricing Paper recommended that PIRC endorse the proposal set out in the paper for the subsequent approval by the CEO and Managing Director of AMP Limited, and the Managing Director of AMP Financial

⁶⁷⁷ Transcript, Rachel Sansom, 16 August 2018, 5117; Exhibit 5.279, 29 May 2013, Paper for Product and Insurance Risk Committee Re MySuper Pricing Report, 17.

⁶⁷⁸ Transcript, Rachel Sansom, 16 August 2018, 5117; Exhibit 5.279, 29 May 2013, Paper for Product and Insurance Risk Committee re MySuper Pricing Report, 25.

⁶⁷⁹ Transcript, Rachel Sansom, 16 August 2018, 5119; Exhibit 5.279, 29 May 2013, Paper for Product and Insurance Risk Committee re MySuper Pricing Report, 29–30.

⁶⁸⁰ Transcript, Rachel Sansom, 16 August 2018, 5122–3.

⁶⁸¹ Transcript, Rachel Sansom, 16 August 2018, 5119; Exhibit 5.279, 29 May 2013, Paper for Product and Insurance Risk Committee Re MySuper Pricing Report, 29–30.

Services under delegation from the boards of AMP Life and National Mutual Life Association of Australasia Limited (NMLA).⁶⁸²

Heat maps prepared by PwC identified that 11 practices had greater than \$400,000 in corporate super revenues, with over 50% of that revenue predicted to be MySuper exposed,⁶⁸³ and said that '[s]everal of the decisions regarding MySuper, such as **[buyer of last resort]** and timing of ADA transition, may be informed through leveraging the heatmap data and complementing it with further qualitative and quantitative research to test solutions'.⁶⁸⁴

The PwC heat maps also set out 'headline calculations' of revenue, listing the gross margin summary for each product based on the size of revenue exposed to MySuper.⁶⁸⁵ The two highest gross margin exposures were for the products Flexible Lifetime Super and CustomSuper.⁶⁸⁶

The majority of members in Flexible Lifetime Super and CustomSuper were not transferred to MySuper until April 2017.⁶⁸⁷ That was only about two months before the date by which the trustees were required to transfer ADAs to MySuper products (30 June 2017).⁶⁸⁸

There was no evidence that either the PIRC Pricing Paper or the PwC heat maps were provided to the AMP trustees. Indeed, Ms Sansom's evidence was that the PIRC Pricing Paper was not a document that she

⁶⁸² Exhibit 5.279, 29 May 2013, Paper for Product and Insurance Risk Committee Re MySuper Pricing Report, 5.

⁶⁸³ Transcript, Rachel Sansom, 16 August 2018, 5122; Exhibit 5.281, 1 May 2013, AMP MySuper Heat Map Analysis, 9.

⁶⁸⁴ Transcript, Rachel Sansom, 16 August 2018, 5123; Exhibit 5.281, 1 May 2013, AMP MySuper Heat Map Analysis, 31.

⁶⁸⁵ Transcript, Rachel Sansom, 16 August 2018, 5123; Exhibit 5.281, 1 May 2013, AMP MySuper Heat Map Analysis, 43.

⁶⁸⁶ Transcript, Rachel Sansom, 16 August 2018, 5123; Exhibit 5.281, 1 May 2013, AMP MySuper Heat Map Analysis, 43.

⁶⁸⁷ Transcript, Rachel Sansom, 16 August 2018, 5125–6; Exhibit 5.282, 22 June 2017, Board Papers AMP Limited, AMP Life and NMLA, 71.

⁶⁸⁸ See SIS Act Pt 33.

would typically see within the office of the trustee, or that would typically be provided to the AMP trustees.⁶⁸⁹ It contained information that Ms Sansom would not generally expect to be provided or communicated to the AMP trustees.⁶⁹⁰ Ms Sansom did not recall reading any documents detailing any discussion with the trustee about adviser revenue streams being exposed to MySuper.⁶⁹¹ And Ms Sansom did not know whether the PwC heat map analysis was used to guide the MySuper transition process.⁶⁹²

The same information given to the AMP trustees about the complexities of the transfers affecting the timing of the transfers was also communicated to APRA.⁶⁹³ The information provided to the AMP trustees was also consistent with information provided to ASIC.⁶⁹⁴

Ms Sansom believed that, if the MySuper transition program was happening today, the current trustee boards would ask questions about profit.⁶⁹⁵

What this part of the case study showed

AMP submitted that it was ‘entirely unexceptional’ that other entities within the AMP Group analysed and modelled the effect the proposed timing of the transfer of ADAs would have on them and developed plans to mitigate any adverse effects.⁶⁹⁶

The ‘other entities’ that AMP refers to are AMP Life and PIRC – they were the entities responsible for developing the transition plans for the transfer of the ADAs. AMP Life was also one of the entities that was contractually obliged to act in the AMP trustees’ members’ best interests in performing the AMP trustees’ powers, duties and discretions.

⁶⁸⁹ Transcript, Rachel Sansom, 16 August 2018, 5115–16.

⁶⁹⁰ Transcript, Rachel Sansom, 16 August 2018, 5121.

⁶⁹¹ Exhibit 5.283, 27 April 2017, Memorandum to AMP Life and NMLA Audit Committee, 121.

⁶⁹² Transcript, Rachel Sansom, 16 August 2018, 5123.

⁶⁹³ Transcript, Rachel Sansom, 16 August 2018, 5117–18.

⁶⁹⁴ Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0190.6935].

⁶⁹⁵ Transcript, Rachel Sansom, 16 August 2018, 5119.

⁶⁹⁶ AMP, Module 5 Case Study Submission, 7 [28].

The ADA timing was ultimately determined by AMP Life as the entity responsible for the transitions.⁶⁹⁷ The determination of timing involved a potential conflict between the interests of members and the interests of the AMP advice business. PIRC or AMP Life were acting on information in the PIRC Pricing Paper, or the PwC heat maps, which was relevant to mitigating adverse effects on the advice business. But none of this was revealed to the trustees. AMP may well be right that all of this is ‘entirely unexceptional’ within AMP. That does not make it right.

AMP also submitted that there was no evidence that the considerations as to profit being made in other parts of the business affected the timing of the ADA transitions approved by the AMP trustees.⁶⁹⁸ I accept that the trustees’ approval of the transition plans did not take into account the consequences for other parts of the business. The trustees simply endorsed the transition plans, prepared by another team within AMP.⁶⁹⁹

The trustees were not told about the detail in the PIRC Pricing Paper or the preparation of the PwC heat maps. The AMP trustees received updates from AMP Life about the progress of the transitions, and information about why the transitions were spread over a number of years.⁷⁰⁰ This was the same information provided to the regulators,⁷⁰¹ and it did not record commercial considerations about the effect the timing of the transfers would have on the AMP Group profits.⁷⁰²

⁶⁹⁷ Exhibit 5.280, 3 May 2013, Trustees MySuper Transition Plan, 8, 10.

⁶⁹⁸ AMP, Module 5 Case Study Submission, 7 [27].

⁶⁹⁹ Transcript, Rachel Sansom, 16 August 2018, 5112.

⁷⁰⁰ Transcript, Rachel Sansom, 16 August 2018, 5153; Exhibit 5.296, 24 March 2015, AMP Super and NM Super Board Papers, 73.

⁷⁰¹ Transcript, Rachel Sansom, 16 August 2018, 5117–18; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0190.6935].

⁷⁰² Transcript, Rachel Sansom, 16 August 2018, 5154.

AMP also submitted that the AMP trustees ‘completed all [ADA] transfers within the mandated timeframe’.⁷⁰³ As noted, the evidence was that the largest ADA transition was completed two months before the time by which the SIS Act required the transfers to be completed.⁷⁰⁴ That the AMP trustees did not breach the SIS Act obligation to complete the transfers by a certain date because AMP Life transferred all ADAs by the required date is not the point. The question is whether the AMP trustees otherwise considered all relevant circumstances and discharged their duties to the members in accordance with the law.

There was no evidence that the AMP trustees took any steps to enquire into the financial effect that the timing of the transition of their members’ ADAs to MySuper products would have on those members. This is so even though Ms Sansom’s evidence was that, if the ADA transition were happening today, the boards that she currently serves would certainly ask questions relevant to profit.⁷⁰⁵ Instead, the evidence suggests that the AMP trustees were content to leave these decisions with AMP Life and other parts of the AMP Group and be provided with information that those entities thought relevant and necessary to provide to them. That is not conduct consistent with the AMP trustees’ obligations to inform themselves of any relevant matters to a decision being made, and does not demonstrate an exercise of the same degree of care, skill and diligence as a prudent superannuation trustee would in the circumstances.

3.2.12 Pricing decisions

Evidence

There were various delegations in place within the AMP Group for approving fees.⁷⁰⁶

⁷⁰³ AMP, Module 5 Case Study Submission, 7 [28].

⁷⁰⁴ Transcript, Rachel Sansom, 16 August 2018, 5125; Exhibit 5.282, 22 June 2017, Board Papers AMP Limited, AMP Life and NMLA, 71.

⁷⁰⁵ Transcript, Rachel Sansom, 16 August 2018, 5119.

⁷⁰⁶ Transcript, Rachel Sansom, 16 August 2018, 5113–14.

One committee that approved fees was PIRC.⁷⁰⁷ Ms Sansom's understanding was that PIRC was a pricing committee within the AMP Business, but that it was not the role of Trustee Services (or Regulatory Governance) to interact with that committee.⁷⁰⁸

PIRC was responsible for determining the initial pricing of the AMP trustees MySuper products in 2013.⁷⁰⁹ Ms Sansom's understanding of this process was that a proposal was brought to the AMP trustee boards for approval from another part of the business.⁷¹⁰

The AMP trustees approved the initial pricing of their MySuper products in 2013,⁷¹¹ and the subsequent changes to that pricing in July 2018.⁷¹² In each case, the fees also had to be approved by the boards of AMP Limited, AMP Life, or both AMP Limited and AMP Life, before they could take effect.⁷¹³ This was because of the significance of the fees to the AMP Group's profits.⁷¹⁴

⁷⁰⁷ Transcript, Rachel Sansom, 16 August 2018, 5113.

⁷⁰⁸ Transcript, Rachel Sansom, 16 August 2018, 5114.

⁷⁰⁹ Transcript, Rachel Sansom, 16 August 2018, 5113; Exhibit 5.278, 13 May 2013, Memorandum to Board of AMP Super and NM Super Concerning MySuper Fee Basis and MySuper Authorisation Application.

⁷¹⁰ Transcript, Rachel Sansom, 16 August 2018, 5113. The proposal was brought to the trustee boards in a memorandum titled 'MySuper Fee basis' dated 13 May 2013: Exhibit 5.278, 13 May 2013, Memorandum to Board of AMP Super and NM Super Concerning MySuper Fee Basis and MySuper Authorisation Application; Transcript, Rachel Sansom, 16 August 2018, 5113. This memorandum was to be read with a memorandum dated 7 May 2013 regarding the applications for MySuper product authorisations: Exhibit 5.278, 7 May 2013, Memorandum to Board of AMP Super and NM Super Concerning MySuper Fee Basis and MySuper Authorisation Application.

⁷¹¹ Exhibit 5.278, 13 May 2013, Memorandum to Board of AMP Super and NM Super Concerning MySuper Fee Basis and MySuper Authorisation Application; Transcript, Rachel Sansom, 16 August 2018, 5113–14.

⁷¹² Transcript, Rachel Sansom, 16 August 2018, 5113–14, 5139–42; Exhibit 5.290, 25 July 2018, ASL and NM Super Board Papers, 10.

⁷¹³ Transcript, Rachel Sansom, 16 August 2018, 5113–14, 5139–42.

⁷¹⁴ Transcript, Rachel Sansom, 16 August 2018, 5113–14, 5139–42.

Ms Sansom said that, since the initial pricing was approved in 2013, various reviews of the pricing have taken place, but the first time a price change was brought to the trustee boards in relation to MySuper products was July 2018.⁷¹⁵ Ms Sansom said that ‘the opportunity to endorse a price change [had not] been there until quite recently’.⁷¹⁶

What this part of the case study showed

As I have explained, the pricing of AMP’s MySuper products was determined by parts of the AMP Group other than the trustees.

AMP submitted that the fact that pricing required approval by others in the AMP Group did not mean that the AMP trustees failed to properly exercise their functions as, without the AMP trustees’ approval, ‘the products would not have been offered to members’.⁷¹⁷ AMP submitted that the trustees were required to ensure that their products could operate sustainably, which required input and approval from others in the AMP Group.⁷¹⁸

There is no doubt that a trustee can rely on information from others, within or outside a corporate group, to inform themselves as to whether the fees charged through their products are ‘sustainable’ for the trustee. But there was no evidence that ASL or NM sought analysis about the anticipated effect the fees would have on investment returns, or whether the fees were competitive. Indeed, as already seen, this level of reporting is only now being incorporated into the BMM – more than four years after the introduction of their MySuper products. Again, the AMP trustees appeared to rely on the assumption that the pricing provided by PIRC in 2013 was consistent with the AMP trustees’ discharge of their duties to their members.

Ultimately, the fees that were approved by the trustees in 2013 were not competitive. They were significantly reduced in 2018 because they were affecting the net performance of members’ investments, and in some cases, they were generating negative returns for the members.

⁷¹⁵ Transcript, Rachel Sansom, 16 August 2018, 5113.

⁷¹⁶ Transcript, Rachel Sansom, 16 August 2018, 5113.

⁷¹⁷ AMP, Module 5 Case Study Submission, 7 [26].

⁷¹⁸ AMP, Module 5 Case Study Submission, 7 [26].

3.2.13 Termination of arrangements

AMP submitted that the AMP trustees were able and would be willing to terminate their outsourcing arrangements in appropriate circumstances if necessary to protect members' interests.⁷¹⁹

In November 2017, following APRA's review of the BMM in March 2017, AMP Enterprise Risk Management and Trustee Services prepared a list of events that could trigger a review, and lead to termination, of the AMP trustees' outsourcing arrangements.⁷²⁰ There were 12 events listed.⁷²¹ Each was a significant event.

In the context of the negative net returns on cash investments, Mr Allert said that, beyond lowering the fees, the AMP trustees were not in a position where they could say to AMP Life that the current arrangements were not acceptable to the AMP trustees' members and move the investments out of AMP Life.⁷²² Mr Allert said that, in the current circumstances, there was no sensible possibility that would happen.⁷²³

I explain what this part of the case study showed as part of the wider considerations of the case study as a whole. I now turn to these.

⁷¹⁹ AMP, Module 5 Case Study Submission, 12 [53]; see also Transcript, Richard Allert, 16 August 2018, 5099.

⁷²⁰ Exhibit 5.289, 30 November 2017, ASL and NM Board Papers 6 December 2017, 67, 125.

⁷²¹ These were: change of ownership; insolvency of AMP Limited (and subsequently AMP Life); significant reputational impact to AMP; change in regulatory requirements that has a significant detrimental impact to AMP; significant change in AMP's strategy and/or its implementation resulting in a diminished commitment to superannuation; failure to adequately remediate breaches that have an impact on members; AMP's inability to provide necessary capital requirements; majority of BMM reports not received over two consecutive quarters; sustained underperformance by AMP against agreed standards with no commitment to rectify; significant increase in member fees; material fraud or non-compliance event; and breakdown in relationship that cannot be rectified within agreed timeframe: Exhibit 5.289, 30 November 2017, ASL and NM Board Papers 6 December 2017, 67, 164–7.

⁷²² Transcript, Richard Allert, 16 August 2018, 5099.

⁷²³ Transcript, Richard Allert, 16 August 2018, 5098–9.

3.3 What the case study showed

3.3.1 Key problem

The central point to be made from the evidence detailed above, and what I have said each aspect of the evidence showed, is that ASL and NM have implemented their outsourcing arrangements with other entities in the AMP Group in a manner that has presented, and, on the face of the evidence, continues to present, real and serious difficulties to each trustee in the proper performance of their obligations.

The problem is not outsourcing in general. Trustees are not, and should not be, prohibited from outsourcing or delegating their powers and duties.⁷²⁴ The problem is the extent to which ASL and NM can discharge, and are discharging, their duties to their members in light of their *particular* outsourcing arrangements and the approach they adopt to those arrangements in light of their position within the AMP Group. They have made themselves submissive to the decisions of those to whom they have outsourced their tasks.

Two themes emerged from the evidence that are particularly important in considering ASL and NM's compliance with these covenants.

The first theme is the deficient reporting to ASL and NM. The evidence illustrated four examples in which the reporting to the trustees under the BMM may be said to be deficient: performance of cash investments; performance of MySuper products; monitoring of investments and indirect costs; and issues concerning distribution of the trustees' products.

The second theme in the evidence was the failure of the trustees to take steps to remedy the deficiencies in information provided to them, or to seek information that would give them a proper understanding of decisions being made by others in the Group. Nothing prevented them from actively testing the information provided to them by parts of the AMP Group, or from seeking further information to satisfy themselves that they had discharged their duties. But they did not do this.

⁷²⁴ See SIS Act s 52(5), which confirms that a trustee is not prevented from engaging or authorising persons to act on its behalf. See also APRA, Prudential Standard SPS 231 and APRA, Prudential Standard SPS 510, which requires the trustee board to have in place frameworks for outsourcing and delegation of duties and powers to others.

The evidence suggests that the trustees did not do this because they relied on the relevant parts of the business, to which the trustees' powers, duties and discretions had been outsourced, to ensure compliance with the trustees' obligations. This was so even where relevant parts of the Group had interests in conflict with those of members of the trustees' funds. To the extent that something went wrong, the trustees expected that it would be brought to their attention. Indeed, that was the premise central to the BMM and the exceptions reporting.

The trustees' exception reporting framework through the BMM is not unlike arrangements in other companies where the board is notified about particular issues within the business on an exceptions basis. There is commercial sense in this type of arrangement. However, problems arise where, as it does in the case of the AMP trustees, the board receives reporting that is deficient. That problem is compounded where the board does not actively seek to test the information or ensure it is sufficient.

I have noted some of the failures to take action in the face of deficient reporting already. This reliance on other parts of the business to act in members' best interests, or to act in a way that would discharge the trustees' duties, was also illustrated through the ADA transition, and decisions as to pricing of the trustees' products.

3.3.2 Overarching conclusions about the trustees' outsourcing arrangements

What conclusions should be drawn from the two themes in the evidence about the extent to which the trustees' particular outsourcing arrangements are consistent with the trustees meeting their duties?

AMP submitted, in effect, that nothing can be drawn from these matters. It submitted that its outsourcing model was effective. It submitted that no findings of possible misconduct were open to me save where AMP had already admitted possible misconduct in a breach report to ASIC or APRA or both. It said that '[t]he evidence received by the Royal Commission

demonstrates the prudent and effective management of the funds by the Trustees'.⁷²⁵

I do not believe that the problems can be so easily swept aside. There are three covenants imposed on the trustees under the SIS Act that require careful consideration in relation to the trustees' outsourcing arrangements: section 52(2)(c) of the SIS Act, which requires the trustee to perform its duties and exercise its powers in the best interests of the beneficiaries; section 52(2)(d), which requires, in general terms, the trustee to prioritise the interests of the beneficiaries over its own and others' interests; and section 52(2)(h), which requires the trustee not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers.

The way that the trustees carried out their outsourcing arrangements may have given rise to breaches of the covenants in section 52(2)(c), (d) and (h) in the following ways.

Section 52(2)(c)

AMP submitted that the duty in section 52(2)(c) of the SIS Act was not a duty to 'achieve particular outcomes for members' and that, 'although the [AMP trustees] will always strive to achieve this, the provision certainly does not impose a strict duty to achieve *the best* outcome for members' (emphasis in original).⁷²⁶ Like others who appeared before the Commission in the fifth round of hearings, AMP submitted that the duty was directed at a proper process not at particular outcomes.⁷²⁷ But again the aphorism may conceal more than it reveals.

It may be accepted that the duty in 52(2)(c) is breached by an inadequate process. It may also be accepted that an inadequate outcome does not demonstrate breach. Neither Counsel Assisting nor any person making submissions suggested otherwise. But it does not follow that the outcome of the process is to be disregarded.

⁷²⁵ AMP, Module 5 Case Study Submission, 1 [5].

⁷²⁶ AMP, Module 5 Case Study Submission, 16 [74].

⁷²⁷ AMP, Module 5 Case Study Submission, 16 [74].

A poor outcome for beneficiaries may point to a specific inadequacy in the process used by the trustee. In general, the poor outcomes achieved by the AMP trustees require an explanation as to why they occurred and went undetected for so long if the trustees' processes were adequate. Indeed, one of the most basic tasks undertaken by a trustee acting in the best interests of its members and exercising the care, skill and diligence of a prudent superannuation trustee would be to engage in a process of self-evaluation to pinpoint the reasons for a poor outcome.

But, outcomes aside, having regard to the deficiencies in reporting, and lack of steps taken by the trustees to satisfy themselves that they were doing the best they could for their members, I am satisfied that the trustees' implementation of their outsourcing arrangements may be conduct that was inconsistent with the covenant in section 52(2)(c). The poor outcomes for members points towards that conclusion.

Section 52(2)(d)

AMP did not accept that its outsourcing arrangements presented difficulties for it in complying with section 52(2)(d) of the SIS Act.⁷²⁸

AMP submitted that the AMP trustees are 'cognisant of the potential for conflicts that may arise within the outsourced model' and are 'mindful of their duties and obligations with regard to conflicts', including Prudential Standard SPS 521: Conflicts of Interest.⁷²⁹ AMP said that the AMP trustees have 'robust policies and frameworks in place for the identification and management of conflicts', and that the outsourcing arrangements expressly deal with conflicts and require the interests of members to be preferred.⁷³⁰

The outsourcing agreements do not require any potential conflicts to be reported to the trustees so that the trustees can monitor how the conflicts are resolved. For example, the Master Outsourcing Agreement between AMP Life and ASL requires AMP Life to prefer the interests of the

⁷²⁸ AMP, Module 5 Case Study Submission, 15–16 [73], 19–20 [90].

⁷²⁹ AMP, Module 5 Case Study Submission, 6 [21].

⁷³⁰ AMP, Module 5 Case Study Submission, 6 [21].

beneficiaries where there is a conflict⁷³¹ but it does not require AMP Life to report that conflict to the trustee.

The circumstances of the ADA to MySuper transition plan illustrate this problem of being uninformed about conflicts. AMP submits that the trustee acted appropriately in approving the transition plan because the trustee was concerned about the management of risk. But the trustee was concerned about the management of risk because that was what AMP Life told the trustee was the reason underlying the transition plan. AMP submitted that '[t]hat other members of the Group had regard to the particular interests of their stakeholders in relation to particular matters does not mean that the Trustees failed to properly exercise their functions'.⁷³² But the trustee was not told about the use of the PwC heat maps to determine effects on advisers or made aware of the obvious possible conflict between the interests of other parts of the AMP Group and the interests of the superannuation beneficiaries in relation to the transition plan.

The decisions about pricing of the trustees' products also illustrate the conflicts inherent in the trustees' operations. AMP submitted that the trustees had the ultimate decision regarding pricing, and that the trustees 'were not forced to accept the pricing offered or approved elsewhere'.⁷³³ That may be true. But the reality is that the pricing of the trustees' products was determined elsewhere in the Group, and the trustees did not seek to be informed of the information underpinning the pricing, or whether that pricing was the best that could be done for their members. And once the fees proved to be uncompetitive and produce poor outcomes for their members, they could only be reduced once there was also approval from other parts of the Group. Mr Allert's evidence was plain that despite the high costs, the trustees had no intention of investing the assets of the funds somewhere else or engaging another investment management service provider.⁷³⁴

⁷³¹ Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6490–.6491, cl 2.6].

⁷³² AMP, Module 5 Case Study Submission, 6–7 [25].

⁷³³ AMP, Module 5 Case Study Submission, 19 [86].

⁷³⁴ Transcript, Richard Allert, 16 August 2018, 5099.

Indeed, Mr Allert's evidence was that the trustees were not in a position where they could say to AMP Life that the current arrangements were not acceptable to the AMP trustees' members and move the investments out of AMP Life.⁷³⁵ Mr Allert said that, in the current circumstances, there was no sensible possibility that would happen.⁷³⁶

These instances show that the trustees were not arming themselves with knowledge of conflicts that existed, or may exist, because of their outsourcing arrangements. And trustees cannot properly exercise their functions as contemplated by section 52(2)(d) without being aware of the conflicts that arise and, with that awareness, being prepared to take steps to test whether the interests of the beneficiaries are truly being preferred.

Section 52(2)(h)

The trustees acknowledged that their outsourcing arrangements have not relieved them of their duties to the members of the funds.⁷³⁷ Indeed, AMP said that the primary intent of the BMM was to ensure that the AMP trustees could and would successfully discharge their obligations to their members.⁷³⁸ And this proposition was central to the Fund Governance Charter, on which AMP relied in its submissions.⁷³⁹

AMP submitted that it was not open to me to find that the AMP trustees may have breached the covenant set out in section 52(2)(h) of the SIS Act by maintaining their outsourcing arrangements.⁷⁴⁰ AMP submitted that its trustees' 'outsourcing agreements do not prevent or hinder the Trustees from exercising their powers and functions ... Rather, the outsourcing agreements are the means by which the Trustees properly perform and

⁷³⁵ Transcript, Richard Allert, 16 August 2018, 5099.

⁷³⁶ Transcript, Richard Allert, 16 August 2018, 5098–9.

⁷³⁷ AMP, Module 5 Case Study Submission, 1–2 [6].

⁷³⁸ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553].

⁷³⁹ AMP, Module 5 Case Study Submission, 1–2 [6].

⁷⁴⁰ AMP, Module 5 Case Study Submission, 19–20 [85]–[89].

exercise many of their functions ... they explicitly require the outsource providers to act in accordance with the Trustees' obligations'.⁷⁴¹

I accept that AMP Life and NMMT are required under the outsourcing agreements to act so as not to cause the trustees to breach their obligations.⁷⁴² But the trustee is still the trustee. It is the trustee that must fulfil its obligations.

The submissions of AMP help to identify the fundamental problem with the trustees' outsourcing arrangements: in practice, it was and is assumed by the AMP Group and the AMP trustees that the outsourced providers can and will fulfil the trustees' duties for the trustees, so that the trustees can be, and are, passive.

The trustees' passivity is manifest in three ways.

First, the passivity is reflected at the most basic level in the contractual agreements. ASL and NM do not pay AMP Life to provide it with services. Rather, ASL and NM are paid by AMP Life to be the trustee of the funds.

Second, it was evident in the evidence given by Mr Allert. His evidence, relied on by AMP in its submissions, was that he did not consider that the issues concerning negative net returns warranted terminating the relationship with AMP, because he had 'complete confidence' that the issues would be fully dealt with by AMP.⁷⁴³ Yet Mr Allert was seemingly indifferent about why the issues had arisen in the first place and why they had been allowed to continue for so long.

Because of this unquestioning trust, the trustee boards depended on exception reporting to bring to their attention any matters that may cause, or may have caused, them to breach any of their duties. The BMM expressly

⁷⁴¹ AMP, Module 5 Case Study Submission, 18 [83].

⁷⁴² Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6488–.6489, cls 2.2 and 2.3]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0125.0272 at .0292, cl 7.1].

⁷⁴³ AMP, Module 5 Case Study Submission, 12 [53]; Transcript, Richard Allert, 16 August 2018, 5099.

recognised this.⁷⁴⁴ And although, as I noted above, at a general level there is nothing objectionable in an exceptions-based reporting structure, reliance on such a structure to the extent that the directors do not interrogate or enquire further into the information provided to them leads to the difficulties that the trustees have faced. And reliance without interrogation and enquiry is not consistent with the duties of the trustees.

AMP sought to meet the inadequacies in the detailed formal rules for reporting to the trustee boards by relying upon the general discretion of Trustee Services and outsourced providers to bring important matters to the attention of the trustee boards. But that directs attention to how the reporting worked in practice if left to the discretion of outsourced providers. The reporting was inadequate. The reporting by AMP Life of investment performance did not provide the AMP trustees with the performance of their products net of fees and taxes. The reporting through the BMM did not enable the AMP trustees to identify the fees being wrongly charged by AMP Capital as a result of the Expense Recovery and Fee Rebate Incidents at the time that the fees were being wrongly charged.

Third, the passivity is demonstrated in the trustees' inability or unwillingness to influence outcomes for members without the agreement of the AMP Group.

Mr Allert's evidence was that the AMP trustees were not in a position to move the investments out of AMP Life. And Ms Sansom said that she had considered the fees to be too high for some time but that it was a matter for the AMP Product Team. Nothing was done until APRA identified the problem, and even then no steps were taken until a month before the Royal Commission's superannuation hearings were due to commence.

AMP submitted that Counsel Assisting had not articulated how the AMP trustees had exercised their powers in a way that was contrary to the interests of the members, relying on the BMM framework to support their argument. In AMP's submission, the BMM was 'plainly a prudent exercise of the [AMP trustees'] responsibility to provide proper governance'.⁷⁴⁵

⁷⁴⁴ Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553].

⁷⁴⁵ AMP, Module 5 Case Study Submission, 15 [73].

But, as AMP has acknowledged, its trustees have breached their statutory obligations in several respects in the last few years because of the conduct of the related parties to whom they have outsourced their functions. The contractual obligations imposed on the related parties did not prevent these breaches. The contractual obligations did not cause the AMP trustees to be made promptly aware of the breaches. In one case (negative net returns to members invested in cash), the AMP trustee became aware of the problem after it had continued for three years and only because of an APRA investigation.

AMP has not sought to explain how it reconciles these breaches with its proposition that the outsourcing arrangements are adequate. Taken as a whole, AMP's outsourcing arrangements allow and encourage the trustee to be passive and both the trustees and the other parts of the AMP Group assume and believe that this is appropriate and acceptable. The trustees, by implementing their outsourcing arrangements in the manner in which they have, and rely upon as the explanation for their passivity, may have contravened the covenant in section 52(2)(h) of the SIS Act.

The potential breaches of the covenants set out in section 52(2)(c), (d) and (h) not having been so far drawn to the attention of the regulator, I refer AMP's conduct to APRA in accordance with paragraph (a) of the Commission's Terms of Reference, for that agency to consider what action it can and should take.

Conclusion

This case study demonstrates two things.

First, the ease with which a trustee within a retail group may substitute the rigour and discipline required to fulfil its duties to members, with leaving others within the group to carry out its tasks, believing that copious process would ensure compliance.

Second, the readiness of APRA, the responsible regulator, to accept, or not identify, this substitution of form for substance.

APRA conducted a review of the BMM in 2017, and found that the BMM largely complied with prudential and legal requirements – indeed, APRA characterised the BMM as ‘robust’,⁷⁴⁶ a characterisation that AMP sought to rely on in its submissions.⁷⁴⁷ APRA’s characterisation of the BMM suggests that its assessment may not have grappled with the way in which the trustees were conducting their outsourcing arrangements, and what that meant for the trustees’ members.

APRA was aware before the hearings for Round 5 of at least some of the issues that I have identified – it had brought the poor performance of MySuper products to the trustees’ attention, and prompted them to identify issues such as the negative net returns to members invested in cash.

But, like the trustees, APRA did not seem to make the link that the trustees’ absolute reliance on the BMM and outsourced arrangements constituted failures of duty when those mechanisms, themselves, failed.

This suggests that APRA needs to do more in its evaluation of how trustees of vertically integrated institutions are complying with their fundamental duties to their beneficiaries. In particular, it highlights the need for APRA to consider whether the Standards and Guidelines for which it is responsible should be revised to improve the ability of both APRA and the trustee within a vertically-integrated group to adequately evaluate whether the trustee is promoting the best interests of members. For example, certain types of decisions by such trustees might be required to be reviewed by an external expert to certify that they are consistent with their obligations owed to members. APRA might also consider whether additional licence conditions should be imposed on some RSE licensees to report particular decisions to APRA for the purpose of evaluating conflicts. But any such developments in APRA’s approach must be more than merely an additional layer of regulatory process. What is required is improvement in the quality of APRA’s evaluation of conflicts management within retail groups, not merely more regulatory boxes to be ticked.

⁷⁴⁶ Exhibit 5.291, 7 April 2017, Letter from APRA to Sansom, 3.

⁷⁴⁷ AMP, Module 5 Case Study Submission, 2 [15].

4 IOOF

4.1 Background

IOOF Holdings Ltd is a publicly listed company. IOOF Investment Management Limited (IIML) and Questor Financial Services Limited (Questor) are subsidiaries of IOOF Holdings.

IIML is an RSE licensee and the trustee of various superannuation funds, including the IOOF Portfolio Service Superannuation Fund (IPS Fund).⁷⁴⁸ Questor was an RSE licensee and was the trustee of various superannuation funds, including The Portfolio Service Retirement Fund (TPS Fund).⁷⁴⁹

IIML is, and Questor was, a dual-regulated entity (DRE). That is, in addition to being the trustee of one or more superannuation funds, the entity is also the responsible entity (RE) for one or more managed investment schemes. Subject to some conditions, an entity that is the RE of a managed investment scheme may itself acquire and hold an interest in the scheme.⁷⁵⁰ And, of course, an entity that is trustee of a superannuation fund can acquire and hold an interest in the scheme. Hence, an entity that is a DRE may, and IIML and Questor did, invest the assets of superannuation funds of which it was trustee in the managed investment schemes of which it was RE. As REs, IIML and Questor also acquired and held interests in those schemes. Arrangements of this kind present a real and continuing possibility of conflict between the interests and duties that attach to each role.

The Commission looked at three aspects of conduct relating to IOOF's superannuation business.

- The examined Questor's conduct in connection with the recovery of an amount that it had wrongly paid to unit holders in a managed investment scheme of which it was RE and in which, as trustee, it had invested, and in which, as RE, it held interests. This event was referred to as 'Questor's over-distribution'.

⁷⁴⁸ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 3 [14]–[16].

⁷⁴⁹ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 3 [14]–[15].

⁷⁵⁰ Corporations Act s 601FG.

- The second aspect of conduct examined related to IOOF's dealings with APRA about questions of governance, management of conflicts of interest and culture more generally.
- The third focused upon IIML's decision, in 2018, to change the fees and charges (the 'pricing') for the IPS Fund by applying the new and lower pricing to new members but only applying the new pricing to existing members if and when the member asked for it to be applied.

Both at the times relevant to the issues examined by the Commission and when the Commission took evidence about those issues, Christopher Kelaher was Managing Director of IOOF Holdings. The Commission heard evidence from Mr Kelaher, Mark Oliver, the General Manager, Distribution, for IOOF and Stephen Glenfield, a General Manager of APRA's Specialised Institutions Division who, at relevant times, was the general manager of APRA's supervisory team supervising IOOF.

On 6 December 2018, after the Commission received evidence, APRA commenced proceedings in the Federal Court against IIML, Questor, Mr Kelaher and four other individuals.⁷⁵¹ I summarise the allegations in that proceeding below. That proceeding having commenced, I make no comment or findings about the matters referred to in the papers filed by APRA. It remains appropriate, however, to say something about a letter Questor sent to members in 2016 in connection with Questor's over-distribution, and IIML's conduct regarding the pricing of the IPS Fund. Both issues lie outside the subject matter of the APRA proceeding.

A related issue arose in the ANZ case study. At the time of the hearings, ANZ had two superannuation trustees, OnePath Custodians (OPC) and Oasis Fund Management Limited (Oasis). In October 2017, ANZ agreed to sell both trustees, along with some other parts of its business, to IOOF. A condition precedent of that sale was that OPC approve a successor fund transfer (SFT) – in other words, the sale agreement could not proceed without OPC's co-operation. The Commission heard evidence from the Chair of OPC and Oasis, Victoria Weekes, about the way OPC approached that decision.

⁷⁵¹ *APRA v Christopher Francis Kelaher & Ors*, Federal Court of Australia, NSD 2274/2018.

4.2 The APRA proceedings

On 6 December 2018, APRA commenced proceedings against IIML, Questor, Mr Kelaher, and four other individuals holding senior positions at IOOF: the Chair, George Venardos; the Chief Financial Officer, David Coulter; the General Manager – Legal Risk and Compliance and Company Secretary, Paul Vine; and the General Counsel, Gary Riordan.⁷⁵² The documents filed by APRA alleged that:⁷⁵³

- Until January 2014, Questor was the RE of two managed investment schemes, known as the Cash Management Trust (CMT) and The Portfolio Service Plan (TPS MIS). Questor invested the funds of the TPS Fund and the TPS MIS in the CMT. In May 2009, Questor as RE for the CMT made an overpayment to unitholders that was distributed to individual investors in the TPS Fund and TPS MIS. Questor did not identify the error until 2011. To address the overpayment, it caused a reduction in distributions from the CMT. This prejudiced new members in TPS Super who had not received any of the overpayment. The board of Questor then approved a plan to (a), use the amount received from a settlement with Questor's custodial services provider to wholly compensate investors in a managed investment scheme of which it was RE, and (b), to compensate superannuation members from the remainder of the settlement amount while using the TPS Fund's general reserve to make up the shortfall. The compensation plan continued to be implemented by IIML following an SFT from TPS Super to IPS Super. IIML did not replenish the general reserve of TPS Super or IPS Super until October 2018, following repeated requests from APRA.
- From around 2007, IIML failed to reinvest certain income distributions in accordance with instructions from clients of its Pursuit investor directed portfolio service product. The failure was not detected until 2014, and affected both superannuation beneficiaries and non-superannuation investors. In 2015, IIML approved a plan to pay compensation to non-superannuation investors from its own funds, and to pay superannuation beneficiaries from the superannuation fund's Operational Risk Financial Reserve (ORFR).

⁷⁵² *APRA v Christopher Francis Kelaher & Ors*, NSD 2274/2018.

⁷⁵³ Concise Statement filed on behalf of APRA dated 6 December 2018.
See also Originating Process filed on behalf of APRA dated 6 December 2018.

- In around 2011, Questor failed to reinstate automatic investment plan instructions given to it by approximately 1,300 clients. The failure was not detected until January 2015, and affected both superannuation beneficiaries and investors in managed investment scheme products. In 2015, Questor approved a plan to compensate non-superannuation investors from Questor's own funds, and superannuation beneficiaries from the superannuation fund's ORFR.
- In 2015, Singtel Optus Pty Ltd requested that IIML transfer the Optus employee default superannuation arrangements from the IPS Fund to an AMP fund. IIML and Mr Kelaher rejected the proposed SFT without taking any or adequate steps to consider whether the transfer was in the best interests of beneficiaries.
- Until 2018, the boards of IIML and Questor did not distinguish between when they were acting as the board of a superannuation trustee or as the board of an RE of a managed investment scheme, and did not identify potential or actual conflicts of interest arising from these dual roles.
- In responding to APRA's concerns about these and other matters, Questor, IIML, and the five individuals demonstrated a lack of understanding of their obligations under the SIS Act and the general law; failed to properly implement a robust conflicts management framework as required by SPS 521; failed to ensure that Questor and IIML complied with APRA's requirements and recommendations in a timely manner or at all; and failed to comply with SPS 520, which requires responsible officers of a superannuation trustee to be aware of their legal obligations.
- The conduct gave rise to breaches of sections 52(2)(b), 52(2)(c), 52(2)(d) of the SIS Act by Questor and IIML, and breaches of sections 52A(2)(c), 52A(2)(d), 52A(2)(f) and 55(1) of the Act by Mr Kelaher and the Chair of IOOF Holdings, George Vernardos.

In the same proceeding, APRA sought disqualification orders under section 126H of the SIS Act against Mr Kelaheer, Mr Venardos, Mr Coulter, Mr Vine and Mr Riordan.

On 6 December 2018, APRA also sent a ‘show cause’ letter to IOOF’s legal representatives, setting out its intention to direct IIML to comply with its RSE licence and to impose additional conditions on the licences of IIML and two other IOOF subsidiaries. The proposed directions to IIML related to ‘breaches, or potential breaches, of the SIS Act and relevant prudential standards identified by Ernst & Young in their report dated 4 September 2018’.⁷⁵⁴ The proposed additional conditions related to what APRA said were ‘failures to adequately identify and manage conflicts of interest throughout the IOOF Group, and failures to comply with legislative requirements and prudential standards’.⁷⁵⁵

The Commission’s Terms of Reference provide that I am not required to inquire, or continue to inquire, into a particular matter to the extent that I am satisfied that the matter is being, or will be, sufficiently and appropriately dealt with by a civil proceeding. I am, of course, satisfied that the matters described above will be sufficiently and appropriately dealt with in those proceedings. I make no findings about the particular contraventions alleged in those proceedings. Whether other forms of proceeding could or should be instituted in respect of these matters is a matter for APRA and I say no more about it.

As I said at the outset, however, it remains appropriate to deal here with one related matter: a letter Questor sent to members of the TPS Fund in respect of Questor’s over-distribution.

⁷⁵⁴ Letter APRA to King & Wood Mallesons, 6 December 2018, 1, <www.apra.gov.au/sites/default/files/show_cause_notice.pdf>.

⁷⁵⁵ Letter APRA to King & Wood Mallesons, 6 December 2018, 1, <www.apra.gov.au/sites/default/files/show_cause_notice.pdf>.

4.3 The 2016 letter

4.3.1 Background

In order to understand the issues relating to the letter, it is necessary to set out some background.

Before 2016, Questor was the RSE licensee for the TPS Fund.⁷⁵⁶ Before 2014, Questor was also the RE of the CMT.⁷⁵⁷ The CMT was a managed investment scheme that invested in cash deposits and short to medium term securities.⁷⁵⁸

Before 2016, Questor held some units in CMT as RSE licensee of the TPS Fund.⁷⁵⁹ In its capacity as RSE licensee of the TPS Fund, Questor held the relevant units in the CMT on trust for the members of the TPS Fund.⁷⁶⁰

NCS was a subsidiary of NAB. NCS was the custodian of the assets of the CMT.⁷⁶¹ As custodian, it was responsible for holding CMT's assets for safekeeping.

In 2009, Questor as RE of the CMT made an over-distribution of \$6.16 million to the unit holders in the CMT.⁷⁶² The over-distribution occurred because NCS mistakenly treated an asset of CMT as income.⁷⁶³ The error was discovered in 2011, when a new custodian of the assets of the CMT audited the assets of which it had been appointed custodian and found the asset was missing.⁷⁶⁴

⁷⁵⁶ Exhibit 5.116, Witness statement of Christopher Kelaheer, 26 July 2018, 3 [14].

⁷⁵⁷ Exhibit 5.116, Witness statement of Christopher Kelaheer, 26 July 2018, 3 [15].

⁷⁵⁸ Exhibit 5.120, 20 October 2013, Memorandum from Head of Risk to General Counsel, 3–4; Transcript, Christopher Kelaheer, 10 August 2018, 4608.

⁷⁵⁹ Transcript, Christopher Kelaheer, 10 August 2018, 4608.

⁷⁶⁰ Transcript, Christopher Kelaheer, 10 August 2018, 4608.

⁷⁶¹ Exhibit 5.116, Witness statement of Christopher Kelaheer, 26 July 2018, 7 [34].

⁷⁶² Exhibit 5.116, Witness statement of Christopher Kelaheer, 26 July 2018, 7 [33].

⁷⁶³ Exhibit 5.129, 18 August 2016, Memorandum Concerning Conflicts and Decision-making Map, 2.

⁷⁶⁴ Transcript, Christopher Kelaheer, 10 August 2018, 4610.

In 2011, Questor sought to recoup, or ‘claw back’, the over-distribution and ‘restore’ the CMT.⁷⁶⁵ From September 2011, Questor, as RE of the CMT, ‘reduced’⁷⁶⁶ the distributions that it paid, including to itself as RSE licensee of the TPS Fund.⁷⁶⁷ The ‘reduction’ in distribution was intended by those who implemented it to continue over three years.⁷⁶⁸ The calculation had apparently been made that, by the end of three years, the ‘over-distribution’ would have been recouped.⁷⁶⁹

The Questor Board was told about the issue in early 2013.⁷⁷⁰ There is no evidence that the board ever approved the ‘reduction’ in distribution.

The reduced distributions affected all members of the TPS Fund for whom some part of the amounts attributable to them in that fund were invested in the CMT. Some members of the TPS Fund had not been invested in the CMT at the time of the over-distribution and therefore did not receive the over-distribution. Some members may have increased their interest in the CMT since the time of the over-distribution. All of these members would suffer loss as a consequence of the reduction in the distribution.

At some time, before October 2013, somebody within Questor formed the intention to compensate those members who suffered loss as a result of the reduction in distribution, and to provide the compensation after the clawback had finished, in amounts that would be assessed then.⁷⁷¹ It is not clear when that intention was formed.

⁷⁶⁵ Transcript, Christopher Kelaher, 10 August 2018, 4645–6.

⁷⁶⁶ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 9 [50(a)].

⁷⁶⁷ Transcript, Christopher Kelaher, 10 August 2018, 4611.

⁷⁶⁸ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 17) [IFL.0029.0001.1190 at .1191].

⁷⁶⁹ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, [50(a)–(b)].

⁷⁷⁰ Transcript, Christopher Kelaher, 10 August 2018, 4617.

⁷⁷¹ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 11 [55(h)]; Exhibit 5.129, 18 August 2018, Memorandum Concerning Conflicts and Decision-making Map, 2.

In October 2015, the board approved compensation to the TPS Fund members.⁷⁷² It decided that part of the compensation would come from the general reserve of the TPS Fund.⁷⁷³

The TPS Fund general reserve was made up of money from various sources, including unallocated interest and asset/liability mismatches.⁷⁷⁴ It did not contain money taken from individual members' contributions or returns. Although not allocated to individual members' accounts, the general reserve was an asset of the TPS. It was vested in Questor on trust for the members.

4.3.2 The letter to members

In 2016, Questor wrote to members of the TPS Fund. The letter said:⁷⁷⁵

Following a periodic review of the CMA, we identified a historical distribution error in an underlying investment of the CMA that resulted in income distributions being credited to your CMA at a lower rate than it should have been.

As is apparent from what has been set out above, this statement was untrue. There was no 'periodic review of the CMA' that identified a historical distribution error. There was no historical distribution error that resulted in income distributions being credited to members' CMA at a lower rate than it should have been. The lower distributions were not an error by Questor. The lower distributions were the result of a deliberate decision made by some employees within Questor. The lower distributions continued after Questor's Board was informed of the decision.

In its written submissions, IOOF submitted that the statement was not misleading. I say more about those submissions later when considering

⁷⁷² Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 10) [IFL.0029.0001.2611 at .2615].

⁷⁷³ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 10) [IFL.0029.0001.2611 at .2615].

⁷⁷⁴ Exhibit 5.305, 19 August 2013, Reserves Policy, 5.

⁷⁷⁵ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 12) [IFL.0029.0001.1164 at .1164].

whether it is open to me to find that there may have been misconduct by Questor in relation to the letter.

The letter sent to members of the TPS Fund in 2016 also said that ‘to ensure you are not disadvantaged, we have calculated compensation to 30 June 2016’.⁷⁷⁶ It then set out the amount that would be applied to the member’s account.⁷⁷⁷ The letter did not explain why the over-distribution occurred or where the compensation money was coming from.

4.4 Changing the pricing for the IPS Fund

In 2018, IIML decided to make some pricing changes as part of ‘Project Evolve’, a broader strategy to simplify IIML’s administration systems.⁷⁷⁸

According to an internal analysis presented to IIML’s leadership group, 29,263 members of IOOF Employer Super (IES) would be better off under the new pricing.⁷⁷⁹ The same paper identified an ‘arbitrage risk’: a risk that existing members would move to the new pricing and pay lower fees.⁷⁸⁰ However, the analysis said that this risk was different from the risks associated with other repricing decisions because of grandfathered commissions, an ‘unengaged membership’, and the fact that many members would be only marginally better off.⁷⁸¹ The analysis noted that there had been very little member movement after a fee reduction in 2014.⁷⁸²

⁷⁷⁶ Exhibit 5.116, Witness statement of Christopher Kelaheer, 26 July 2018, Exhibit CK-2 (Tab 12) [IFL.0029.0001.1164].

⁷⁷⁷ Exhibit 5.116, Witness statement of Christopher Kelaheer, 26 July 2018, Exhibit CK-2 (Tab 12) [IFL.0029.0001.1164].

⁷⁷⁸ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 206.

⁷⁷⁹ Exhibit 5.113, 31 January 2018, Memorandum, Broom and Mason to IOOF Leadership Group, 5.

⁷⁸⁰ Exhibit 5.113, 31 January 2018, Memorandum, Broom and Mason to IOOF Leadership Group, 5.

⁷⁸¹ Exhibit 5.113, 31 January 2018, Memorandum, Broom and Mason to IOOF Leadership Group, 5.

⁷⁸² Exhibit 5.113, 31 January 2018, Memorandum, Broom and Mason to IOOF Leadership Group, 5.

Mr Oliver said that the analysis reflected two assessments made by IOOF.⁷⁸³ The first was that members who did not have a financial adviser, ‘and were therefore unengaged’, were unlikely to move to the new pricing.⁷⁸⁴ The second was that members with a grandfathered trail commission were unlikely to move to the new pricing.⁷⁸⁵ Mr Oliver said this reflected IOOF’s experience that ‘products with grandfathered trails tend to take longer to move to a new price point’, even though members would be better off under the new pricing.⁷⁸⁶

In February 2018, a management paper was given to IIML’s board. The paper proposed that *new* members would be charged according to the new pricing, but that *existing* member pricing would not change; existing members would be ‘grandfathered’.⁷⁸⁷ The paper referred to the ‘arbitrage risk’, but assessed it as a low risk.⁷⁸⁸ At the meeting, the board asked management whether the new pricing *should* apply to all existing clients.⁷⁸⁹

Mr Oliver’s team considered this question. They found that applying the new pricing to existing members would cost \$8 million per year.⁷⁹⁰ They also found that of the 29,000 members who would be better off, about 20,000 had a grandfathered commission.⁷⁹¹

Management prepared a revised paper for the board.⁷⁹²

⁷⁸³ Transcript, Mark Oliver, 10 August 2018, 4599–600.

⁷⁸⁴ Transcript, Mark Oliver, 10 August 2018, 4599.

⁷⁸⁵ Transcript, Mark Oliver, 10 August 2018, 4600; see also Exhibit 5.113, 31 January 2018, Memorandum, Broom and Mason to IOOF Leadership Group, 5.

⁷⁸⁶ Transcript, Mark Oliver, 10 August 2018, 4600.

⁷⁸⁷ Exhibit 5.107, 12 February 2018, Board Papers for Meeting of Directors of IIML, 66.

⁷⁸⁸ Exhibit 5.107, 12 February 2018, Board Papers for Meeting of Directors of IIML, 66.

⁷⁸⁹ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 9; Exhibit 5.109, 13 February 2018, Emails between Oliver, Mason and Others.

⁷⁹⁰ Exhibit 5.109, 13 February 2018, Emails between Oliver, Mason and Others.

⁷⁹¹ Exhibit 5.109, 13 February 2018, Emails between Oliver, Mason and Others.

⁷⁹² Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 15.

The revised paper, dated 2 March 2018, pointed out that:

The setting of fees for superannuation products gives rise to a potential conflict between IIML's best interests duty to members in its capacity as Trustee and its corporate objective of deriving income from a retail product.

Where there is a conflict, IIML as Trustee of the Products is required to give priority to the duties to, and interests of, members, and act fairly between and within classes of members of the fund.⁷⁹³

The revised paper said that about half of the existing members 'may potentially benefit under the new pricing'.⁷⁹⁴ It said that those members would not be automatically moved to the new pricing⁷⁹⁵ but that, to manage the conflict identified in the paper, there would be a communication plan where:⁷⁹⁶

All financial advisers will receive notification of the new product pricing and features prior to launch in April 2018. The notice will recommend that advisers review their clients' current situation and needs, before advising whether it is in their best interests to transfer to the new product offering.

Members would also receive a letter in the mail about the 'new features and benefits' and refer them to the updated PDSs that would be available on IOOF's website 'if they would like more information'.⁷⁹⁷ The revised paper did not say that the letter would tell members about the lower fees. The paper also did not say how many members had grandfathered commissions, or how likely those members were to move to the new pricing of their own accord.⁷⁹⁸

Sometime before 22 March 2018, a director sent an email to management about the matters dealt with in that paper.⁷⁹⁹ The director observed that it

⁷⁹³ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 28.

⁷⁹⁴ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 15.

⁷⁹⁵ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 16.

⁷⁹⁶ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 16.

⁷⁹⁷ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 16.

⁷⁹⁸ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 15–16.

⁷⁹⁹ Exhibit 5.110, 22 March 2018, Email Mota to Broom and Others with Attachment, March IIML Papers.

was in members' interests to have the lower pricing, but in IIML's interests for them to have the higher pricing and said that IIML had to prioritise the interests of members.⁸⁰⁰

Management prepared a further paper, dated 22 March 2018, providing more information to the board.⁸⁰¹ This further paper said, as part of the background to the proposal, that upon completion of the simplification project (Project Evolve), IIML 'will be better placed to deliver lower fees to all members and minimise account erosion, while continuing to invest in the future growth and value enhancement for all members'.⁸⁰²

The paper then dealt with a number of matters relevant to members' best interests.

First, the paper said that IIML could not tell whether individual members would actually be better off.⁸⁰³ It suggested that if a member moved to a new fee arrangement without grandfathered commissions, 'they may be charged a separate advice fee from their adviser' but, as the paper went on to say, that would depend on whether the member sought advice.⁸⁰⁴

Second, the paper said that applying the fee changes to all members who would be better off would reduce the income to the fund by approximately \$10 million per annum, which would make any change 'unsustainable and unviable'.⁸⁰⁵

Third, the paper said that the strategy was 'not revenue-driven', but was intended to 'facilitate a sustainable and viable transition to a more cost-effective structure for all members'.⁸⁰⁶

⁸⁰⁰ Exhibit 5.110, 22 March 2018, Email Mota to Broom and Others with Attachment, March IIML Papers.

⁸⁰¹ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 206.

⁸⁰² Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 206.

⁸⁰³ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

⁸⁰⁴ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

⁸⁰⁵ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

⁸⁰⁶ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

Fourth, the paper said that appropriate communications would ‘minimise risks of disengagement’.⁸⁰⁷

The general tenor of the paper was that an ‘approach which sees the recommended pricing only apply to new members, while allowing all members to access the new pricing on request, based on their personal circumstances and needs, would seem to provide an optimal approach’.⁸⁰⁸ The paper did not explain that members without advisers, or members with advisers who received grandfathered commissions, were unlikely to switch to the new pricing.

On 23 March 2018, the board considered the matter. Only the two independent directors voted. They approved the changes and communication plan.⁸⁰⁹

4.5 ANZ transaction

As already noted, ANZ has agreed to sell its superannuation business to IOOF. The Commission looked at how the ANZ trustee approached its role in that transaction.

OPC, Oasis and OnePath Life Limited (OnePath Life) are all subsidiaries of ANZ. They operate within the Pensions and Investments (P&I) business unit of ANZ Wealth, which is in turn a division of ANZ.⁸¹⁰ OPC and Oasis are both RSE licensees of regulated superannuation funds. OnePath Life is a life company. OPC is the RSE licensee of two regulated superannuation funds, the OnePath MasterFund (the MasterFund) and the Retirement Portfolio Service (the Retirement Portfolio). OPC issues a number of superannuation products through the MasterFund. Contributions into those products are invested through investment-linked life policies issued to OPC

⁸⁰⁷ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

⁸⁰⁸ Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

⁸⁰⁹ Exhibit 5.112, 30 May 2018, Board Papers, Meeting of IIML Board, 10.

⁸¹⁰ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 6 [11].

by OnePath Life. OnePath Life is also the administrator and group insurer of the MasterFund.⁸¹¹

ANZ has agreed to sell OPC and Oasis, and other parts of the P&I business, to IOOF Holdings.⁸¹² At the time of the relevant hearings, the transaction had not been completed. ANZ has separately agreed to sell OnePath Life to Zurich Financial Services Australia Limited.⁸¹³

The boards of OPC and Oasis were not consulted about the transaction.⁸¹⁴ They have no direct control over whether the transaction proceeds. However, a condition precedent of the transaction is that OPC redeem the investment-linked life policies issued by OnePath Life, and transfer the assets of the MasterFund to another superannuation fund. Either OPC or an IOOF company must be the trustee of that other fund.⁸¹⁵ The purpose of this condition is to separate the business being sold to IOOF Holdings from the business being sold to Zurich.⁸¹⁶

The OPC Board must approve the redemption and transfer.⁸¹⁷ At the time Ms Weekes gave evidence, the board had given 'in principle' approval to consider an SFT from the MasterFund to the Retirement Portfolio.⁸¹⁸ The board preferred this option, as it would have the least impact on members.⁸¹⁹ It would also have some benefits, including removing the complex investment structure (currently in place through OnePath Life's life policies) without incurring capital gains tax.⁸²⁰ However, the board had not decided whether to make the transfer. Ms Weekes said it would

⁸¹¹ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 7 [18].

⁸¹² Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 7 [13].

⁸¹³ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 7 [18].

⁸¹⁴ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 7 [14].

⁸¹⁵ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 7 [19].

⁸¹⁶ Transcript, Victoria Weekes, 15 August 2018, 5027.

⁸¹⁷ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 8 [22].

⁸¹⁸ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 11 [36].

⁸¹⁹ Transcript, Victoria Weekes, 15 August 2018, 5027.

⁸²⁰ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 20 [94].

only do so if the transfer was in the best interest of beneficiaries of both the MasterFund and the Retirement Portfolio.⁸²¹

Two specific issues about the transaction arose.

The first related to grandfathered commissions. ANZ management had given the board a number of papers about the transaction that dealt with grandfathered commissions. One noted a ‘working assumption’ that commissions would continue to be grandfathered, and that ‘support from the advisor network is critical’ to the transaction.⁸²² Another referred to risks that could arise if grandfathered commissions were ‘disturbed’.⁸²³

Ms Weekes said that the management papers did not necessarily reflect the view of the board.⁸²⁴ Both she and others on the board had queried those statements.⁸²⁵ In particular, Ms Weekes did not accept that ‘disturbing’ grandfathered commissions would have any negative effects on members.⁸²⁶ The board had asked for legal advice and would consider the issue further.⁸²⁷

The board had not previously considered whether it was in the best interests of members to keep paying commissions.⁸²⁸ However, the advice it asked for would cover grandfathered commissions both ‘in the status quo’ and after the transaction.⁸²⁹ Ms Weekes was clear that she and the OPC Board

⁸²¹ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 22 [106].

⁸²² Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, Exhibit VW-2 [ANZ.801.042.0085].

⁸²³ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, Exhibit VW-2 [ANZ.801.042.0085].

⁸²⁴ Exhibit 5.252, Board Meeting Papers Onepath Custodians, 26 February 2018.

⁸²⁵ Transcript, Victoria Weekes, 15 August 2018, 5031.

⁸²⁶ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 20 [92].

⁸²⁷ Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 20 [90].

⁸²⁸ Transcript, Victoria Weekes, 15 August 2018, 5032.

⁸²⁹ Transcript, Victoria Weekes, 15 August 2018, 5032.

would make any decision about grandfathered commissions regardless of the wishes of the parent company – whether ANZ or IOOF.⁸³⁰

The second issue related to IOOF Holdings. Ms Weekes said that as part of deciding whether the transfer was in members' best interests, the board needed to consider matters that 'pertain to IOOF'.⁸³¹ Ms Weekes said that the board was not just concerned with the 'technical transaction' or the systems and structures that would be in place after the transaction was complete.⁸³² The board was also concerned with IOOF's view about the business and future.⁸³³ To that end, the board had received media reports about IOOF and a legal report identifying some issues.⁸³⁴

In January 2018, the board had requested a meeting with IOOF 'to give comfort to the Board that members best interest obligations will be met going forward'.⁸³⁵ At the time of her evidence in August 2018, that meeting had not occurred. This was a deliberate decision. Ms Weekes said that considering the transfer was a complex process, and the board was focused on getting the information it needed.⁸³⁶ Engaging with IOOF too early could 'confuse the very deliberate and careful considerations and the component parts of our decision'.⁸³⁷ Once the board was ready, it would consider engaging directly.⁸³⁸

⁸³⁰ Transcript, Victoria Weekes, 15 August 2018, 5032.

⁸³¹ Transcript, Victoria Weekes, 15 August 2018, 5029.

⁸³² Transcript, Victoria Weekes, 15 August 2018, 5029; Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 15 [62(c)].

⁸³³ Transcript, Victoria Weekes, 15 August 2018, 5029; Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 15 [62(c)].

⁸³⁴ Transcript, Victoria Weekes, 15 August 2018, 5035.

⁸³⁵ Exhibit 5.253, 29 March 2018, Board Meeting Agenda OnePath Custodians, 16.

⁸³⁶ Transcript, Victoria Weekes, 15 August 2018, 5033.

⁸³⁷ Transcript, Victoria Weekes, 15 August 2018, 5033.

⁸³⁸ Transcript, Victoria Weekes, 15 August 2018, 5033–4.

Ultimately, Ms Weekes was clear that if the board was not satisfied that joining the IOOF group was in the best interests of members, it would not approve the SFT.⁸³⁹

Following APRA's announcement of proceedings against IIML, Questor, and IOOF senior executives, ANZ announced that 'Given the significance of APRA's action, we will assess the various options available to us while we seek urgent information from both IOOF and APRA.'⁸⁴⁰

4.6 What the case study showed

4.6.1 Did Questor mislead TPS members in breach of section 12DA of the ASIC Act?

Counsel Assisting submitted that Questor may have engaged in misleading and deceptive conduct, in breach of section 12DA of the ASIC Act, by sending the letter to TPS members saying that they would receive compensation for a 'historical distribution error'.⁸⁴¹ IOOF submitted that such a finding was not open.⁸⁴² It submitted that the 'historical distribution error' in the letter meant the over-distribution, and on that basis everything else in the letter was true.⁸⁴³

There are a number of reasons that I cannot accept this submission.

First, the letter said that the problem had been detected 'following a periodic review'.⁸⁴⁴ In fact, the problem was detected when the new custodian took over from NCS. The statement in the letter was not true. Questor did not submit that it was.

⁸³⁹ Transcript, Victoria Weekes, 15 August 2018, 5034.

⁸⁴⁰ ANZ, 'Update on Sale of Wealth Businesses' (Media Release, 7 December 2018).

⁸⁴¹ Counsel Assisting, Module 5 Closing Submission, 65 [228.3].

⁸⁴² IOOF, Module 5 Case Study Submission, 11 [45].

⁸⁴³ IOOF, Module 5 Case Study Submission, 11 [46].

⁸⁴⁴ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 12) [IFL.0029.0001.1164].

Second, the letter said that a ‘historical distribution error’ had ‘resulted in’ a lower rate of return.⁸⁴⁵ As IOOF submitted, the expression ‘historical distribution error’ means the over-distribution. But the over-distribution did not ‘result in’ a reduced rate of return. Questor’s decision to claw back the over-distribution caused the reduced rate of return. The clawback was not inevitable. Questor chose to recoup the loss to the CMT in this manner.

Third, the letter did not explain that the compensation was being paid out of an asset held on trust for those members. Nor did it explain the choices Questor had made that led to the need for compensation.

Taken as a whole, the letter created the impression that an unexplained ‘error’ had reduced members’ payments, and Questor was now paying them back. In fact, Questor had chosen to reduce their payments to make up a loss in a different fund it controlled. It was using money it held on trust for them to pay compensation to them. In this way, the letter may have been misleading.

There is no evidence that this possible contravention of the ASIC Act is presently under investigation. The authority responsible for such a contravention is ASIC. I refer the matter to ASIC, pursuant to paragraph (a) of the Commission’s Terms of Reference for ASIC to consider what course it should take.

4.6.2 Pricing changes

Counsel Assisting submitted that IIML may have breached section 52(2) (c) of the SIS Act, and prioritised its own interests over the interests of members of the fund in breach of section 52(2)(d) of the Act, by not applying the new IES pricing to members who would be better off.⁸⁴⁶

IOOF rejected that suggestion. It submitted that the repricing decision was part of a broader strategy to benefit all members,⁸⁴⁷ that there was no

⁸⁴⁵ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 12) [IFL.0029.0001.1164].

⁸⁴⁶ Counsel Assisting, Module 5 Closing Submission, 65 [229.1].

⁸⁴⁷ IOOF, Module 5 Case Study Submission, 13 [56].

evidence that retaining revenue was an important consideration for IIML,⁸⁴⁸ and that in any case IIML was not able to identify which members would be better off.⁸⁴⁹ IOOF emphasised that IIML made the new pricing available to existing members.⁸⁵⁰

There were three troubling aspects of IOOF's approach to the pricing changes.

The first is that IIML appeared to assume that financial advisers will not act in members' best interests. Mr Oliver's evidence was that members paying a grandfathered trail commission are generally slower to move to new pricing, even when it is in their interests to do so. That can only happen if members are not receiving appropriate advice.

The second is that IIML management may not have given priority to members' best interests. Management knew that members would be better off if they moved, but assumed that they would not. Management relied on that assumption when setting the new pricing. In fact, it set the pricing such that if all new members took it up immediately the product would become 'unviable'. That is, IIML's management were proposing a pricing scheme under which either some members would be worse off because their financial advisers failed to act in their interests, or the product would be unviable. Despite apparently believing that some financial advisers would be slow to move clients to lower pricing, IIML's communication plan relied on those same advisers to advise members about the lower pricing.

Third, IIML management did not explain this to the board. None of the board papers explain IIML's experience with grandfathering. None of the papers explain how many members were paying trail commission. In those circumstances, the board could not make an informed decision about the proposal or the communication plan.

Having regard to these matters, I am satisfied that IIML may have failed to act in the best interests of members and thereby contravened section 52(2)(c) of the SIS Act. The matter not having been drawn to the

⁸⁴⁸ IOOF, Module 5 Case Study Submission, 13 [59].

⁸⁴⁹ IOOF, Module 5 Case Study Submission, 14 [62].

⁸⁵⁰ IOOF, Module 5 Case Study Submission, 15 [63].

attention of the regulator, I refer the conduct to APRA in accordance with paragraph (a) of the Commission's Terms of Reference, for its consideration.

4.6.3 ANZ transaction

Finally, it is as well to say something about the conduct of the OPC Board. OPC is a trustee within a large retail group. The sale of OPC and Oasis was one part of a larger transaction, arranged by and for the benefit of the trustee's parent group. The trustee's approval of the SFT was a condition precedent to that transaction.

The tenor of Ms Weekes' evidence was that the OPC Board was focused on the interests of its members. Her evidence was that the board actively considered the various matters involved, sought more information when necessary, was prepared to challenge management, and tried to think strategically about both the substantive decision and the board's decision-making processes. That focus on OPC's members, despite significant and potentially conflicting interests of the parent group, is to be commended.

5 ANZ branch selling program

5.1 Background

OnePath Custodians Pty Ltd (OPC) is a wholly owned subsidiary of ANZ and an RSE licensee. OPC offers a superannuation product that it refers to as Retail Smart Choice Super. OPC says this is a basic, low fee superannuation product⁸⁵¹ that is 'designed to be used by a broad range of people irrespective of their age and income'.⁸⁵² This case study considered the distribution of the Retail Smart Choice Super product through ANZ branches.

⁸⁵¹ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [290]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221.

⁸⁵² Exhibit 5.310, Witness statement of Timothy Mullaly, 8 March 2018, Exhibit TM-3 [ASIC.0041.0006.0051 at .0076].

Mark Pankhurst, Head of Superannuation, Pensions and Investments for ANZ Wealth, gave evidence about this case study.

5.2 Evidence

From 2012 until August 2018, OPC engaged ANZ to distribute the Retail Smart Choice Super product through ANZ branches.⁸⁵³ The distribution process followed a ‘scripted general advice model’.⁸⁵⁴ It was designed to ‘leverage’ a regulatory exemption that allowed branch staff, who were not financial planners, to provide general advice and sell certain financial products by following a script.⁸⁵⁵ Branch staff were not allowed to make a recommendation, provide advice, or take into account any information about the customer. If they knew that Retail Smart Choice Super was not suitable for the customer, they could not say so.⁸⁵⁶

The distribution process was as follows. When a customer came into an ANZ branch for help – about any matter, not just superannuation – branch staff could conduct an ‘A–Z Review’. An A–Z Review involved the staff member asking the customer questions about their financial situation, and discussing the customer’s ‘goals and needs’.⁸⁵⁷ At the end of the A–Z Review, the staff member could recommend retail banking products to the customer.⁸⁵⁸ This was a general discussion about the customer’s finances and ANZ’s banking products. It had nothing to do with superannuation.

After the A–Z Review, the staff member read the customer a ‘delinking statement’.⁸⁵⁹ In full, that statement was:⁸⁶⁰

⁸⁵³ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [290]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221.

⁸⁵⁴ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291].

⁸⁵⁵ Exhibit 5.261, September 2013, Sale of Wealth Products by Retail Distribution, 6.

⁸⁵⁶ Exhibit 5.261, September 2013, Sale of Wealth Products by Retail Distribution, 5.

⁸⁵⁷ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 104 [289].

⁸⁵⁸ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 104 [289].

⁸⁵⁹ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291(b)].

⁸⁶⁰ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-215 [ANZ.800.873.0025].

Now that we've completed the A–Z Review, would you like me to provide you with some general information on ANZ Smart Choice Super, which is designed to be a simple low cost way for customers to manage their superannuation.

Please be aware that I won't be able to use or reference any of the information you've already provided me when discussing this product with you.

Would you like to know more about this product?

If the customer wanted more information, the staff member would offer to refer the customer to an ANZ financial planner.⁸⁶¹ From June 2015, a referral was only offered to customers with funds under management or whose gross yearly salary was over \$50,000.⁸⁶² If the customer declined, or no referral was offered, the process would continue.

The staff member would then give the customer a pack of documents that included a product disclosure statement (PDS) and a brochure. The staff member would read aloud the first two pages of the brochure.⁸⁶³ Those two pages included a 'general advice disclosure', which said that the staff member could 'only provide general advice' and that the customer should consider if the product was 'right for you'.⁸⁶⁴ From 2014, it also said that the information given by the staff member did not take into account the customer's 'personal circumstances, objectives or needs'.⁸⁶⁵ The staff member also read out from the brochure a statement of 'things you need to know'. These were that the customer should consider exit fees or additional costs, changes in investment risk exposure, and loss of any insurance they

⁸⁶¹ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291(d)].

⁸⁶² Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291(d)].

⁸⁶³ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291(e)], [291(b)].

⁸⁶⁴ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-216 [ANZ.800.873.0001].

⁸⁶⁵ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-217 [ANZ.800.873.0009]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-218 [ANZ.800.873.0017]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-219 [ANZ.800.891.0038]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-220 [ANZ.800.875.0001].

had through their current superannuation.⁸⁶⁶ At this point, if requested, the staff member would help the customer open a Retail Smart Choice Super account.⁸⁶⁷

Mr Pankhurst said that ANZ thought that this process meant customers only received general advice, not personal financial advice (which branch staff were not allowed to provide).⁸⁶⁸ ANZ monitored compliance with the process through a 'mystery shopping' program, customer surveys and tests of branch staff members. ANZ found that the process was complied with in the large majority of cases.⁸⁶⁹

Between 1 June 2016 and 30 June 2018, 60,466 customers opened a Retail Smart Choice Super account on the same day that they had an A–Z Review. Of those customers, 23,967 made a contribution or rollover into their account.⁸⁷⁰ In total, 400,988 Retail Smart Choice Super accounts were opened between 2012 and 30 June 2018.⁸⁷¹ When Mr Pankhurst gave evidence, the value of funds under management in Retail Smart Choice Super products was approximately \$3.6 billion.⁸⁷²

⁸⁶⁶ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-217 [ANZ.800.873.0009]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-218 [ANZ.800.873.0017]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-219 [ANZ.800.891.0038]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-220 [ANZ.800.875.0001].

⁸⁶⁷ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291(f)].

⁸⁶⁸ Transcript, Mark Pankhurst, 16 August 2018, 5055.

⁸⁶⁹ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 107 [306]; Exhibit 5.257, Witness statement of Mark Pankhurst, 14 August 2018, 3 [9].

⁸⁷⁰ Exhibit 5.257, Witness statement of Mark Pankhurst, 14 August 2018, 4 [10]. Due to data limitations, ANZ does not know how many A–Z Reviews were conducted before June 2016: Exhibit 5.257, Witness statement of Mark Pankhurst, 14 August 2018, 2 [8].

⁸⁷¹ Exhibit 5.257, Witness statement of Mark Pankhurst, 14 August 2018, 2 [6].

⁸⁷² Transcript, Mark Pankhurst, 16 August 2018, 5060.

5.2.1 The Services Deed

OPC engaged ANZ to perform the distribution process through a services deed executed in August 2012.⁸⁷³ OPC did not pay ANZ for providing the distribution service.⁸⁷⁴ Mr Pankhurst said that OPC would distribute revenue from Retail Smart Choice Super as part of its ordinary arrangements with ANZ.⁸⁷⁵

In 2012 the Deed referred to branch staff providing information ‘within’ the A–Z Review process.⁸⁷⁶ In September 2016, well after ASIC started investigating the matter, the Deed was amended to refer to providing information ‘after’ the A–Z Review process.⁸⁷⁷ Mr Pankhurst was ‘surprised’ by the wording of the earlier version, because he had always understood that the information was to be provided after the A–Z Review.⁸⁷⁸ ANZ submitted that the earlier wording was an error or ‘infelicity of expression’ that did not reflect the actual arrangements.⁸⁷⁹ I accept that, in practice, the process operated in the way described above. The earlier version of the Deed simply highlights, perhaps inadvertently, that the sales process was seen within ANZ as inextricably entwined with the A–Z Review.

5.2.2 ANZ’s consideration of risks

In September 2011, ANZ’s Managing Director of Distribution for Australia Division made a presentation to ANZ’s Chief Risk Officer identifying a number of risks with the ‘scripted general advice’ model. Those risks included a failure to ensure the correct process was followed, failure to provide the general advice warning, and failure to ensure that only general

⁸⁷³ Exhibit 5.260, 3 August 2012, Deed of Amendment to the Services Deed between ANZ and OnePath Custodians.

⁸⁷⁴ Transcript, Mark Pankhurst, 16 August 2018, 5059–60.

⁸⁷⁵ Transcript, Mark Pankhurst, 16 August 2018, 5060.

⁸⁷⁶ Exhibit 5.260, 3 August 2012, Deed of Amendment to the Services Deed between ANZ and OnePath Custodians, 22.

⁸⁷⁷ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-153 [ANZ.800.778.0254 at .0283].

⁸⁷⁸ Transcript, Mark Pankhurst, 16 August 2018, 5059.

⁸⁷⁹ ANZ, Module 5 Case Study Submission, 6 [19].

advice was provided.⁸⁸⁰ It also included a risk that regular breaches ‘would be seen by the regulator as “systemic”[,], putting ANZ’s licence at risk’.⁸⁸¹ The presentation described the ‘inherent risk rating’ of the process as ‘extreme’, but that with controls the ‘residual risk rating’ was ‘medium’.⁸⁸² The presentation said that distribution of Tier 1 products (such as Retail Smart Choice Super) through branches was a ‘key component’ of ANZ’s strategy to ‘improve its wealth penetration’.⁸⁸³ It recommended that the Chief Risk Officer accept the risks.⁸⁸⁴

Two years later, in 2013, ANZ identified a number of specific risks in the distribution process. One was that discussing Retail Smart Choice Super directly after the A–Z Review might ‘imply to the customer that the staff member believes Retail Smart Choice Super is suitable for them’.⁸⁸⁵ The ‘delinking statement’ and ‘general advice warning’ were intended to address this risk by separating the A–Z Review from the provision of information about Retail Smart Choice Super. Another risk, which one paper described as the ‘key risk’, was that customers would switch their superannuation without understanding the consequences, and end up with a less suitable product.⁸⁸⁶ The ‘things you need to know’ statement was intended to address this risk.

⁸⁸⁰ Exhibit 5.262, 30 September 2011, Retail Distribution Advisory Risk, Australia Division, 2.

⁸⁸¹ Exhibit 5.262, 30 September 2011, Retail Distribution Advisory Risk, Australia Division, 3.

⁸⁸² Exhibit 5.262, 30 September 2011, Retail Distribution Advisory Risk, Australia Division, 3.

⁸⁸³ Exhibit 5.262, 30 September 2011, Retail Distribution Advisory Risk, Australia Division, 2.

⁸⁸⁴ Exhibit 5.262, 30 September 2011, Retail Distribution Advisory Risk, Australia Division, 2.

⁸⁸⁵ Exhibit 5.261, September 2013, Sale of Wealth Products by Retail Distribution.

⁸⁸⁶ Exhibit 5.261, September 2013, Sale of Wealth Products by Retail Distribution, 4.

5.2.3 ASIC investigation

In September 2014, ASIC started investigating ANZ's distribution process.⁸⁸⁷ In December 2016, ASIC gave ANZ a 'position paper' that said that ASIC suspected that the distribution process breached the law.⁸⁸⁸ In May 2017, ASIC sent ANZ a draft court pleading that alleged that the distribution process breached the law.⁸⁸⁹ Between May 2017 and July 2018 the parties negotiated. On 5 July 2018, ASIC accepted an enforceable undertaking (EU) from ANZ.⁸⁹⁰

The EU recorded that ASIC held several concerns. One of those concerns was that the distribution process may not have allowed for informed decision-making, because customers may not have realised that branch staff were not considering their personal circumstances.⁸⁹¹ Another was that branch staff had provided personal advice.⁸⁹² The EU said that ASIC was concerned that ANZ may have breached sections 912A, 964A and 961K of the Corporations Act. ANZ acknowledged in the EU that ASIC's concerns were reasonably held.⁸⁹³

Under the EU, ANZ agreed to stop using the distribution process, or any similar process, within 45 days of the EU.⁸⁹⁴ In submissions, ANZ said it had stopped the practice 'from 18 August 2018'.⁸⁹⁵

⁸⁸⁷ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 107 [300].

⁸⁸⁸ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-2 [ASIC.0041.0003.2761].

⁸⁸⁹ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-6 [ASIC.0041.0001.7093].

⁸⁹⁰ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221 [ANZ.800.870.0001].

⁸⁹¹ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221 [ANZ.800.870.0001 at .0004].

⁸⁹² Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221 [ANZ.800.870.0001 at .0004].

⁸⁹³ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221 [ANZ.800.870.0001 at .0004].

⁸⁹⁴ Exhibit 5.256, Witness statement of Mark Pankhurst, 105 [290].

⁸⁹⁵ ANZ, Module 5 Case Study Submission, 6 [20].

5.3 What the case study showed

5.3.1 Distribution process

Superannuation is a complex financial product that, for many people, is one of their biggest assets. It is different in both character and importance from retail products like a bank account. However, ANZ's distribution process effectively added Retail Smart Choice Super to its normal sales process for retail products. As ANZ identified, this process gave rise to two significant risks: first, that the customer would conclude from it being offered immediately after the A–Z review that the staff member thought the product suitable for the customer; and second, that the customer would switch superannuation accounts when it was not wise to do so. ANZ submitted to the Commission that both risks were mitigated by the 'delinking statement', the 'general advice disclosure', the statements made to the customer that they should consider their existing superannuation product, and the fact that the statements were read verbatim.⁸⁹⁶ I do not agree.

Information about Retail Smart Choice Super was provided to customers immediately after they were asked about their financial situation and had discussed their 'goals and needs'. As ANZ recognised, the very structure of that process could imply that staff were suggesting the product because it was right for them. If customers believed that the product was suitable for them, they would be more likely to switch. Yet, in fact, the product might not be suitable. Indeed, branch staff might know (from the A–Z Review) that Smart Choice Super was *not* suitable, but could not tell the customer. In other words, ANZ's process required its staff to stand by while customers made decisions that were not in their interests. Reading out two short scripted statements could not overcome this risk.

The second risk was that customers would switch their superannuation without proper consideration, and be worse off as a result. The considerations involved in switching superannuation – such as exit fees, investment risk, and insurance – are important and often complex. Every customer should carefully consider them before making a decision. ANZ's own risk assessments and scripts acknowledged this. Yet the distribution process ultimately led to the staff member offering to help the customer

⁸⁹⁶ ANZ, Module 5 Case Study Submission, 8 [33], [35].

apply for an account on the spot. Few customers could appropriately consider those complex issues and make an informed decision to open a new account right away, particularly if they had not come to the branch to talk about superannuation. Again, this problem could not be overcome by short scripted statements.

5.3.2 Misconduct

Despite its acknowledgment in the EU that ASIC's concerns were reasonably held, ANZ submitted to the Commission that its conduct did not breach section 912A of the Corporations Act or fall below community standards and expectations.

Effective controls?

ANZ submitted that it had behaved prudently by identifying the risks in the process and putting in place appropriate controls.⁸⁹⁷ It submitted that its control framework was effective, pointing to the results of the mystery shopping program.⁸⁹⁸ But those results showed only that in most (but not all) cases, branch staff were complying with the process. They did not show that the process was effective. In particular, they did not show whether customers understood that the discussion about Retail Smart Choice Super was entirely separate from the A–Z Review.⁸⁹⁹ And even if that was understood, ANZ's controls did not show whether customers would be harmed by switching to the offered product.

To Mr Pankhurst's knowledge, ANZ has never considered whether customers were worse off as a result of switching to Retail Smart Choice Super.⁹⁰⁰ In its submissions, ANZ submitted that ASIC had not 'definitively' identified any customer who was worse off.⁹⁰¹ The suggestion appeared to be that I should not make any of the adverse findings invited by Counsel Assisting without definitive evidence that customers were worse off.

⁸⁹⁷ ANZ, Module 5 Case Study Submission, 7 [32].

⁸⁹⁸ ANZ, Module 5 Case Study Submission, 9 [37].

⁸⁹⁹ Transcript, Mark Pankhurst, 16 August 2018, 5065–6.

⁹⁰⁰ Transcript, Mark Pankhurst, 16 August 2018, 5067.

⁹⁰¹ ANZ, Module 5 Case Study Submission, 6 [23], 9 [37].

I do not find this submission convincing. ASIC had only conducted ‘a preliminary analysis’ of ‘a small number of customers’.⁹⁰² At the least, some of those customers had given up Total and Permanent Disability (TPD) Insurance coverage as a result of switching to Retail Smart Choice Super.⁹⁰³ ANZ further observed that of the customers ASIC reviewed, all but one were paying lower fees in Retail Smart Choice Super than in their old superannuation fund. However, as ANZ’s own scripts acknowledged, there are important matters other than fees that are relevant. The distribution process did not allow for proper consideration of those matters.

ASIC’s guidance

Underlying a number of ANZ’s submissions was the proposition that ANZ’s practices were consistent with ASIC’s published guidance, and with ASIC’s views (as ANZ understood them). In particular, ANZ referred to a risk paper dated July 2011. That paper recorded that in 2009, ANZ had sought ASIC’s view about branch distribution of a different product. According to the paper, ASIC had indicated to ANZ that:⁹⁰⁴

The ability to provide general advice was not compromised by prior awareness or concurrent completion of a customer fact find process. The crucial factor was the absence of a personal recommendation as to the suitability of, or, [recommendation] to acquire a product.’

ANZ referred to ASIC’s Regulatory Guide 244, which states that ASIC will ‘not consider general advice to be personal advice’ where the customer is told that they are not being given personal advice and their relevant circumstances are not considered.⁹⁰⁵ ANZ also submitted that its training of branch staff exceeded the minimum requirements set by ASIC’s Regulatory Guide 146.⁹⁰⁶

I do not doubt that at the time ANZ began to sell Retail Smart Choice Super in branches, it believed that its conduct was lawful. In particular,

⁹⁰² Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 16 [76].

⁹⁰³ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 16 [76].

⁹⁰⁴ Exhibit 5.263, July 2011, Wealth Risk Mass Market Wealth Australian Distribution Advice and Distribution Risk, 18.

⁹⁰⁵ ASIC, Regulatory Guide 244, 13 December 2012, reg 244.23.

⁹⁰⁶ ANZ, Module 5 Case Study Submission, 9 [36].

I accept that it thought it possible to sell superannuation under a ‘general advice model’ and that this view of the matter was discouraged neither by ASIC’s response when ANZ raised the question with it nor by the requirements set out in the above-mentioned regulatory guides. It would have been better if ASIC had made clear that distributing complex financial products in this way was unacceptable. But I do not consider that this excuses ANZ’s conduct. First, ANZ knew the risks of the process from its own analyses. Its primary concern should have been whether the distribution process was appropriate for customers, which it was not. Second, ANZ did not respond to the regulator’s expressions of concern. By 2014, ANZ knew that ASIC had concerns about the process. By 2016, it knew that ASIC suspected it had breached sections 912A, 961B and 961K of the Corporations Act. By May 2017, it knew that ASIC was threatening to go to court alleging contravention of those provisions. Yet ANZ continued to use the distribution process. It continued using the process while negotiating the EU. It continued using the process after the EU was signed. In fact, it did not stop the process until three days before the absolute deadline imposed by the EU. The only conclusion can be that the profitability of this sales channel was more important than the probability that what was being done was contrary to law.

Breaches

Under section 912A(1)(a), ANZ was required to do all things necessary to ensure that its financial services were provided ‘efficiently, honestly and fairly’. As I have explained above, ANZ’s process:

- could have led customers to wrongly believe staff thought the product was suitable for their individual needs;
- prevented staff from telling customers if staff thought the product was unsuitable; and
- not only facilitated, but encouraged, customers opening an account without the customer properly considering the consequences.

ANZ recognised those risks. It should not have distributed a superannuation product in this way. In doing so, ANZ may not have ensured that financial services were provided ‘efficiently, honestly and fairly’ as required under section 912A(1)(a). As ASIC has accepted an EU from ANZ in respect of its concerns, I do not consider it necessary to refer these matters to ASIC.

6 Suncorp Portfolio Services Limited

6.1 Background

Suncorp Portfolio Services Limited (SPSL), a company within the Suncorp group, is the trustee of two superannuation funds, Suncorp Master Trust (the Master Trust) and the Suncorp Pooled Superannuation Trust.⁹⁰⁷ At the time of the Commission's inquiries, the Master Trust had funds under administration of around \$6.8 billion and approximately 216,000 members.⁹⁰⁸ The Master Trust contains a number of different divisions as a result of several successor fund transfers between 2008 and 2011.⁹⁰⁹ The assets in at least three of those divisions are invested in life insurance policies issued by Suncorp Life and Superannuation Limited (Suncorp Life), another company within the Suncorp group.

The evidence focused on two issues:

- the payment of amounts by SPSL to Suncorp Life for services, and the disclosure of those payments to members; and
- some aspects of SPSL's responses to the MySuper reforms.

⁹⁰⁷ Transcript, Maurizio Pinto, 13 August 2018, 4806.

⁹⁰⁸ Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 3 [12].

⁹⁰⁹ Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 2 [9]; Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, Exhibit EAC-1 [SUN.1506.0001.0007].

The Commission heard evidence from Mr Maurizio Pinto, the Executive Manager of the Office of the Superannuation Trustee within SPSTL.⁹¹⁰

6.2 Evidence

6.2.1 Payments to Suncorp Life

SPSTL and Suncorp Life share the administration of the Master Trust. SPSTL currently provides administration services to 75% of its membership, and Suncorp Life provides administration services to the remaining 25%.⁹¹¹ Before a recent rebalancing between investment through life insurance policies and investments managed through the Suncorp Group Trust, 'Suncorp Life was administering 45 per cent of the membership and SPSTL was administering the remaining 55 per cent'.⁹¹²

SPSTL does not recover the costs of its administration of the Master Trust directly from the fund. Instead, administration and other fees are determined for each product and charged to members. Once paid, the fees form part of SPSTL's general revenue.⁹¹³ This differs from the administration reserve model generally adopted by 'not for profit' RSE licensees. Under that model, a trustee charges fees to cover its estimated expenses. The fees are paid into a reserve from which the trustee's expenses can be paid or reimbursed. By contrast, SPSTL simply receives fees as general revenue rather than paying them into a reserve.⁹¹⁴ However, as trustee, SPSTL still has the usual right to be indemnified for a liability incurred in its capacity as trustee.⁹¹⁵

⁹¹⁰ Transcript, Maurizio Pinto, 13 August 2018, 4804; Exhibit 1.164, Witness statement of Maurizio Pinto, 5 August 2018; Exhibit 5.165, Witness statement of Maurizio Pinto, 6 August 2018.

⁹¹¹ Transcript, Maurizio Pinto, 13 August 2018, 4813.

⁹¹² Transcript, Maurizio Pinto, 13 August 2018, 4813.

⁹¹³ Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 38 [91]. This is expressly authorised by the trust deed: Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, Exhibit EAC-1 [SUN.1506.0001.0007 at 0035].

⁹¹⁴ Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 38 [91].

⁹¹⁵ Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, Exhibit EAC-1 [SUN.1506.0001.0007 at 0035].

SPSL maintains a reserve in the Master Trust that it applies to meet or to reimburse itself for the liabilities it incurs as trustee. The reserve is mostly made up of surplus contributions tax amounts.⁹¹⁶ This tax surplus arises because SPSL collects 15% of every taxable superannuation contribution.⁹¹⁷ However, in some circumstances SPSL is entitled to tax deductions. As a result, not all of the 15% it collects needs to be remitted to the ATO to pay the tax due on taxable superannuation contributions. SPSL keeps the difference.⁹¹⁸

The Trustee Reserve Policy provides that SPSL has a right of reimbursement for properly incurred expenses that SPSL has paid from its own funds.⁹¹⁹ The board is required to satisfy itself that expenses are of a reasonable amount.⁹²⁰

A services deed made between SPSL and Suncorp Life provides that SPSL will pay any tax surplus to Suncorp Life in consideration for the provision of 'Additional Services'.⁹²¹ 'Additional Services' is defined by reference to services listed in various schedules, and include 'Administration Services', 'Fund Accounting Services', 'Investment Services' and 'Compliance Services', as well as any other services agreed by the parties.⁹²² The expression expressly excludes services provided under the life insurance policies issued by Suncorp Life to SPSL.

⁹¹⁶ Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 33 [77].

⁹¹⁷ Transcript, Maurizio Pinto, 13 August 2018, 4807.

⁹¹⁸ Transcript, Maurizio Pinto, 13 August 2018, 4808.

⁹¹⁹ Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 41–2 [97]; Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-1 [SUN.1501.0005.6886].

⁹²⁰ Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 41–2 [97]; Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-1 [SUN.1501.0005.6886].

⁹²¹ Transcript, Maurizio Pinto, 13 August 2018, 4809–10; Exhibit 5.166, 18 April 2018, Board Submission.

⁹²² Transcript, Maurizio Pinto, 13 August 2018, 4810–11.

Each financial year between 2013 and 2016, management recommended to the SPSL Board that all of the tax surplus should be paid to Suncorp Life.⁹²³ The annual submission by management generally included a breakdown of the cost of services.⁹²⁴ The management submission referred to a ‘four step test’ for the board in reaching its decision.⁹²⁵

- Understand the quantum of the surplus.
- Understand the quantum of Additional Services.
- Consider the appropriateness of paying Suncorp Life the surplus in consideration of those Additional Services. It was said that the reasonableness of the payment could be determined by: the disparity of the fee payable for a particular year with previous financial years; the services provided by Suncorp Life in the particular year and over the life of the services deed; and the risk sharing nature of the agreement.
- If SPSL determines that the ongoing value of the fee exceeds the ongoing value of the Additional Services, it should initiate negotiations with Suncorp Life to seek a reduction.

On its face, this process required the board to compare the ‘value’ of the fee with the ‘value’ of the Additional Services. But there was no evidence that any attempt was made to value the Additional Services. Rather, the evidence suggested that the cost incurred by SPSL was used as a ‘proxy’ for the value attributed to the Additional Services.⁹²⁶

⁹²³ Transcript, Maurizio Pinto, 13 August 2018, 4809; Exhibit 5.320, Witness statement of Maurizio Pinto, 27 July 2018, Exhibit MP-2 [SUN.1501.0005.5563]; Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-2 [SUN.1506.0011.0267]; Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-2 [SUN.1506.0011.0260].

⁹²⁴ See, eg, Exhibit 5.166, 18 April 2013, Board Submission.

⁹²⁵ See, eg, Exhibit 5.166, 18 April 2013, Board Submission; see also Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-2 [SUN.1501.0004.6602]; Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-2 [SUN.1501.0005.0948].

⁹²⁶ Exhibit 5.320, Witness statement of Maurizio Pinto, 27 July 2018, Exhibit MP-2 (Tab 19) [SUN.1501.0005.5563].

A 2017 board submission (for the 2016 financial year) acknowledged that a number of Additional Services could not be accurately valued, but asserted that the value of Additional Services would be significantly higher than the fee actually charged if there was a more reliable methodology for their allocation.⁹²⁷

Mr Pinto told the Commission that an equivalent submission has not yet been made to the board in 2018 (for the 2017 financial year).⁹²⁸

6.2.2 MySuper transition and ADA transfers

The Commission also heard evidence about SPSL's transition to the MySuper regime.⁹²⁹

As I have noted elsewhere, in 2013 the law was changed to require all RSE licensees to transfer accrued default amounts (ADAs) to a MySuper default option by 1 July 2017.

SPSL started transferring ADAs to its MySuper default option on 9 June 2017, and finished on 19 June 2017 – 13 days before the five year time limit expired.⁹³⁰ Mr Pinto told the Commission that the timing of the transition of ADAs was a deliberate strategy to reduce the implementation risk of the transfer of approximately \$790 million of members' funds.⁹³¹ He said that the transfer happened after SPSL finished a 'Super Simplification Program'.⁹³² This program ran from 2015 to November 2017 and had a number of components, including information technology outsourcing, business

⁹²⁷ Exhibit 5.320, Witness statement of Maurizio Pinto, 27 July 2018, Exhibit MP-2 (Tab 19) [SUN.1501.0005.5563].

⁹²⁸ Transcript, Maurizio Pinto, 13 August 2018, 4809.

⁹²⁹ Exhibit 5.170, 2013, MySuper Transition Plan.

⁹³⁰ Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 30 [32]; Transcript, Maurizio Pinto, 14 August 2018, 4838.

⁹³¹ Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 30 [32].

⁹³² Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 30 [32].

process outsourcing, and the simplification of SPSSL's existing suite of products.⁹³³

One consequence of not transferring ADAs sooner was that members with ADAs continued to be charged grandfathered commissions until just before the statutory deadline. After the transfer, commissions could not be charged because of the MySuper rules. But if members gave an investment direction and opted out of the transfer, they would remain in a choice product, the MySuper rules would not apply and grandfathered commissions would continue to be paid.

Members were notified of the transfer on 6 March 2017. Yet SPSSL had started communicating with advisers much earlier. Suncorp, in one 2013 email, told advisers that commissions would be payable on products that contained ADAs 'until' 2017.⁹³⁴ It said that, for choice members who had made an investment decision, '[g]randfathered commissions [will still be] paid on insurance and [funds under administration]'.⁹³⁵

SPSSL also emailed advisers recommending that 'you call or write to your key MySuper customers and encourage them to make an investment decision'.⁹³⁶ It emailed advisers lists of their clients who would be affected by the MySuper changes. Mr Pinto said that the trustee had provided the lists and files to an 'intermediaries' team, which was set up to 'assist advisers' and 'build relationships with advisers', without knowing what the documents would be used for.⁹³⁷ Mr Pinto accepted that an effect of making an investment decision was that the member would not transition into a MySuper product and would continue to pay commissions.⁹³⁸

⁹³³ Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 19–20 [21].

⁹³⁴ Transcript, Maurizio Pinto, 14 August 2018, 4837–8; Exhibit 5.165, Witness statement of Maurizio Pinto, 6 August 2018, Exhibit MP-4 (Tab 3) [SUN.1508.0007.4238].

⁹³⁵ Exhibit 5.165, Witness statement of Maurizio Pinto, 6 August 2018, Exhibit MP-4 [SUN.1508.0007.4238].

⁹³⁶ Exhibit 5.165, Witness statement of Maurizio Pinto, 6 August 2018, Exhibit MP-4 [SUN.1508.0007.4238]; Transcript, Maurizio Pinto, 14 August 2018, 4839.

⁹³⁷ Transcript, Maurizio Pinto, 14 August 2018, 4840–1.

⁹³⁸ Transcript, Maurizio Pinto, 14 August 2018, 4839.

6.2.3 FoFA and grandfathering of commissions

The FoFA legislation was passed by Parliament on 25 June 2012 and commenced on 1 July 2012. Compliance with the FoFA reforms, including the ban on conflicted remuneration, became mandatory from 1 July 2013. Less than one week before that deadline, amendments were made to the Product Issue and Distribution Agreement between SPSL, Suncorp Life and Suncorp Financial Services Pty Ltd (Suncorp Financial).⁹³⁹

Clause 7 of the Agreement as amended provides for payment of commission and other fees by SPSL to Suncorp Financial as consideration for distribution of SPSL and Suncorp Life's products, including superannuation products.

Internal Suncorp emails from June 2013 said (in relation to the amendments): 'It is critical that these are finalised by this date to ensure that commissions can continue to be paid for any new clients into our products for the next 12 months and ... can be Grandfathered after 1 July 2014'.⁹⁴⁰ SPSL, as trustee of the Master Trust, agreed to these amendments.

The amount of commissions paid to licensees from the Master Trust has decreased somewhat, from \$19,570,000 to \$14,717,000 between 1 January 2013 and 1 January 2018.⁹⁴¹ But even if that rate of decrease continues, grandfathered commissions will continue to be paid for many years to come.

6.3 What the case study showed

6.3.1 Use of the tax surplus

Counsel Assisting submitted that SPSL, by its conduct in relation to the tax surplus, may have contravened the best interests obligations; the duty to

⁹³⁹ Exhibit 5.375, 24 June 2013, Document Approval Process Form for Distribution Agreement (SFS, SPSL and Suncorp Life), 17.

⁹⁴⁰ Exhibit 5.375, 24 June 2013, Document Approval Process Form for Distribution Agreement (SFS, SPSL and Suncorp Life), 5.

⁹⁴¹ Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 32 [33].

exercise the degree of care, skill and diligence a prudent superannuation trustee would exercise; and the applicable prudential standards.

SPSL submitted that the obligation in the services deed to pay Suncorp Life the tax surplus gave rise to an expense incurred by SPSL for which it was entitled to be indemnified.⁹⁴² If followed, so the argument went, that the payments to Suncorp Life under the services deed were a proper exercise of SPSL's right of indemnity.⁹⁴³

It will be recalled that the trustee may be indemnified for properly incurred expenses. To be properly incurred, the expenses must be reasonable. And it will be recalled that the management submissions to the board of SPSL said that the board should consider matters bearing upon whether the account to be paid for 'Additional Services' was reasonable. It is not clear that SPSL could decide whether payment of the tax surplus amounts to Suncorp Life was (or is) a properly incurred and reasonable expense. While the four step process set out in the management submissions evidently was directed to those issues, I observe that:

- So far as the evidence goes, the surplus has always been paid to the maximum extent.⁹⁴⁴
- Only limited information is provided to the SPSL Board about the *value* of the services provided by Suncorp Life. Instead, the management submission focused on the *cost* to Suncorp Life of providing those services. That is not the same thing.
- There was no evidence before the Commission of any independent valuation of the services having been requested or undertaken.⁹⁴⁵

⁹⁴² SPSL, Module 5 Case Study Submission, 15–16 [43].

⁹⁴³ SPSL, Module 5 Case Study Submission, 15 [42].

⁹⁴⁴ Exhibit 5.320, Witness statement of Maurizio Pinto, 27 July 2018, Exhibit MP-2 (Tab 19) [SUN.1501.0005.5563].

⁹⁴⁵ One management submission said that the cost of individual projects is not benchmarked against what they could be delivered for externally. Exhibit 5.166, 18 April 2013, Board Submission, 5.

- It is anything but clear – and I greatly doubt that the trustee could determine – whether services were provided and paid for under the services deed or under some other contractual arrangement.⁹⁴⁶

Prudential Standard SPS 231: Outsourcing requires RSE licensees to be able to demonstrate that outsourcing to an associated entity is conducted on an arm's length basis.⁹⁴⁷ Although SPSSL's written submissions pointed out that the standard came into effect after the services deed was executed, SPSSL did not go so far as to suggest that SPSSL need not comply with the standard.⁹⁴⁸ The arrangements between SPSSL and Suncorp Life by which Suncorp Life is paid for Additional Services are unlikely to meet those requirements.

Whether or not that is so, I consider that the arrangement made between SPSSL and Suncorp Life may not have been administered by SPSSL in accordance with its obligation to exercise the degree of care, skill and diligence a prudent superannuation trustee would have exercised, in accordance with the covenant set out in section 52(2)(b) of the SIS Act. I refer the relevant conduct to APRA, pursuant to paragraph (a) of the Commission's Terms of Reference, for APRA to consider what action it can and should take.

Separate questions about disclosure to members about the use of the tax surplus were canvassed in written submissions. SPSSL submitted that it had a right of remuneration and a right of indemnity and that both are explained to members in relevant product disclosure statements (PDSs) –

⁹⁴⁶ One management submission said there was overlap between the Additional Services and services provided in return for administration fees: Exhibit 5.320, Witness statement of Maurizio Pinto, 27 July 2018, Exhibit MP-2 (Tab 19) [SUN.1501.0005.5563]. Mr Pinto agreed that SPSSL could not be certain that the member was not paying twice for the cost of Suncorp Life's calculation of the unit price, for example: Transcript, Maurizio Pinto, 14 August 2018, 4831.

⁹⁴⁷ APRA, Prudential Standard SPS 231, 15 November 2012, [16].

⁹⁴⁸ SPSSL, Module 5 Case Study Submission, 17 [48].

albeit that the right of remuneration can be precisely quantified in the form of fees whereas the right of indemnity, by its nature, can not.⁹⁴⁹

In its written submissions, Suncorp submitted that there was no basis for finding that the PDS and Product Guide were misleading. It submitted that there was no basis for an assumption that the administration fees expressly payable by members to SPSL should be ‘comprehensive and exhaustive of all administration expenses of the Master Trust’.⁹⁵⁰ It also submitted that there could be no reasonable expectation that the fact that excess contributions will be paid to Suncorp Life for administration services will be disclosed. Suncorp submitted that ‘the fact that excess contributions tax amounts may be used to pay expenses of the Master Trust is disclosed in plain terms in the Product Guide’.⁹⁵¹

I agree with Suncorp’s submission that the PDS and Product Guide were not themselves misleading. The PDS and Product Guide revealed to readers that excess contributions tax collected from members would not be refunded to members. The PDS and Product Guide also revealed that the excess contributions tax might be used to cover administrative expenses that were incurred by the fund. What this meant in terms of the effective amounts paid by a member towards administration of the fund was not revealed by the PDS and Product Guide but, as Suncorp submits, SPSL had no stand-alone obligation to include within the PDS a statement of administration fees that is ‘comprehensive and exhaustive of all administration expenses of the Master Trust’.

However, this raises a broader question about the adequacy of the disclosures required to be made by trustees as to the amounts paid by members towards administration.

ASIC’s Regulatory Guide 97 provides that a trustee must not use any income tax deductions to reduce the administration fee it discloses.⁹⁵² That is, if a trustee charges an administration fee of \$100 but receives a \$15 income tax deduction, it must disclose the fee as \$100, not \$85.

⁹⁴⁹ SPSL, Module 5 Case Study Submission, 15 [41].

⁹⁵⁰ SPSL, Module 5 Case Study Submission, 15 [41].

⁹⁵¹ SPSL, Module 5 Case Study Submission, 17 [51].

⁹⁵² ASIC, Regulatory Guide 97, March 2017, reg 97.172.

The benefit of the deduction should be disclosed under a separate heading within the PDS.

Suncorp, of course, did not use the tax surplus to reduce its disclosed fees. Suncorp simply kept it. Mr Pinto acknowledged that the result of retaining the tax surplus in 2016 was that members of the fund effectively paid a 1.05% administration fee.⁹⁵³ However, as Mr Pinto also acknowledged, that fact would not be obvious to members.⁹⁵⁴ If consumers are to be able to make informed comparisons between funds then they need to be able to understand the implications to them, in dollar or percentage terms, of a fund retaining excess contributions tax. Otherwise, it will be effectively impossible to compare a fund that adopts this practice, and therefore charges a lower face administration fee, with a fund that does not adopt this practice and charges a transparent administration fee that covers all administration expenses.

6.3.2 Misconduct in respect of MySuper and ADA transfers

It will be recalled that RSE licensees were obliged to attribute default contributions to a MySuper product *by* 1 July 2017. SPSL submitted that its conduct was reasonable because it completed the transfer within that legislative time limit.⁹⁵⁵ As I have noted elsewhere, the legislative deadline for compliance represented an outer limit. It did not mean that RSE licensees were entitled to wait until 30 June 2017 to comply. They were still required to comply with their other obligations, including their covenant to act in the best interests of members.

SPSL also submitted that it was reasonable to complete the transfer after the Super Simplification Program, because of the complexity that existed before that program was completed.⁹⁵⁶ There are two difficulties with this submission. The first is that the Program was not implemented until 2015, long after the transition requirement was known. If it was part

⁹⁵³ Transcript, Maurizio Pinto, 14 August 2018, 4823.

⁹⁵⁴ Transcript, Maurizio Pinto, 14 August 2018, 4823.

⁹⁵⁵ SPSL, Module 5 Case Study Submission, 18 [53].

⁹⁵⁶ SPSL, Module 5 Case Study Submission, 18 [53].

of the transition strategy, why did it not start until 2015? The second is that Mr Pinto said that the transfer, which occurred in June 2017, started ‘immediately following the completion of the [Program]’.⁹⁵⁷ But he also said that the Program was ‘implemented from 2015 until November 2017’.⁹⁵⁸ If that is right, the Program was not completed until after the transfer had occurred. This apparent contradiction was not explored in evidence. But even accepting that all of the work of the relevant Program was complete at the time of transfer, I am not persuaded that it provides an adequate reason for Suncorp’s delay. At best, it was one factor among others.

One of those other factors was that until the transition happened, commission payments would be made to advisers in respect of ADAs. Advisers stood to benefit from a delayed transition. Members did not. Yet rather than writing to members to inform them of this fact (among others), SPSL wrote to advisers to recommend that the adviser encourage the member to make an investment decision. SPSL submitted that an investment decision did not necessarily mean a continued payment of commission, since a client could tell their adviser they desired to be invested in the MySuper product.⁹⁵⁹ Strictly speaking, that is true. But taken as a whole, the communications suggest a focus on encouraging members to take action that would stop them from being transferred to a MySuper product.

I consider that Suncorp’s delay in transferring ADAs, and its actions encouraging advisers to contact members, each may have breached the covenant to act in the best interests of its members. It might also have been a breach of its covenant to prioritise the interests of members over others (like financial advisers). The conduct not having been drawn to the attention of the regulator, I refer the relevant conduct to APRA, pursuant to paragraph (a) of the Commission’s Terms of Reference, for APRA to consider what action it can and should take.

⁹⁵⁷ Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 30 [32].

⁹⁵⁸ Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 19 [21].

⁹⁵⁹ SPSL, Module 5 Case Study Submission, 19 [58]–[59].

6.3.3 Grandfathered commissions

As described above, the Distribution Agreement between SPSL, Suncorp Life and Suncorp Financial was apparently amended, at least in part, for the express purpose of maintaining grandfathered commissions. This topic was not explored in Mr Pinto's oral evidence. Nor did Counsel Assisting submit that Suncorp's conduct in this respect constituted misconduct or conduct falling below community standards or expectations.

In the circumstances, I do not make any findings about this conduct. I only observe that, on its face, it is difficult to understand how amending the agreement to allow for grandfathered commissions to be maintained was in members' best interests. Commission payments reduce members' benefits. But it is not clear what benefits, if any, were to flow to members as a result of the amendments. On the limited material available, it is not clear that members' interests were even considered when the decision was made. If it were the case that the amendments would result in continued reduction of members' benefits with no corresponding benefit, Suncorp should not have agreed to them. But, as I say, I make no finding.

7 QSuper

7.1 Background

This case study highlighted the steps taken by QSuper to make its products and services more accessible to its vulnerable members, including Aboriginal and Torres Strait Islander members living in remote communities.

Evidence in this case study was given by Ms Lynette Melcer, the Head of Technical Advice for the QSuper Board.⁹⁶⁰ QSuper is a public sector fund and is the default superannuation fund for all employees of Queensland government departments and employees of a number of Queensland government agencies.⁹⁶¹ It has funds under management of more than \$104 billion.⁹⁶²

⁹⁶⁰ Transcript, Lynette Melcer, 13 August 2018, 4710.

⁹⁶¹ Transcript, Lynette Melcer, 13 August 2018, 4711.

⁹⁶² Transcript, Lynette Melcer, 13 August 2018, 4711.

7.2 Evidence

During the fourth round of hearings, the Commission had heard that significant issues affecting Aboriginal and Torres Strait Islander people living in remote communities were the barriers to their engagement with and ability to access their superannuation.

The Commission heard that many Aboriginal and Torres Strait Islander people living in such communities were unaware of their superannuation entitlements or experienced difficulty when accessing those entitlements, due to factors including geographical isolation, the ways in which superannuation funds have implemented identification requirements, and complexities associated with Indigenous kinship structures.⁹⁶³

During that round of hearings, Mr Nathan Boyle, a Senior Policy Analyst in ASIC's Indigenous Outreach Program, told the Commission that in 2014, he and Ms Melcer visited the Lockhart River community in Far North Queensland.⁹⁶⁴ Mr Boyle and Ms Melcer met with a significant number of people who were unable to access their superannuation entitlements, and provided those people with assistance.⁹⁶⁵

In the Commission's fifth round of hearings, Ms Melcer gave evidence about her experience with the Lockhart River community, and about her involvement in QSuper and industry initiatives to assist Aboriginal and Torres Strait Islander people to access their superannuation.⁹⁶⁶

QSuper estimated that 5,648 of its members identified as Aboriginal and/or Torres Strait Islander people.⁹⁶⁷ An estimate was necessary because

⁹⁶³ Transcript, Lynda Edwards, 3 July 2018, 3719; Transcript, Nathan Boyle, 3 July 2018, 3720–2.

⁹⁶⁴ Transcript, Nathan Boyle, 3 July 2018, 3757.

⁹⁶⁵ Transcript, Nathan Boyle, 3 July 2018, 3757.

⁹⁶⁶ Transcript, Lynette Melcer, 13 August 2018, 4713–21.

⁹⁶⁷ Transcript, Lynette Melcer, 13 August 2018, 4712.

QSuper does not ask its members whether they identify as Aboriginal and/or Torres Strait Islander people.⁹⁶⁸

In relation to the trip to the Lockhart River community, Ms Melcer explained that she and Mr Boyle spent three days working with more than 100 Aboriginal and Torres Strait Islander people who were members of QSuper, AMP, Sunsuper and LGIAsuper.⁹⁶⁹ Ms Melcer and Mr Boyle assisted those people to complete superannuation-related forms, prepare supporting documentation and get in contact with their superannuation funds.⁹⁷⁰

Ms Melcer said that the people she assisted faced a number of distinct difficulties. Among other things, many people experienced difficulties in satisfying the identification requirements of superannuation funds; some did not have a valid driver's licence, passport or birth certificate.⁹⁷¹ They also faced difficulties interacting with superannuation funds and completing paperwork, due in part to a lack of access to necessary technology, including computers and functioning photocopiers.⁹⁷² At least one person experienced difficulties proving his medical condition: it was hard for him to find two medical practitioners who could attest to his condition: his community was only visited by the Royal Flying Doctor Service.⁹⁷³ In addition, at least one person had faced difficulties obtaining a death certificate for a relative within her kinship group, but outside her immediate family unit.⁹⁷⁴ The difficulties were compounded by the fact that this person had to travel a significant distance to make inquiries about obtaining the death certificate.⁹⁷⁵

⁹⁶⁸ Transcript, Lynette Melcer, 13 August 2018, 4712.

⁹⁶⁹ Transcript, Lynette Melcer, 13 August 2018, 4714.

⁹⁷⁰ Transcript, Lynette Melcer, 13 August 2018, 4718.

⁹⁷¹ Transcript, Lynette Melcer, 13 August 2018, 4714.

⁹⁷² Transcript, Lynette Melcer, 13 August 2018, 4715.

⁹⁷³ Transcript, Lynette Melcer, 13 August 2018, 4715–16.

⁹⁷⁴ Transcript, Lynette Melcer, 13 August 2018, 4717.

⁹⁷⁵ Transcript, Lynette Melcer, 13 August 2018, 4717.

Ms Melcer told the Commission about steps that QSuper took to assist its Aboriginal and Torres Strait Islander members upon her return from the Lockhart River community. QSuper conducted a search of members living in Far North Queensland with whom it had lost contact, and noticed that there were many duplicate records.⁹⁷⁶ QSuper merged these duplicate records.⁹⁷⁷ QSuper then conducted further research into its lost superannuation accounts with the assistance of electoral offices and the Registry of Births, Deaths and Marriages.⁹⁷⁸ QSuper attempted to obtain contact details for the next of kin of members who had died, and wrote to members who it knew were over the preservation age.⁹⁷⁹ The communications were written in a straightforward way, without using jargon.⁹⁸⁰ The exercise undertaken by QSuper resulted in it reconnecting 80 people with lost superannuation totalling over \$2 million, and paying out 17 estates valued at \$1.7 million.⁹⁸¹ Ms Melcer's evidence was that this exercise did not involve any additional cost to QSuper, and did not require any additional resources.⁹⁸² Ms Melcer said that she viewed it as an obligation of QSuper to ensure that members can 'get the[ir] money when they need it'.⁹⁸³

Ms Melcer said that the steps taken by QSuper had led to members of other superannuation funds contacting QSuper, after which QSuper referred those people to the relevant fund.⁹⁸⁴ However, QSuper's ability to assist members of other funds had since been diminished as a result of reforms associated with the MyGov platform.⁹⁸⁵ She said that the process of reconnecting people with lost superannuation had been undertaken by QSuper by

⁹⁷⁶ Transcript, Lynette Melcer, 13 August 2018, 4718.

⁹⁷⁷ Transcript, Lynette Melcer, 13 August 2018, 4718.

⁹⁷⁸ Transcript, Lynette Melcer, 13 August 2018, 4718.

⁹⁷⁹ Transcript, Lynette Melcer, 13 August 2018, 4718–19.

⁹⁸⁰ Transcript, Lynette Melcer, 13 August 2018, 4721; Exhibit 5.141, 13 August 2018, Draft Letter to Member.

⁹⁸¹ Transcript, Lynette Melcer, 13 August 2018, 4719.

⁹⁸² Transcript, Lynette Melcer, 13 August 2018, 4719.

⁹⁸³ Transcript, Lynette Melcer, 13 August 2018, 4719.

⁹⁸⁴ Transcript, Lynette Melcer, 13 August 2018, 4719–20.

⁹⁸⁵ Transcript, Lynette Melcer, 13 August 2018, 4720.

using the ATO website but now can be done only through the MyGov platform and only by the person concerned.⁹⁸⁶

Since Ms Melcer's trip to the Lockhart River community, Ms Melcer has raised awareness within QSuper of issues affecting its vulnerable members, including its Aboriginal and Torres Strait Islander members living in remote communities.⁹⁸⁷ Ms Melcer has also engaged in broader advocacy work, including through the Indigenous Superannuation Working Group (ISWG).⁹⁸⁸

Ms Melcer explained that in 2016, following a recommendation discussed at the 2015 ISWG Summit,⁹⁸⁹ the Australian Transaction Reports and Analysis Centre (AUSTRAC) released a compliance guidance protocol for the identification of Aboriginal and Torres Strait Islander people (AUSTRAC Guidance).⁹⁹⁰ Ms Melcer provided feedback on drafts of the AUSTRAC Guidance.⁹⁹¹ When Ms Melcer was asked about the steps that QSuper had taken to ensure that its front line employees understood and implemented the AUSTRAC Guidance, she said that QSuper was committed to ensuring that it was 'as flexible as possible' in respect of identification requirements for its vulnerable members, including its Aboriginal and Torres Strait Islander members.⁹⁹² Ms Melcer provided the Commission with an example of a letter that QSuper had received from a community legal centre on Mornington Island, Queensland, which contained various details about one of its clients, as an alternative form of identification.⁹⁹³ Ms Melcer said that it was 'not an impost at all' for QSuper to offer these types of alternative verification procedures.⁹⁹⁴

⁹⁸⁶ Transcript, Lynette Melcer, 13 August 2018, 4720.

⁹⁸⁷ Transcript, Lynette Melcer, 13 August 2018, 4720.

⁹⁸⁸ Transcript, Lynette Melcer, 13 August 2018, 4721.

⁹⁸⁹ Exhibit 5.143, 13 August 2018, Report of Indigenous Superannuation Summit July 2015; Transcript, Lynette Melcer, 13 August 2018, 4723.

⁹⁹⁰ Transcript, Lynette Melcer, 13 August 2018, 4723.

⁹⁹¹ Transcript, Lynette Melcer, 13 August 2018, 4723.

⁹⁹² Transcript, Lynette Melcer, 13 August 2018, 4723.

⁹⁹³ Exhibit 5.144, 13 August 2018, Identity Declaration, Junkuri Laka, Mornington Island.

⁹⁹⁴ Transcript, Lynette Melcer, 13 August 2018, 4724.

Ms Melcer was asked about ways to improve the experience of vulnerable people, including Aboriginal and Torres Strait Islander people living in remote communities, with superannuation.⁹⁹⁵ Ms Melcer provided a number of suggestions.

In the context of binding nominations, Ms Melcer identified that legislation currently only permits a person to nominate their legal personal representative or 'dependent' to receive death benefits.⁹⁹⁶ Ms Melcer suggested that the definition of 'dependent' should be expanded in a way that accommodates the kinship structures operating in Aboriginal and Torres Strait Islander communities.⁹⁹⁷

Ms Melcer also gave evidence that some funds do not permit the early release of superannuation funds on the ground of severe financial hardship.⁹⁹⁸ Ms Melcer recognised that these types of claims were the most difficult claims to assess, but said that it was 'absolutely not an impost' for QSuper to offer early release on this basis, because the members who make such claims are 'in a situation where they need [their funds]'.⁹⁹⁹

Ms Melcer was asked whether it would be beneficial to lower the preservation age for Aboriginal and Torres Strait Islander people.¹⁰⁰⁰ Ms Melcer did not consider that to be desirable, but suggested that lower life expectancy could be taken into account in other ways.¹⁰⁰¹ For example, Ms Melcer suggested that it could be used by trustees and medical professionals in the course of assessing TPD claims.¹⁰⁰²

In response to a question about whether superannuation funds should ask their members whether they consider themselves to be Aboriginal

⁹⁹⁵ Transcript, Lynette Melcer, 13 August 2018, 4726.

⁹⁹⁶ Transcript, Lynette Melcer, 13 August 2018, 4726.

⁹⁹⁷ Transcript, Lynette Melcer, 13 August 2018, 4726.

⁹⁹⁸ Transcript, Lynette Melcer, 13 August 2018, 4727.

⁹⁹⁹ Transcript, Lynette Melcer, 13 August 2018, 4727.

¹⁰⁰⁰ Transcript, Lynette Melcer, 13 August 2018, 4727.

¹⁰⁰¹ Transcript, Lynette Melcer, 13 August 2018, 4727–8.

¹⁰⁰² Transcript, Lynette Melcer, 13 August 2018, 4727.

and Torres Strait Islander people, Ms Melcer said that this should not be mandatory.¹⁰⁰³ Ms Melcer said that QSuper ‘strive[s] to really understand the person that we’re talking to ... and solving [problems] for that member’, and as a result of that approach, QSuper did not need to collect information about the background of its members in this way.¹⁰⁰⁴

Finally, when asked what measures superannuation funds could take to assist vulnerable members, including Aboriginal and Torres Strait Islander people living in remote and regional communities, Ms Melcer made a number of suggestions, all of which were focused on the need for funds to understand their members.¹⁰⁰⁵

7.3 What the case study showed

This case study demonstrated that superannuation funds can take a number of steps— as QSuper has done – to better inform vulnerable members of their entitlements and to remove barriers to access. Further, this can be done at little or no cost. The case study also highlighted a number of areas for potential reform, which are addressed in the chapter of this report dealing with the superannuation sector.

8 Hostplus

8.1 Background

Hostplus Pty Limited (Hostplus) is the trustee for the Hostplus Superannuation Fund.¹⁰⁰⁶ Hostplus is a profit-for-member industry superannuation fund that was established in 1988 by the Australian Hotels Association and the Liquor, Hospitality and Miscellaneous Workers’ Union (now United Voice).¹⁰⁰⁷ Most of its members work in the hospitality and

¹⁰⁰³ Transcript, Lynette Melcer, 13 August 2018, 4728.

¹⁰⁰⁴ Transcript, Lynette Melcer, 13 August 2018, 4728.

¹⁰⁰⁵ Transcript, Lynette Melcer, 13 August 2018, 4729.

¹⁰⁰⁶ ‘Hostplus’ is used to refer to both the trustee and the fund, unless otherwise indicated.

¹⁰⁰⁷ Transcript, David Elia, 14 August 2018, 4844; Exhibit 5.321, Witness statement of David Elmslie, 26 July 2018, 4 [10], [16].

tourism industries.¹⁰⁰⁸ As at August 2018, Hostplus had approximately \$34.5 billion in funds under management and just over 1.1 million members.¹⁰⁰⁹

The Commission looked at two aspects of Hostplus' conduct:

- its use of funds on corporate hospitality to attract and retain employers; and
- its retention strategies to retain members in the fund.

The Commission heard evidence from David Elia, who has been the Chief Executive Officer of Hostplus since 2003.¹⁰¹⁰

To put the conduct in its proper context, I should explain three matters.

The first is that Hostplus is a high performing superannuation fund.¹⁰¹¹ Mr Elia said that the Hostplus default option had been the top performing default product in Australia based on return on investment (net of fees and taxes) over the period of 1, 3, 5, 7, 15 and 20 years.¹⁰¹²

Second, Hostplus's members tend to be young and disengaged, with low superannuation balances. At the time of Mr Elia's evidence, the average balance was approximately \$30,000, less than half the industry mean.¹⁰¹³ Almost 50% of Hostplus's members had a total balance of less than \$6,000.¹⁰¹⁴ At 30 June 2017, 296,898 member accounts were 'inactive':

¹⁰⁰⁸ Exhibit 5.321, Witness statement of David Elmslie, 26 July 2018, 4 [10]; Transcript, David Elia, 14 August 2018, 4844.

¹⁰⁰⁹ Transcript, David Elia, 14 August 2018, 4844.

¹⁰¹⁰ Transcript, David Elia, 14 August 2018, 4843; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 3 [1], [10].

¹⁰¹¹ Transcript, David Elia, 14 August 2018, 4845.

¹⁰¹² Transcript, David Elia, 14 August 2018, 4845; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 11 [44].

¹⁰¹³ Transcript, David Elia, 14 August 2018, 4845.

¹⁰¹⁴ Transcript, David Elia, 14 August 2018, 4846; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 6 [19].

that is, no contribution had been received in the preceding 12 months.¹⁰¹⁵ The fund's members are largely young people who have recently entered the workforce, are employed on a casual or part-time basis, and who regularly change employment.¹⁰¹⁶

The consequences of disengagement and low balances can be significant. For example, the Commission received a half-yearly member statement dated 30 June 2017. The statement showed that the member had not made any contributions to the account during the previous six months. The member had received net investment returns of \$83.91, paid administration fees of \$39 and insurance premiums of \$565.59, and had a closing balance of \$1,216.54.¹⁰¹⁷ If the member did not act, their account balance would reduce.¹⁰¹⁸

The third point to notice is that Hostplus has two sources of revenue.¹⁰¹⁹ The first is administration fees collected from members. The second source is a tax benefit that Hostplus receives on members' insurance premiums.¹⁰²⁰ The benefit arises because Hostplus collects 15% of every taxable superannuation contribution, but in some circumstances is entitled to tax deductions. As a result, not all the 15% it collects needs to be remitted to the ATO. In practice, this benefit yields Hostplus an amount equal to 15% of the insurance premiums paid by members.¹⁰²¹ Hostplus retains these amounts in an administration reserve. As at May 2018, Hostplus' administration reserve was forecast to hold a balance of approximately \$172 million as at 30 June 2018.

¹⁰¹⁵ Transcript, David Elia, 14 August 2018, 4846–7; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 6 [20].

¹⁰¹⁶ Transcript, David Elia, 14 August 2018, 4845–6, 4855.

¹⁰¹⁷ Transcript, David Elia, 14 August 2018, 4862; Exhibit 5.177, 30 June 2017, Member Statement.

¹⁰¹⁸ Transcript, David Elia, 14 August 2018, 4862–3.

¹⁰¹⁹ Exhibit 5.362, 15 March 2018, Draft Australian Asset Owner Stewardship Code, 106.

¹⁰²⁰ Transcript, David Elia, 14 August 2018, 4859; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

¹⁰²¹ Transcript, David Elia, 14 August 2018, 4859; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

At the time of the events described below, Hostplus's revenue from the tax benefit was likely to significantly reduce. Proposed legislation would require members with balances of less than \$6,000, under the age of 25, or who had not made a contribution in 13 months, to 'opt-in' to insurance. Over 670,739 members (paying 43% of total insurance premiums) would have their insurance cover end if this legislation was introduced,¹⁰²² reducing the benefit to Hostplus by approximately \$14.5 million per year.¹⁰²³ Further, Hostplus intends to comply with the Insurance in Superannuation Voluntary Code of Practice, which provides that insurance cover must end if no contribution has been made within 13 months.¹⁰²⁴ Even without legislative change, this change would reduce Hostplus's revenue.

8.2 Evidence

8.2.1 Marketing and corporate hospitality

Hostplus spends a significant amount each year on marketing and entertainment. In the year ended 30 June 2017, Hostplus's marketing and entertainment expenses were \$21.44 million.¹⁰²⁵ This has increased from \$13.12 million in 2013.¹⁰²⁶ Part of this money is spent on corporate entertainment, where Hostplus senior executives 'informally entertain current and prospective employers'.¹⁰²⁷ For example, the Commission heard that Hostplus spent approximately \$260,000 on corporate entertainment for employers to attend the Australian Open tennis competition in 2018.¹⁰²⁸

¹⁰²² Transcript, David Elia, 14 August 2018, 4859; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

¹⁰²³ Transcript, David Elia, 14 August 2018, 4859–60; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

¹⁰²⁴ Hostplus, Module 5 Case Study Submission, 1 [5].

¹⁰²⁵ Transcript, David Elia, 14 August 2018, 4865; Exhibit 5.321, Witness statement of David Elmslie, 26 July 2018, Exhibit DE-2 (Tab 5) [HOS.0014.0001.0257].

¹⁰²⁶ Transcript, David Elia, 14 August 2018, 4865; Exhibit 5.321, Witness statement of David Elmslie, 26 July 2018, Exhibit DE-2 (Tab 5) [HOS.0014.0001.0257].

¹⁰²⁷ Transcript, David Elia, 14 August 2018, 4866; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 8 [27].

¹⁰²⁸ Transcript, David Elia, 14 August 2018, 4867.

Mr Elia agreed that the amount spent on marketing and entertainment expenses was ‘not an insignificant sum of money’, but said that it was ‘done for the right purposes’ of retaining the default status of the fund for employers currently with Hostplus¹⁰²⁹ and to build brand awareness.¹⁰³⁰ Mr Elia said that hosting employers at events such as the Australian Open was a way to establish and retain relationships that are ‘absolutely critical in terms of retaining the default fund status ... and, therefore, retaining members’.¹⁰³¹ That is, the ultimate purpose of the entertainment spend was to grow and retain funds to take advantage of scale.¹⁰³²

Mr Elia was asked why he thought employers needed to be entertained to select Hostplus as their default fund. He said that the high performance of the fund was not enough to retain default status.¹⁰³³ He said that Hostplus loses approximately \$500 million a year in rollovers to underperforming, and high cost, funds.¹⁰³⁴ He said that:¹⁰³⁵

Relationships are absolutely critical. And where you have – you may have one or two individuals ostensibly making default fund decisions on behalf of their entire workforce. Let me tell you, I don’t like it. I don’t like the fact that we lose default fund status or lose employers to other competitors, to poorer performing funds, high fee paying funds. It does not make any sense to me. So retention of defaults is absolutely critical. And unashamedly – unashamedly, we utilise, you know, entertainment, corporate hospitality, in order to strengthen the relationships we have with our employers. You need to do that.

¹⁰²⁹ Transcript, David Elia, 14 August 2018, 4869.

¹⁰³⁰ Transcript, David Elia, 14 August 2018, 4870.

¹⁰³¹ Transcript, David Elia, 14 August 2018, 4867.

¹⁰³² Transcript, David Elia, 14 August 2018, 4866; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 8 [27].

¹⁰³³ Transcript, David Elia, 14 August 2018, 4867–8, 4870.

¹⁰³⁴ Transcript, David Elia, 14 August 2018, 4870.

¹⁰³⁵ Transcript, David Elia, 14 August 2018, 4868.

8.2.2 Retention strategies

Hostplus's member retention strategies were directed at members who were inactive and had a balance of \$6,000 or less. Mr Elia agreed that inactive members with low balances were less likely to be engaged with their superannuation, and may have moved on to another employer and, as a result, may have joined another superannuation fund.¹⁰³⁶

Where an RSE licensee holds funds in an account that becomes a 'lost member account', it must pay those funds to the ATO. An account becomes a 'lost member account' where the balance is less than \$6,000 and the member is a 'lost member' (among other things, where the member has not contacted the fund or made a contribution in the last 12 months).¹⁰³⁷

Hostplus wrote to members who appeared likely to become 'lost members' to encourage them to exclude themselves permanently from the 'lost member' process,¹⁰³⁸ such as by contacting the fund and indicating that they wished to continue to be a member of the fund.¹⁰³⁹ One such letter read:

We are writing to advise that your account may soon be closed and your money transferred to the Australian Tax Office. Your account has been identified as at risk of becoming inactive and under current legislation we are required to transfer inactive accounts to the ATO.

...

Please note if your money is transferred to the ATO your super may not experience the same level of investment return as it would with Hostplus.

The letters did not explain why the member would be transferred or the precise effect the transfer might have on their retirement savings.

¹⁰³⁶ Transcript, David Elia, 14 August 2018, 4848.

¹⁰³⁷ *Superannuation Industry (Supervision) Regulations 1994* (Cth), reg 1.03A(2)(a) and reg 1.03A(2)(b).

¹⁰³⁸ *Superannuation Industry (Supervision) Regulations 1994* (Cth), reg 1.03A(2)(a) and reg 1.03A(2)(b).

¹⁰³⁹ Exhibit 5.173, 26 February 2015, Letter to Lost Members at February 2015; Transcript, David Elia, 14 August 2018, 4850.

Hostplus also ran a marketing campaign called ‘Tick the Box Hit the Box Office’.¹⁰⁴⁰ Members were told that if they permanently opted out of the ATO lost member process, they would go into the draw to win a ‘Hoyts VIP Black card’.¹⁰⁴¹ The evidence was that around 18,500 members responded to the campaign.¹⁰⁴² Approximately 2,000 of those members exited the fund. Of the remainder, 2,000 members had balances of less than \$2,000, and approximately 180 members had their balance eroded to \$0.¹⁰⁴³

8.3 What the case study showed

8.3.1 Keeping low balance members in the fund

Hostplus submitted that there was no evidence that it had sought to keep low balance members in the fund, or engaged in any retention strategy, for the purpose of obtaining the tax benefit.¹⁰⁴⁴ Mr Elia rejected the proposition that Hostplus was reliant on the premiums paid by inactive low balance members.¹⁰⁴⁵

The administration reserve was expected to reduce from \$172 million, as at 30 June 2018, to \$45 million, by 2022 to 2023, if insurance cover ceased because no contribution had been made in 13 months.¹⁰⁴⁶ And the tax benefit accruing to the administration reserve was expected to reduce by approximately \$14.5 million per year.¹⁰⁴⁷ That amount is not insignificant. In those circumstances, it would not be surprising if Hostplus was, to at least

¹⁰⁴⁰ Transcript, David Elia, 14 August 2018, 4852; Exhibit 5.175, 2016, Inactive Template Letter Cycle 1.

¹⁰⁴¹ Transcript, David Elia, 14 August 2018, 4852; Exhibit 5.175, 2016, Inactive Template Letter Cycle 1.

¹⁰⁴² Transcript, David Elia, 14 August 2018, 4852.

¹⁰⁴³ Transcript, David Elia, 14 August 2018, 4852.

¹⁰⁴⁴ Hostplus, Module 5 Case Study Submission, 3 [17].

¹⁰⁴⁵ Transcript, David Elia, 14 August 2018, 4860.

¹⁰⁴⁶ Transcript, David Elia, 14 August 2018, 4859; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

¹⁰⁴⁷ Transcript, David Elia, 14 August 2018, 4859–60; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

some extent, reliant on the premiums paid by those members to operate the fund.

I accept that, as Hostplus submits, it is an ‘all profits to member’ superannuation fund, so any tax benefit it obtains accrues to the members as a whole.¹⁰⁴⁸ Even in those circumstances, retention strategies that seek to preserve this position and that do not have adequate regard to the member’s circumstances or interests may be conduct that falls below community standards and expectations.

Mr Elia said that, since providing to the Commission the letters regarding permanent exclusion, Hostplus has developed processes and is undertaking to review those members who have been permanently excluded to ensure that permanent exclusion is in their best interests.¹⁰⁴⁹ Hostplus also referred to this program of works in its submissions.¹⁰⁵⁰

8.3.2 Conduct falling below community standards and expectations in relation to retention strategies

Counsel Assisting submitted that Hostplus’s conduct in sending the letters to inactive members fell below community standards and expectations, because the letters gave the impression that the member would lose their account balance to the ATO and did not explain the consequences of their choice.

Hostplus rejected that submission.¹⁰⁵¹ It submitted that the confusion said to arise from the letters was inherently improbable, and that there was no evidence that any Hostplus member was in fact confused or misled by the letters.¹⁰⁵²

In his evidence, Mr Elia said that ‘having looked at some of these particular statements [in the letters to members], there is no doubt in my mind that we could be a lot better at articulating the message’.¹⁰⁵³ I agree. The letters sent

¹⁰⁴⁸ Hostplus, Module 5 Case Study Submission, 4 [21].

¹⁰⁴⁹ Transcript, David Elia, 14 August 2018, 4856.

¹⁰⁵⁰ Hostplus, Module 5 Case Study Submission, 3 [14].

¹⁰⁵¹ Hostplus, Module 5 Case Study Submission, 1 [5].

¹⁰⁵² Hostplus, Module 5 Case Study Submission, 2 [9].

¹⁰⁵³ Transcript, David Elia, 14 August 2018, 4851.

by Hostplus did not give the member enough information to assist them to make an informed decision about whether to stay with the fund. This was particularly so in the case of the 'Tick the Box Hit the Box Office' marketing campaign, where members were offered the possibility of financial reward for staying with the fund, without any information about the consequence of their choice.

There was no evidence before the Commission about the particular circumstances of the members who received the letters, or who permanently excluded themselves. Considering the fund's demographics, it is not unlikely some or many were young members who had possibly joined another superannuation fund by that time. I cannot say whether members who received the letters and decided to stay with the fund made an informed choice.

The retention communications in evidence may have departed from community standards and expectations. The community expects trustees to communicate to their members clearly and transparently and to be careful not to mislead. This is particularly so having regard to the high levels of disengagement on the part of members, which Mr Elia acknowledged was a likely trait of Hostplus's members.¹⁰⁵⁴

8.3.3 Consideration of section 68A

Section 68A was inserted into the SIS Act in 2004.¹⁰⁵⁵ It was modelled on section 78 of the *Retirement Savings Accounts Act 1997* (Cth), which was a provision inserted to ensure that employers were not influencing employees'

¹⁰⁵⁴ Transcript, David Elia, 14 August 2018, 4848.

¹⁰⁵⁵ Senate, Hansard, 22 June 2004 at 24,540, 24,551–2. It was introduced by the government as an amendment to the amending Bill, Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2003 (Cth), and described as the 'so-called kickback amendment'.

superannuation decisions.¹⁰⁵⁶ Parliament saw the insertion of section 68A as an ‘important protection for employees’ used to help ‘get to a stage where it is employees who are making real decisions [about their superannuation] rather than their employers’.¹⁰⁵⁷ The mischief Parliament was trying to address was ‘to ban payments to employers, which would include the so-called ‘soft dollar’ arrangements,^[1058] in exchange for choosing their fund as the default fund’.¹⁰⁵⁹

Mr Elia said that the board had considered section 68A in the context of corporate hospitality expenses.¹⁰⁶⁰ In general terms, that section prohibits a trustee or its associate from supplying or offering to supply goods or services *on the condition* that the person’s employees will be members of the fund.¹⁰⁶¹ The board’s view was that the offers were not made to employers ‘on a conditionality basis’.¹⁰⁶² Mr Elia did not agree that they could be characterised as ‘inducements’ to employers to remain with the fund.¹⁰⁶³

Mr Elia’s evidence suggested that, at least to some extent, employers are choosing a default fund based on relationships with executives and employees of superannuation funds and are influenced by inducements

¹⁰⁵⁶ Senate, Hansard, 22 June 2004 at 24,540, 24,553. It was concerned with eliminating third-line forcing: see Senate, Hansard, 25 March 1997 at 2439–40; Senate, Hansard, 12 May 1997 at 3080–1. Note the different nature of Retirement Savings Account (defined in *Retirement Savings Account Act 1997* (Cth) s 8 as a superannuation product offered by an RSE licensee), in that they are products offered by banks outside any trustee relationship. See also Senate, Hansard, 24 March 1997 at 2193–209 for debate about the Bill before the amendment inserting the equivalent of SIS Act s 68A.

¹⁰⁵⁷ Senate, Hansard, 22 June 2004 at 24,554.

¹⁰⁵⁸ ‘Soft dollar’ payments were those where inducements were used to incentivise someone: see Senate, Hansard, 22 June 2004 at 24,552. This term was used in the context of ASIC *Report 30: Disclosure of Soft Dollar Benefits*, released June 2004, which concerned inducements to financial advisers.

¹⁰⁵⁹ Senate, Hansard, 22 June 2004 at 24,555.

¹⁰⁶⁰ Transcript, David Elia, 14 August 2018, 4871.

¹⁰⁶¹ SIS Act s 68A(1).

¹⁰⁶² Transcript, David Elia, 14 August 2018, 4871.

¹⁰⁶³ Transcript, David Elia, 14 August 2018, 4871.

or experiences offered to them, including by way of corporate hospitality.¹⁰⁶⁴ His evidence suggested that these offers were important to employers, and that performance of the fund, net benefits to members, and other product features are subsidiary considerations for employers in selecting a default fund.¹⁰⁶⁵

Mr Elia said that Hostplus offers things such as tickets to sporting events to employers to maintain and build its relationship with those employers.¹⁰⁶⁶ Yet it is difficult to see that the conduct could breach section 68A given the specific wording that the offers be made ‘*on the condition that*’ the employer will ensure their employees remain or become members of the fund.¹⁰⁶⁷ The hospitality and other benefits provided were not offered or received on that condition.

The prohibition of conduct that may improperly influence decisions is not novel. In the context of elections, the law has long sought to prohibit expenditure on such things as food, drink and entertainment that is intended to influence the vote of an elector.¹⁰⁶⁸ Provisions of that kind seek to prohibit conduct that is intended to influence or interfere with a decision in circumstances where the decision should be made free of such influence or interference. Legislation of this kind provides a much better model of regulation than the existing provisions of section 68A.

It is not right that an employer should choose a default fund for its employers because of benefits that the employer may personally enjoy, but which have nothing to do with the merits of the fund or what it has to offer their employees.

ASIC is the regulator responsible for the general administration of section 68A.¹⁰⁶⁹ In its written submissions to the Commission, ASIC said that

¹⁰⁶⁴ Transcript, David Elia, 14 August 2018, 4868–70.

¹⁰⁶⁵ Transcript, David Elia, 14 August 2018, 4868–70.

¹⁰⁶⁶ Transcript, David Elia, 14 August 2018, 4868–70.

¹⁰⁶⁷ Transcript, David Elia, 14 August 2018, 4871.

¹⁰⁶⁸ See, eg, *Treating Act 1696* (Imp); *Commonwealth Electoral Act 1902* (Cth) s 176. See also Colin Hughes, ‘Electoral Bribery’ (1998) 7(2) *Griffith Law Review* 209, 210–11.

¹⁰⁶⁹ SIS Act s 6(1)(c).

the Hostplus case study shows that section 68A as currently framed is ineffective: despite significant expenditure from fund assets for the benefit of employers, there was no breach of that section. ASIC identified the deficiency as the requirement that the inducement be ‘on the condition that’ the employees joined the fund.¹⁰⁷⁰ I agree.

Section 68A(1) and (3) should be repealed and provisions made along the lines of the long-established electoral law prohibitions against bribing electors. The redrawn provisions should hinge upon whether the conduct *would* induce, or could reasonably be *expected* to induce, a person’s choice of default fund for their employees who have made no choice of fund.

9 Board governance

9.1 Background

United Super Pty Ltd is the trustee of Construction and Building Unions Superannuation, better known as Cbus.

Australian Super Pty Ltd is the trustee of the AustralianSuper Fund.

Sunsuper Pty Ltd is the trustee of the Sunsuper Superannuation Fund.

Cbus, AustralianSuper and Sunsuper are ‘profit-for-member’ superannuation funds. The shareholders of each RSE licensee are trade unions and employer organisations. Those shareholders are entitled, under the RSE licensees’ respective constitutions, to appoint directors to the trustee board. The Commission looked at three issues that can arise as a result of this structure: tenure, in the case of AustralianSuper; size, in the case of Cbus; and dismissal, in the case of Sunsuper.

The Commission heard oral evidence about these issues from AustralianSuper’s Chief Executive, Ian Silk. The Commission also received

¹⁰⁷⁰ ASIC, Module 5 Policy Submission, 3–4 [16]–[17].

written statements from the Chair of United Super, Stephen Bracks,¹⁰⁷¹ and the Chair of Sunsuper, Andrew Fraser.¹⁰⁷²

9.2 Evidence

9.2.1 Director tenure – AustralianSuper

In 2007, AustralianSuper amended its constitution to include term limits for its directors. As amended, the constitution provides that directors are appointed for three years. At the end of one three year term, they may be re-appointed for another three year term. In June 2017, AustralianSuper revised its Board Renewal Policy to introduce a maximum tenure of 12 years (four three-year terms).

The amendment to the constitution operates only prospectively – that is, it only applies to directors who were appointed after December 2007.¹⁰⁷³ As a result, the 12-year maximum in the Board Renewal Policy also operates prospectively. Because four of the board’s current directors were appointed before 2007, their appointments are not subject to any tenure limitation.¹⁰⁷⁴ For those four directors, there is no policy in place at AustralianSuper that provides for their maximum tenure.¹⁰⁷⁵

At the time of Mr Silk’s evidence, the shareholders were considering whether tenure limits should apply to those four directors. The board, including the four directors, had unanimously asked the shareholders to do this.¹⁰⁷⁶ This was because to apply those limits, the shareholders would need to agree to a constitutional change. AustralianSuper cannot enforce a tenure limit without their agreement. The shareholders had not made a decision when Mr Silk gave his evidence.

¹⁰⁷¹ Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018; Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018.

¹⁰⁷² Exhibit 5.331, Witness statement of Andrew Fraser, 30 July 2018; Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018.

¹⁰⁷³ Transcript, Ian Silk, 9 August 2018, 4523.

¹⁰⁷⁴ Transcript, Ian Silk, 9 August 2018, 4523–4.

¹⁰⁷⁵ Cf APRA, Prudential Standard SPS 510, 31 October 2016, par 23(b).

¹⁰⁷⁶ Transcript, Ian Silk, 9 August 2018, 4524.

9.2.2 Number of directors – Cbus

Cbus is a large superannuation fund with over 755,000 members and \$39 billion in funds under management.¹⁰⁷⁷ Cbus's shareholder organisations are Master Builders Australia, the Australian Council of Trade Unions (ACTU) and three unions.¹⁰⁷⁸ Cbus's board ordinarily has 16 directors. Seven directors are appointed by Master Builders Australia and seven by the union shareholders.¹⁰⁷⁹ There is one independent director, and the chair is appointed by the ACTU after consultations between the stakeholders.¹⁰⁸⁰

Since 2013, the board's self-assessments have identified that some directors think the board is too big, and that this affects its functioning. Other directors disagree.¹⁰⁸¹ In 2015, an independent consultant considered the effectiveness of the board.¹⁰⁸² It held interviews with all board members and senior management, and compared Cbus's arrangements against best practice. The consultant recommended that it reduce its board to 12 directors, and said that this was a high priority.¹⁰⁸³ In 2016, APRA did a prudential review of Cbus. APRA said it was concerned that the size of the board limited the effectiveness of the board's decision-making.¹⁰⁸⁴

¹⁰⁷⁷ Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, 6 [14].

¹⁰⁷⁸ Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, 4 [11].

¹⁰⁷⁹ Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, 4 [11].

¹⁰⁸⁰ Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, 12 [32]–[35].

¹⁰⁸¹ Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, Exhibit SPB-1 (Tab 24) [CBUS.0001.0023.0071].

¹⁰⁸² Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, Exhibit SPB-1 (Tab 27) [CBUS.0001.0023.0211].

¹⁰⁸³ Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, Exhibit SPB-1 (Tab 27) [CBUS.0001.0023.0211 at .0238].

¹⁰⁸⁴ Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, Exhibit SG-1-94 [APRA.0007.0002.2728].

Mr Bracks said that Cbus does not think that the size of the board is a problem.¹⁰⁸⁵ But since 2015 the Chair and CEO have spoken to shareholders about the issue.¹⁰⁸⁶ In 2017, the Master Builders Association suggested both it and the CFMEU give up a board seat. They suggested that one of their nominated directors, who had been recommended by Cbus's investment team, should move to the independent director position.¹⁰⁸⁷ However, the shareholders could not agree.¹⁰⁸⁸ Cbus has not changed its board size.

In recent years, both employer and union shareholders have nominated directors based on their skills or experience.¹⁰⁸⁹ But Cbus cannot force them to do this. As a result, some directors are still appointed based on their links to shareholder organisations.¹⁰⁹⁰

9.2.3 Appointment and dismissal of directors – Sunsuper

The Sunsuper Superannuation Fund is a large profit-for-member fund, with \$55 billion in funds under management and more than 1.3 million members. The shareholders of Sunsuper are the Chamber of Commerce and Industry Queensland (CCIQ), an employer organisation, as well as the Queensland Council of Unions and the Australian Workers Union of Employees, Queensland Branch (AWUEQ).¹⁰⁹¹ Sunsuper's board has an 'equal representation' structure, with three directors appointed by CCIQ, three appointed by the union bodies, and three independent directors.¹⁰⁹² In early 2016, the three directors appointed by CCIQ were not affiliated with that organisation.

¹⁰⁸⁵ Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018, 8 [27].

¹⁰⁸⁶ Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018, 8 [32].

¹⁰⁸⁷ Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018, 9 [35].

¹⁰⁸⁸ Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018, 9 [35].

¹⁰⁸⁹ Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, Exhibit SPB-1 (Tab 21) [CBUS.0002.0001.0352 at .0352]; Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, Exhibit SPB-1 (Tab 27) [CBUS.0001.0023.0211 at .0221].

¹⁰⁹⁰ See, eg, Exhibit 5.348, 11 August 2017, Letter from D Perkins (President, Master Builders Australia) to Stephen Bracks (Chair, United Super P/L).

¹⁰⁹¹ Exhibit 5.331, Witness statement of Andrew Fraser, 30 July 2018, 16 [65].

¹⁰⁹² Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 44 [155].

In April 2016, CCIQ announced that it would remove all three of its appointed directors and replace them with the President, Vice President and CEO of CCIQ. The first change would take place immediately, with the remaining changes to be complete by September 2016.¹⁰⁹³ One of the existing directors had announced his retirement, but the other two had been appointed in 2014 and 2015.¹⁰⁹⁴ CCIQ had not told Sunsuper about this plan before announcing it.¹⁰⁹⁵

The Chair of Sunsuper told CCIQ that he was very concerned about CCIQ's actions. In particular, he was worried that it could damage Sunsuper's reputation and derail tender negotiations that were at a delicate stage. He said that he was also concerned that APRA might intervene, with potentially serious reputational and commercial effects.¹⁰⁹⁶ After getting this letter, CCIQ decided not to remove one of the three directors, but said that it still planned to replace the other two.¹⁰⁹⁷

Various correspondence, meetings and other communications followed. Sunsuper continued to press CCIQ to reconsider its decision.¹⁰⁹⁸ The three independent directors on the board, and the AWUEQ, also sent separate letters asking CCIQ to reconsider.¹⁰⁹⁹ APRA wrote to Sunsuper saying it had 'serious concerns' that the board changes would 'materially impact the

¹⁰⁹³ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-177 [SSU.2001.0001.0628].

¹⁰⁹⁴ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 56 [210].

¹⁰⁹⁵ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 55 [201].

¹⁰⁹⁶ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-179 [SSU.2001.0001.0743].

¹⁰⁹⁷ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-180 [SSU.2001.0001.0749].

¹⁰⁹⁸ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 56–64 [214]–[265].

¹⁰⁹⁹ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-182 [SSU.2001.0001.0752]; Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-200 [SSU.2001.0001.0612].

stability and continuity of the Board'.¹¹⁰⁰ It met with Sunsuper's directors and shareholders, as well as separately with CCIQ.¹¹⁰¹ The tendering party also told Sunsuper it was very concerned about the events.¹¹⁰² Ultimately, in July 2016, CCIQ replaced two of its nominated directors with its President and Vice President.

There was no doubt that under the Sunsuper constitution, CCIQ was entitled to act as it did.¹¹⁰³ Although Sunsuper, the independent directors, and other shareholders sought to persuade it to act differently, there was nothing preventing CCIQ summarily replacing one third of the board. There was no limit on its powers of appointment and dismissal (except that the new directors would need to be 'fit and proper').

In 2017, an independent consultant did a governance review of Sunsuper.¹¹⁰⁴ Because of the events that had happened and the recommendations made as a result of the review, Sunsuper introduced a number of governance changes, including a consultation process for selecting directors and minimum notice periods before a shareholder can remove a nominated director.¹¹⁰⁵

The Chair of Sunsuper considered that what had happened was 'not best practice'. However, he said that he thought it had led to some positive governance changes.¹¹⁰⁶

¹¹⁰⁰ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-186 [SSU.2001.0001.0541].

¹¹⁰¹ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 60 [237]; Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-203 [SSU.2001.0001.0615]; Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-211 [SSU.2001.0001.0880].

¹¹⁰² Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 61 [245].

¹¹⁰³ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 56 [207].

¹¹⁰⁴ Exhibit 5.331, Witness statement of Andrew Fraser, 30 July 2018, Exhibit APF-33 [SSU.1003.0001.0176].

¹¹⁰⁵ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 69 [308].

¹¹⁰⁶ Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 56 [207].

9.3 What the case studies showed

Shareholder control of the appointment of directors is a fundamental feature of company law. A premise for that control is that the directors are responsible for protecting the interests of shareholders in the management of the company. That premise needs amplification and modification in the case of a corporate trustee of a superannuation fund. The directors are to manage the company not only in the interests of shareholders but in the interests of members of the fund.

All superannuation trustees are obliged to prioritise the interests of members. Profit-for-member fund trustees differ from retail fund trustees. Retail fund trustees look to the interests of the members of their funds but also to the interests of their shareholders in, among other things, the trustee making a profit and paying a dividend.

If it could be said that an advantage of profit-for-member fund trustees is that they need only look to the interests of members and not also to the interests of shareholders, then it would seem to follow that one of the premises for unhindered control by shareholders over appointment of directors is reduced in force, if not eliminated. It follows that the rules for the appointment of directors should focus only on achieving governance that will be in the best interests of members.

Each of the case studies illustrated ways in which the rules conferring control over appointment of directors on shareholders might be at odds with that focus. In the case of AustralianSuper and Cbus, the requirement for shareholder approval of constitutional changes meant governance reforms have been slowed. In the case of Sunsuper, the exercise of shareholder power of appointment caused at least a time of instability and it might have led (but did not lead) to more serious consequences.

This is not to say that the conduct described might amount to misconduct. Nor do I think there was conduct of the trustee that might have fallen below community standards and expectations. The appointment of directors is conduct of the shareholders, not the trustee. I do not think it is necessary to reach a view about whether in any of the case studies the conduct of any shareholder might fall below community standards and expectations and Counsel Assisting did not submit that I should consider doing so. But I do note that these case studies, together with the case studies concerning mergers, invite consideration of whether shareholders should be required

to exercise their powers in the best interests of members.

10 Mergers

10.1 Background

The Commission looked at two case studies about proposals to merge superannuation funds. In both cases, the merger did not proceed because of disputes over who would sit on the board of the merged entity.

The Electricity Supply Industry Superannuation (Qld) Ltd (Energy Super) is the RSE licensee of Energy Super (the Energy Super Fund), which has over 47,500 members and \$7.2 billion in funds under management.¹¹⁰⁷ During 2016 there were merger discussions between Energy Super and Equisuper Pty Ltd (Equisuper), the RSE licensee of the Equisuper Superannuation Fund.

The Chair of the Board of Energy Super, Scott Wilson, gave evidence about this case study. Mr Wilson was nominated by the Electrical Trades Union Queensland and Northern Territory (the ETU), and has been on the board since 2011.¹¹⁰⁸

CSF Pty Ltd (CSF) is the RSE licensee for the MyLifeMyMoney Superannuation Fund (the CSF Fund),¹¹⁰⁹ which has approximately 75,000 members and \$9.3 billion in funds under management.¹¹¹⁰ In 2017, CSF was involved in negotiations with Sydney Catholic Super Pty Ltd (SCS), which is the RSE licensee of the Australian Catholic Superannuation and Retirement Fund (the SCS Fund).

The Commission heard evidence from Mr Peter Haysey, the Deputy Chair of CSF. The Commission also received witness statements from Mr David Hartley, a director of CSF, and Mr Greg Cantor, the Chief

¹¹⁰⁷ Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 3 [24].

¹¹⁰⁸ Transcript, Scott Wilson, 10 August 2018, 4666.

¹¹⁰⁹ Exhibit 5.237, Witness statement of Peter Haysey, 24 July 2018, 1 [1].

¹¹¹⁰ Transcript, Peter Haysey, 15 August 2018, 4997; see also Exhibit 5.237, Witness statement of Peter Haysey, 24 July 2018, 5 [26].

Executive Officer of SCS.

10.2 Evidence

10.2.1 Energy Super

In 2016, Energy Super was interested in merging with another superannuation fund. It thought that a merger would benefit its members through increasing membership numbers, changing its membership demographic and reducing administration costs.¹¹¹¹ It had held merger discussions with several superannuation funds since 2011.¹¹¹²

The most advanced discussions were with Equipsuper. Those discussions began in early 2016.¹¹¹³ In May 2016, staff from Energy Super and Equipsuper performed an evaluation study that found that there were many benefits of a merger, including increased scale in investments and lower investment fees.¹¹¹⁴

On 2 June 2016, Energy Super wrote to Equipsuper proposing that the merged board be equally split between directors from each entity, with Energy Super's contribution including two union-nominated directors, two employer-nominated directors, and one independent director.¹¹¹⁵

¹¹¹¹ Transcript, Scott Wilson, 10 August 2018, 4683–5.

¹¹¹² Since 1 January 2012, Energy Super had engaged in merger discussions that had gone to a stage where Energy Super considered that a merger may be possible. Those discussions were with: AUSCOAL Superannuation Pty Ltd as trustee of the Mine Superannuation Fund: Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 43 [211(a)]; AUST (Queensland) Pty Ltd as trustee of Allied Unions Superannuation Trust (Queensland): Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 43 [211(b)]; and Maritime Super Pty Ltd as trustee of Maritime Super: Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 43 [211(c)].

¹¹¹³ Transcript, Scott Wilson, 10 August 2018, 4687.

¹¹¹⁴ Transcript, Scott Wilson, 10 August 2018, 4688; Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-60 [EYS.0013.0001.0090 at .0091].

¹¹¹⁵ Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-80 [EYS.0008.0001.1325].

This reflected the existing board of Energy Super, which had one independent director, four employer-nominated directors, and four directors nominated by either the ETU or the Australian Municipal, Administrative, Clerical and Services Union Queensland (QSU).¹¹¹⁶ The largest employers contributing to the Energy Super Fund were Queensland Government-owned corporations such as Energy Queensland Limited and the Queensland Electricity Transmission Corporation Limited.¹¹¹⁷

On 15 June 2016, the Chair of Equipsuper Andrew Fairley wrote to the then Chair of Energy Super, Mark Williamson, saying:¹¹¹⁸

It is important to the Equip board there be a commitment from Energy to adopt the approach of a skills-based board. This would logically mean that in circumstances where a skills matrix has been established by the merged fund[,] in the event that persons nominated by the unions or employers did not have the necessary skills as measured by an independent third party consultant ... then the board would retain a right to not accept the nomination, and to request another nomination of individuals that did have the appropriate skills.

A process would need to be developed, based on objective criteria, using arm's length parties to make judgments about the skill levels of individuals concerned.

The proposal about board appointments differed from Energy Super's existing process. Energy Super did not engage a third party consultant to evaluate nominees to its board.¹¹¹⁹ Rather, when candidates were being considered, it engaged with the nominating organisation to 'talk to them about who we're after'.¹¹²⁰ Further, under the Energy Super constitution, to be appointed to the board a person must satisfy Energy Super's Fit

¹¹¹⁶ Transcript, Scott Wilson, 10 August 2018, 4665–7; Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-1 [EYS.0001.0001.0005 at .0015].

¹¹¹⁷ Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 3 [25].

¹¹¹⁸ Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-81 [EYS.0014.0001.3075].

¹¹¹⁹ Transcript, Scott Wilson, 10 August 2018, 4690.

¹¹²⁰ Transcript, Scott Wilson, 10 August 2018, 4676.

and Proper Policy.¹¹²¹ The Fit and Proper Policy contains a board skills matrix. Applying that matrix shows the experience and diversity of the board, and identifies gaps the board should fill.¹¹²² Mr Wilson said that Energy Super has regard to that matrix when considering new board appointments,¹¹²³ and since June 2014 the board's performance (as distinct from proposed appointments) has been analysed by an independent consultant each year.¹¹²⁴

Mr Wilson said that he agreed that it was reasonable to have a skills-based board.¹¹²⁵ He said that Energy Super had not been opposed to Equisuper's approach, but wanted to see the process and criteria that would be involved.¹¹²⁶

By late July 2016, Energy Super and Equisuper had appointed a joint working committee of directors of their respective boards and had entered into a memorandum of understanding.¹¹²⁷ The parties aimed to enter into an implementation agreement by the end of October 2016.¹¹²⁸

In September 2016, a report by KPMG concluded that a merger of Energy Super and Equisuper would provide 'members and employers with annual cost benefits of up to \$20.5 million'.¹¹²⁹ The report also concluded that the new fund size would strengthen corporate governance and achieve additional scale.¹¹³⁰ KPMG thought that superannuation funds the size of

¹¹²¹ Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-1 [EYS.0001.0001.0005 at .0017].

¹¹²² Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-1 [EYS.0005.0001.0029 at .0049–.0050].

¹¹²³ Transcript, Scott Wilson, 10 August 2018, 4690.

¹¹²⁴ Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 16 [83]–[84].

¹¹²⁵ Transcript, Scott Wilson, 10 August 2018, 4690.

¹¹²⁶ Transcript, Scott Wilson, 10 August 2018, 4690–1.

¹¹²⁷ Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-61 [EYS.0013.0001.0002].

¹¹²⁸ Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-61 [EYS.0013.0001.0002].

¹¹²⁹ Exhibit 5.133, 6 September 2016, KPMG Project Power High Level Assessment, 4.

¹¹³⁰ Exhibit 5.133, 6 September 2016, KPMG Project Power High Level Assessment, 27.

Equipsuper and Energy Super should consider mergers, to achieve benefits of scale and to combat risks such as low member growth and competition from larger and similar sized funds.¹¹³¹

Following that report, the funds engaged with member and employer stakeholders to get their views about the potential merger.¹¹³² But it appears that it was at this point that the merger discussions started to collapse.

On 13 September 2016, Mr Wilson emailed a fellow ETU-appointed director of Energy Super, Peter Simpson, saying that he and the Chair of Energy Super were ‘trying to pull up the merger’ (meaning to stop it going ahead).¹¹³³ Mr Wilson said that from the outset of negotiations in early 2016, Mr Fairley had said that Equipsuper would not accept union-nominated directors on the board of the new fund. At the same time, other directors of Equipsuper told Energy Super ‘not to worry’ about it.¹¹³⁴ Mr Wilson said that when he sent the email he believed that the merger would not ultimately proceed. As a result, he wanted to stop it to avoid spending any more money.¹¹³⁵

On 23 November 2016, Mr Simpson sent an email to the Chair and CEO of Energy Super, saying he had ‘concerns that our position on having a spot on the board has been undermined by the wording’ of the draft constitution provided by Equipsuper.¹¹³⁶ For reasons that were not explained in evidence, Mr Simpson then forwarded this email to Mark Bailey, the then Queensland Minister for Energy, saying:¹¹³⁷

I’m unsure if you’re across Energy Super’s current discussions with Equip Super in Victoria about a possible merger?

¹¹³¹ Exhibit 5.133, 6 September 2016, KPMG Project Power High Level Assessment, 3.

¹¹³² Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-55 [EYS.0013.0001.0128 at .0130–.0131].

¹¹³³ Exhibit 5.134, 13 September 2016, Emails to and from Mr Wilson, September 16.

¹¹³⁴ Transcript, Scott Wilson, 10 August 2018, 4693.

¹¹³⁵ Transcript, Scott Wilson, 10 August 2018, 4693.

¹¹³⁶ Exhibit 5.135, 23 November 2016, Email from Simpson, November 16.

¹¹³⁷ Exhibit 5.136, 23 November 2016, Email from Simpson, November 16, 3.

... The GOCs [government owned corporations] that are represented on the [Energy Super] board will have a big say in whether or not any merger proceeds ... we may need to talk to you about Govt's position on this prior to Xmas.

The next day, on 24 November 2016, Mr Simpson again forwarded Mr Bailey correspondence between him and other board members regarding his proposed amendments to Equipsuper's constitution.¹¹³⁸ Mr Simpson then forwarded the chain of emails to an organiser for the ETU, stating, 'I will talk to Bailey down the track about Govt knocking this off ... my aim is to not have it happen'.¹¹³⁹

Despite these events, the merger process continued. At a joint meeting of directors of Energy Super and Equipsuper on 1 December 2016, management of Energy Super was asked to work on a principles paper that would articulate the proposed board appointment process and identify the differences between each of the funds' Fit and Proper policies and board appointment processes. It was proposed that Equipsuper would then review the paper and identify potential amendments to the constitution to circulate.¹¹⁴⁰

At about the same time, Mr Fairley was asking Equipsuper's employer representatives about their views on the merger. On 15 December 2016, Mr Williamson emailed a number of Energy Super board members. He told them Mr Fairley had said that, out of five Equipsuper employers, one was 'indifferent', two were 'passively against' and two 'aggressively against' the merger.¹¹⁴¹ One of those employer representatives said that it would 'aggressively oppose merger plans with Energy Super', based on '1. Dilution of shareholding status [and] 2. Board appointment process'. This employer apparently said that it preferred Equipsuper's Board Skills Policy. Mr Williamson said that Mr Fairley told him Equipsuper would not proceed

¹¹³⁸ Exhibit 5.137, 24 November 2016, Email from Simpson, November 16.

¹¹³⁹ Exhibit 5.137, 24 November 2016, Email from Simpson, November 16.

¹¹⁴⁰ Exhibit 5.131, Witness statement of Scott Wilson, 26 July, Exhibit SW-85 [EYS.0008.0001.0761 at .0762–.0763].

¹¹⁴¹ Exhibit 5.131, Witness statement of Scott Wilson, 26 July, Exhibit SW-86 [EYS.0008.0003.0019].

with the merger unless Energy Super agreed that there were no automatic rights for the ETU and QSU to nominate board positions, and that all board members had to comply with Equipsuper's Board Skills Policy.¹¹⁴²

Mr Wilson said in evidence that this was a problem for Energy Super. He said that Energy Super valued the engagement of the unions as an important feature of the fund and that unions contributed significantly to the fund, including in respect of member engagement¹¹⁴³ and representation of member's interests.¹¹⁴⁴

At a meeting on 20 December 2016, the board of Energy Super resolved that the merger should proceed, but on the basis that there would ongoing union representation on the merged board.¹¹⁴⁵ The same day, Mr Fairley wrote to Mr Williamson terminating the merger discussions. Mr Fairley said that 'the Equip employers' would not agree to 'an entitlement to appoint member directors in the manner proposed'.¹¹⁴⁶

Mr Williamson's response on the next day expressed his disappointment that discussions had been terminated, and said that the board of Energy Super 'unanimously agreed the merger is still in the best interest of our Members'.¹¹⁴⁷

10.2.2 CSF Pty Ltd

Like Energy Super, CSF has been open to merger opportunities for some years.¹¹⁴⁸ Mr Haysey said that CSF believes there to be significant benefits of a merger with SCS, particularly the benefits of increased scale, and that

¹¹⁴² Exhibit 5.131, Witness statement of Scott Wilson, 26 July, Exhibit SW-86 [EYS.0008.0003.0019].

¹¹⁴³ Transcript, Scott Wilson, 10 August 2018, 4670.

¹¹⁴⁴ Transcript, Scott Wilson, 10 August 2018, 4697.

¹¹⁴⁵ Transcript, Scott Wilson, 10 August 2018, 4696–8.

¹¹⁴⁶ Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-51 [EYS.0008.0003.0364].

¹¹⁴⁷ Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-52 [EYS.0008.0001.0718].

¹¹⁴⁸ Transcript, Peter Haysey, 15 August 2018, 4998.

any increase in the number of members and funds under management would lead to reduced administration costs for members.¹¹⁴⁹

In December 2016, CSF commissioned Rice Warner to conduct an assessment of the potential benefits of a merger with SCS.¹¹⁵⁰ That report said that the CSF and SCS funds would both benefit from increased scale, and faced challenges in growing individually from their current positions. The report concluded that '[t]he potential to merge CSF and [SCS] presents a unique opportunity at a time when the superannuation industry faces a period of rationalisation and change'.¹¹⁵¹

Mr Haysey said that merger discussions between CSF and SCS started in 2017, and that CSF believed that a merger of the funds was in the best interests of their members.¹¹⁵² However, from the outset of negotiations, it became clear that the primary point of contention was the composition of the board of the successor fund.¹¹⁵³

Initially, on the basis that CSF regarded its fund as demonstrating superior performance (a point about which I make no finding), CSF proposed that the CEO, CIO and Deputy Chair should come from CSF, and that CSF should be the successor fund.¹¹⁵⁴ CSF was content for the Chair to come from SCS.¹¹⁵⁵ By contrast, SCS thought that appointments at board and executive level should be determined by an independent process.¹¹⁵⁶

¹¹⁴⁹ Transcript, Peter Haysey, 15 August 2018, 4998.

¹¹⁵⁰ Exhibit 5.240, December 2016, Merger Assessment Prepared by Rice Warner.

¹¹⁵¹ Exhibit 5.240, December 2016, Merger Assessment Prepared by Rice Warner.

¹¹⁵² Transcript, Peter Haysey, 15 August 2018, 5001.

¹¹⁵³ That is not to say that other issues were not important to one, or other, of the parties. Mr Hartley, for example, said that SCS was concerned about the continued operation by CSF of its banking services: Exhibit 5.248, Witness statement of David Hartley, 13 August 2018, 64–67 [169].

¹¹⁵⁴ Transcript, Peter Haysey, 15 August 2018, 5003; Exhibit 5.241, 27 March 2017, Letter CSF to the Chair of SCS.

¹¹⁵⁵ Transcript, Peter Haysey, 15 August 2018, 5002–3; Exhibit 5.241, 27 March 2017, Letter CSF to the Chair of SCS.

¹¹⁵⁶ Exhibit 5.242, 6 April 2017, Letter ACSRF to CSF.

As negotiations progressed, CSF changed its proposal for the SCS Chair to be the Chair of the merged fund, and asserted that ‘a new independent chair is essential’.¹¹⁵⁷

By September 2017, CSF and SCS had agreed on all elements of the proposed merger except who would be in the role of Chair.¹¹⁵⁸ By this time, CSF contended that the Chair should be Daniel Casey.¹¹⁵⁹ Mr Casey had been employed by CSF as a consultant to assist with the merger process. This became known to SCS ‘late in the process’.¹¹⁶⁰ SCS did not consider that Mr Casey was an appropriately independent person to chair the merged fund.

On 26 October 2017, the Chair of SCS submitted a ‘final proposal’ to CSF. He proposed that the merged fund have equal board representation, an independent chair selected through a market search process, and that CSF’s CEO be the ongoing CEO.¹¹⁶¹ That is, the only matter appearing to be in dispute between the two funds was who would chair the merged fund.

CSF did not accept the proposal. Negotiations ended.

Mr Haysey told the Commission that the merger discussions failed because CSF thought that its fund, rather than the SCS Fund, should be the successor fund. He said that CSF thought that if its proposal was not accepted, the policies and procedures that (it believed) led to its superior returns might not be guaranteed.¹¹⁶² In circumstances where the board of the new fund would set policies and procedures, and both parties agreed to equal representation on the board and an independent chair,¹¹⁶³ it is not clear why the question of which fund should merge into which would be a matter of any real moment.

¹¹⁵⁷ Exhibit 5.243, 9 May 2017, Letter CSF to ACSRF.

¹¹⁵⁸ Exhibit 5.244, 27 September 2017, Email Bugden to Haddock.

¹¹⁵⁹ Exhibit 5.244, 27 September 2017, Email Bugden to Haddock.

¹¹⁶⁰ Transcript, Peter Haysey, 15 August 2018, 5008.

¹¹⁶¹ Exhibit 5.245, 26 October 2017, Letter ACSRF to CSF.

¹¹⁶² Transcript, Peter Haysey, 15 August 2018, 5011.

¹¹⁶³ Transcript, Peter Haysey, 15 August 2018, 5011.

In any event, merger discussions began again in early 2018. They continued at the time Mr Haysey gave evidence in August 2018.¹¹⁶⁴

10.3 What the case study showed

In both cases, the trustee considered that the proposed merger was desirable, and had independent advice to that effect. I have no reason to doubt those views were correct. But in both cases, the proposed merger did not proceed because of a dispute about the board composition of the merged entity.

It is not apparent why those disagreements caused negotiations to collapse. In the case of Energy Super, both parties agreed that it was appropriate to have a skills-based board; the dispute was over who would nominate the directors. In the case of CSF, both parties agreed to an equal representation board and an independent chair; the dispute was over who the first chair should be (or, perhaps, which fund should merge into which). These were differences of detail, not substance. It is troubling that such differences of detail should have prevented the mergers proceeding where they were otherwise in the best interests of members. If, as some of the communications may be read as suggesting, there was some difference in principle, what exactly was the principle?

This conduct of Energy Super and CSF suggests that the trustees may have lost sight of their fundamental obligation to act in the best interests of members. In doing so, their conduct fell below community standards and expectations.

11 Trustee money management

11.1 Background

In three case studies, the Commission looked at issues about management and expenditure of superannuation trust moneys.

¹¹⁶⁴ Transcript, Peter Haysey, 15 August 2018, 5012.

AustralianSuper Pty Ltd (AustralianSuper) is the RSE licensee for the AustralianSuper Fund. The AustralianSuper Fund has approximately \$140 billion in funds under management¹¹⁶⁵ and 2.2 million members. It is Australia's largest superannuation fund.¹¹⁶⁶

The Commission examined three different issues concerning AustralianSuper: its approach to one investment it had made, its 'cash' investment option, and two items of its expenditures. The Commission looked at AustralianSuper's spending on a publication called *The New Daily*, and on an advertising campaign known as 'Fox and Henhouse'. The Commission heard evidence from AustralianSuper's Chief Executive, Ian Silk, and its Head of Mid-Risk Portfolios, Jason Peasley.

United Super Pty Ltd is the trustee of Construction and Building Unions Superannuation, better known as Cbus. Cbus has over 755,000 members and \$39 billion in funds under management.¹¹⁶⁷

The Commission looked at payments made by Cbus to 'partner' organisations, including union and employer organisations that are its shareholders. The Commission received written statements from Stephen Bracks, the Chair of United Super;¹¹⁶⁸ Jarrod Coysh, Group Executive Employers, Corporate Development and Strategy;¹¹⁶⁹ Kristian Fok, Chief Investment Officer;¹¹⁷⁰ and Robbie Campo, Group Executive of Brand, Advocacy, Marketing and Product.¹¹⁷¹

¹¹⁶⁵ Transcript, Jason Peasley, 8 August 2018, 4434.

¹¹⁶⁶ Transcript, Ian Silk, 9 August 2018, 4522.

¹¹⁶⁷ Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, 6 [14].

¹¹⁶⁸ Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018;
Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018.

¹¹⁶⁹ Exhibit 5.338, Witness statement of Jarrod Coysh, 31 July 2018.

¹¹⁷⁰ Exhibit 5.339, Witness statement of Kristian Fok, 31 July 2018.

¹¹⁷¹ Exhibit 5.340, Witness statement of Robbie Campo, 3 August 2018.

CSF Pty Ltd (CSF) is the RSE licensee for the MyLifeMyMoney Superannuation Fund (the CSF Fund).¹¹⁷² The CSF Fund has approximately 75,000 members and \$9.3 billion in funds under management.¹¹⁷³

The Commission looked at payments made by CSF to a group known as the Australian Family Network,¹¹⁷⁴ which had personal links to one of CSF's senior executives. The Commission also looked at the use of corporate credit cards by the same senior executive. The Commission heard evidence from Mr Peter Haysey, the Deputy Chair of CSF.

11.2 Evidence

11.2.1 AustralianSuper

Investments

AustralianSuper invests in the IFM Australian Infrastructure Fund (the Infrastructure Fund), an investment portfolio that provides exposure to infrastructure assets. One of those assets was Pacific Hydro Pty Ltd, a renewables development company.¹¹⁷⁵ Other assets include Melbourne Airport, Port of Brisbane and Southern Cross Station in Melbourne's central business district.¹¹⁷⁶ Historically, the Infrastructure Fund was the main way that AustralianSuper Fund invested in unlisted Australian infrastructure assets.

IFM Holdings Pty Ltd is the investment manager of the Infrastructure Fund. IFM is a fund manager owned by a company called Industry Super Holdings (ISH). ISH is in turn owned by the trustees of 27 industry super funds,

¹¹⁷² Exhibit 5.237, Witness statement of Peter Haysey, 24 July 2018, 1 [1].

¹¹⁷³ Transcript, Peter Haysey, 15 August 2018, 4997; see also Exhibit 5.237, Witness statement of Peter Haysey, 24 July 2018, 5 [26].

¹¹⁷⁴ The Australian Family Network consists of Family Pack Services Pty Ltd and Paul Clancy Consulting Pty Ltd (formerly known as Australian Family Magazine Pty Ltd): Exhibit 5.238, Witness statement of Peter Haysey, 3 August 2018, 20 [103].

¹¹⁷⁵ Transcript, Jason Peasley, 8 August 2018, 4434.

¹¹⁷⁶ Exhibit 5.62, Witness statement of Jason Peasley, 1 August 2018, 2 [1.6].

including AustralianSuper.¹¹⁷⁷ It has approximately \$100 billion in funds under management. IFM, through the Infrastructure Fund, was the sole shareholder in Pacific Hydro until IFM sold Pacific Hydro in 2016.

AustralianSuper is not the only investor in the Infrastructure Fund, although it is a significant one. It regularly engages with IFM regarding the performance of the Infrastructure Fund, and has a representative on the Infrastructure Fund investor advisory committee.¹¹⁷⁸

In 2011, AustralianSuper thought that its investment in Pacific Hydro was underperforming. It conducted an internal review, as it ordinarily did when an investment underperformed. The review sought to understand the reasons for investment underperformance, and to work out what to do about it.¹¹⁷⁹

As a result of the review, AustralianSuper told IFM that it wanted to reduce its exposure to Pacific Hydro over time.¹¹⁸⁰ AustralianSuper then became more heavily engaged with IFM on the subject of Pacific Hydro's performance, and, from time to time, AustralianSuper received direct presentations from Pacific Hydro's management.¹¹⁸¹

In mid-2014, Pacific Hydro's performance deteriorated and its value was written down significantly.¹¹⁸² IFM initiated a strategic review of its investment in Pacific Hydro. AustralianSuper was significantly involved with that review. It told IFM what it expected would be the nature and scope of that review. In particular, AustralianSuper told IFM that the review should cover the governance of Pacific Hydro and Pacific Hydro's place in the Infrastructure Fund's portfolio.¹¹⁸³ AustralianSuper remained involved as the

¹¹⁷⁷ Transcript, Jason Peasley, 8 August 2018, 4435.

¹¹⁷⁸ Transcript, Jason Peasley, 8 August 2018, 4436; Exhibit 5.62, Witness statement of Jason Peasley, 1 August 2018, 5 [5.1].

¹¹⁷⁹ Transcript, Jason Peasley, 8 August 2018, 4438–9.

¹¹⁸⁰ Exhibit 5.62, Witness statement of Jason Peasley, 1 August 2018, Exhibit JRP 6.1 [ASU.0018.0001.0028]; Transcript, Jason Peasley, 8 August 2018, 4439.

¹¹⁸¹ Transcript, Jason Peasley, 1 August 2018, 4441.

¹¹⁸² Transcript, Jason Peasley, 8 August 2018, 4442.

¹¹⁸³ Exhibit 5.62, Witness statement of Jason Peasley, 1 August 2018, Exhibit JRP 6.5 [ASU.0018.0001.0001].

review progressed, and from time to time representatives of AustralianSuper met with the IFM review team.¹¹⁸⁴

The review resulted in a number of changes at Pacific Hydro. Among other things, several directors of Pacific Hydro resigned.¹¹⁸⁵ AustralianSuper thought that the review provided 'corrective action' to the business, which improved its operations and allowed the asset to be prepared for sale.¹¹⁸⁶ In 2016, the Infrastructure Fund sold Pacific Hydro, generating returns significantly higher than its valuation before the write downs in 2014. Ultimately, the return over the life of the Infrastructure Fund's investment in Pacific Hydro was approximately 7.2%.¹¹⁸⁷

The second investment issue concerned the Fund's 'cash' investment option. Between 2016 and 2018, members invested in this option received an average return between 2.35% and 2.74%. The return of 2.35% and 2.74% was net of a 0.05% investment management fee.¹¹⁸⁸

In 2018, APRA wrote to AustralianSuper and other RSE licensees expressing concern that 'cash' options offered by some superannuation funds included significant proportions of non-cash assets.¹¹⁸⁹ APRA was concerned that members who invested in such options would expect the return and volatility of cash, but might, in fact, be invested in non-cash assets with different characteristics. That is, APRA's concern was that members might not be getting the investment they had bargained for. At the time, AustralianSuper's non-cash securities comprised 1.84% of its 'cash' accumulation option.¹¹⁹⁰ Although this was a relatively small proportion, having received APRA's letter AustralianSuper instructed its investment

¹¹⁸⁴ Transcript, Jason Peasley, 8 August 2018, 4446.

¹¹⁸⁵ Transcript, Jason Peasley, 8 August 2018, 4448.

¹¹⁸⁶ Transcript, Jason Peasley, 8 August 2018, 4451.

¹¹⁸⁷ Exhibit 5.62, Witness statement of Jason Peasley, 1 August 2018, 4 [4.2].

¹¹⁸⁸ Transcript, Ian Silk, 9 August 2018, 4540.

¹¹⁸⁹ Transcript, Ian Silk, 9 August 2018, 4540.

¹¹⁹⁰ Exhibit 5.88, Witness statement of Ian Silk, 30 July 2018, 9 [3.15].

manager to divest all non-cash securities. The exposure to non-cash securities within the cash options is now zero.¹¹⁹¹

Spending

The first spending issue examined related to a publication called *The New Daily*. In the second half of 2012, AustralianSuper received a proposal from Industry Super Australia Pty Ltd (ISA) to participate in the establishment of an online news publication for the benefit of industry super members.¹¹⁹² ISA provides, among other things, collective marketing and research services to many industry funds.¹¹⁹³ AustralianSuper is a shareholder in ISA's parent company, ISH.¹¹⁹⁴

AustralianSuper considered the proposal on the basis that it was a marketing strategy, not an investment. It considered the publication's potential to help AustralianSuper engage its members, provide them with information about superannuation, and, ultimately, retain and grow its membership.¹¹⁹⁵ The board decided that the amount to be paid out was a relatively small amount of money, which was worth spending in the context of its multi-pronged marketing approach.¹¹⁹⁶

AustralianSuper bought two million partly paid shares in *The New Daily*, at a total cost of \$2 million.¹¹⁹⁷ Because the purchase was not an investment by the AustralianSuper Fund intended to generate investment returns for members, but a tool to enhance the fund's engagement with members,¹¹⁹⁸ the subscription price was paid out of the administration fee paid by members. That fee pays for all non-investment costs of the AustralianSuper

¹¹⁹¹ Exhibit 5.89, Witness statement of Ian Silk, 31 July 2018, 26–7 [19.3], noting that the divestment was made by an instruction to the relevant investment manager, IFM, on 12 July 2018 and was completed on 20 July 2018.

¹¹⁹² Exhibit 5.90, Witness statement of Paul Schroder, 1 August 2018, 2 [7.1].

¹¹⁹³ Transcript, Ian Silk, 9 August 2018, 4541.

¹¹⁹⁴ Transcript, Ian Silk, 9 August 2018, 4535–6.

¹¹⁹⁵ Exhibit 5.90, Witness statement of Paul Schroder, 1 August 2018, 3 [7.6].

¹¹⁹⁶ Transcript, Ian Silk, 9 August 2018, 4534.

¹¹⁹⁷ Transcript, Ian Silk, 9 August 2018, 4529.

¹¹⁹⁸ Transcript, Ian Silk, 9 August 2018, 4528.

Fund, including marketing.¹¹⁹⁹ The shares were held as an asset separate from the fund, owned by AustralianSuper in its personal capacity.

In the latter half of 2015, The New Daily Pty Ltd asked its shareholders to make further funding contributions so that *The New Daily* could continue its operations.¹²⁰⁰ AustralianSuper thought that *The New Daily* was not operating as successfully as it had hoped, and decided not to make any further contribution.¹²⁰¹ Some other shareholders did not contribute.¹²⁰² As a result, ISH offered to acquire all the shares in *The New Daily* from AustralianSuper and the other shareholders for nothing. The offer was made on the basis that IFM would continue operating the publication and shareholders could continue to use its services.¹²⁰³ Because AustralianSuper had accounted for the share purchase as part of its administration expenses, the shares carried no continuing value for it.¹²⁰⁴ And because the shares were not acquired as an asset of the superannuation fund, this disposal was at no cost to members. Accordingly, AustralianSuper thought that transferring the shares for free was fair and reasonable,¹²⁰⁵ particularly as *The New Daily* would keep operating and AustralianSuper would still have access to its services.¹²⁰⁶ *The New Daily* continues to be published by ISH.¹²⁰⁷

The second spending issue concerned the ‘Fox and Henhouse’ advertising campaign. The campaign was developed by ISA, in conjunction with a number of its members (including AustralianSuper), and broadcast on television in 2017.¹²⁰⁸ The ‘Fox and Henhouse’ advertisement was the

¹¹⁹⁹ Transcript, Ian Silk, 9 August 2018, 4528.

¹²⁰⁰ Transcript, Ian Silk, 9 August 2018, 4535.

¹²⁰¹ Transcript, Ian Silk, 9 August 2018, 4535.

¹²⁰² Transcript, Ian Silk, 9 August 2018, 4535.

¹²⁰³ Transcript, Ian Silk, 9 August 2018, 4535; Exhibit 5.90, Witness statement of Paul Schroder, 9 [9.3].

¹²⁰⁴ Exhibit 5.90, Witness statement of Paul Schroder, 1 August 2018, 9 [9.3].

¹²⁰⁵ Exhibit 5.90, Witness statement of Paul Schroder, 1 August 2018, 9 [9.3].

¹²⁰⁶ Transcript, Ian Silk, 9 August 2018, 4535.

¹²⁰⁷ Transcript, Ian Silk, 9 August 2018, 4535.

¹²⁰⁸ Transcript, Ian Silk, 9 August 2018, 4541.

third in a series of advertisements about banks offering superannuation products.¹²⁰⁹ Mr Silk said the advertisement was a response to lobbying by retail wealth management businesses, including banks, to change the superannuation default system. AustralianSuper thought such changes would expose workers to ‘significant risks of mis-selling, cross-selling and conflicts of interest that would have done them significant damage’.¹²¹⁰ Mr Silk said the campaign was an important part of the strategy to maintain industry funds as the most common default superannuation funds in Australia.¹²¹¹

ISA initially proposed to air the advertisement in 2016. However, AustralianSuper decided not to participate because it thought the Australian federal election was too close.¹²¹² The decision was based on the timing of the election, not the substance of the advertisement.¹²¹³ The advertisement was not broadcast in 2016.

In February 2017, after the election campaign, ISA was finalising the advertisement.¹²¹⁴ At the time, there was no legislative proposal or Bill about the default superannuation system being considered by the Federal Parliament. Mr Silk said that the advertisement was run in anticipation of legislation that ISA, and AustralianSuper thought would disrupt the default fund system.¹²¹⁵ Mr Silk said that AustralianSuper’s main concern was that the anticipated changes would disadvantage members because of the risk that employers may nominate lower performing funds as default

¹²⁰⁹ Transcript, Ian Silk, 9 August 2018, 4542.

¹²¹⁰ Transcript, Ian Silk, 9 August 2018, 4543. Mr Silk referred to surveys and reports that demonstrated that small and medium business enterprises in particular were vulnerable to approaches from their business bank to transfer default superannuation to a fund associated with the bank: Transcript, Ian Silk, 9 August 2018, 4548–9; Exhibit 5.351, February 2015, Bank Cross-selling to Employers: A Threat to Australia’s Super Safety Net, Briefing Notice; Exhibit 5.352, September 2016, Default Funds and the Banks; Exhibit 5.353, February 2015, SME Employer Attitudes to Superannuation.

¹²¹¹ Transcript, Ian Silk, 9 August 2018, 4544.

¹²¹² Transcript, Ian Silk, 9 August 2018, 4544.

¹²¹³ Transcript, Ian Silk, 9 August 2018, 4544.

¹²¹⁴ Exhibit 5.94, 3 January 2017, AustralianSuper CEO Report.

¹²¹⁵ Transcript, Ian Silk, 9 August 2018, 4548.

funds, as well as the impacts on the scale of the fund if it lost members.¹²¹⁶ The advertisement eventually aired in June 2017, with the approval of AustralianSuper.¹²¹⁷

For AustralianSuper, the success of the campaign depended on the likelihood that federal politicians, including cross-bench senators, would not support legislative reform to the default system. According to Mr Silk, the campaign was successful because ‘the objective that it was seeking to achieve has been achieved’.¹²¹⁸ However, he added that ‘[f]orces continue to seek to pursue that legislative change’.¹²¹⁹

11.2.2 Cbus

Cbus has ‘partnership agreements’ with many organisations. Its ‘partners’ include its shareholders who comprise both trade unions and employer organisations. Cbus pays its partners for marketing opportunities like attending conferences, putting its logo on merchandise, or advertising in trade publications.¹²²⁰

In 2015, a KPMG report found that Cbus had paid over \$7 million to its shareholder organisations in five years.¹²²¹ But it also found that Cbus did not have any formal way to determine whether it was getting value out of what it paid for.¹²²² After receiving this report, Cbus introduced a number of process changes. It also hired an independent consultant to review the benefits of its industry partnerships program. Cbus ended up introducing a revised ‘Industry Partnership Strategy and Evaluation Model’. This model measured different variables and tried to assess the overall value of each

¹²¹⁶ Transcript, Ian Silk, 9 August 2018, 4549–50.

¹²¹⁷ Transcript, Ian Silk, 9 August 2018, 4549, 4551; Exhibit 5.95, 17 July 2017, Email from Silk to APRA.

¹²¹⁸ Transcript, Ian Silk, 9 August 2018, 4554.

¹²¹⁹ Transcript, Ian Silk, 9 August 2018, 4554.

¹²²⁰ Exhibit 5.340, Witness statement of Robbie Campo, 3 August 2018, 8–9 [21].

¹²²¹ Exhibit 5.368, 20 May 2015, Cbus-United Super Pty Ltd, Audit & Risk Management Committee Agenda, 178.

¹²²² Exhibit 5.368, 20 May 2015, Cbus-United Super Pty Ltd, Audit & Risk Management Committee Agenda, 173.

partnership to Cbus.¹²²³ The model was put into practice in 2016/2017, and is applied to both shareholders and non-shareholder partners.¹²²⁴

11.2.3 CSF

The CSF Fund is an industry fund, with most of its members drawn from the education, health and social welfare sectors. Since 2011, CSF has had a particular strategy to attract members from the childcare and early education industries.¹²²⁵ Australian Family is a marketing and communications network organisation that operates in the early education and care sector.¹²²⁶ It has provided services to CSF since 2010.

Since 1 January 2013, CSF has paid over \$2 million to Australian Family for marketing, consulting and other services. Of that amount, over \$500,000 related to sponsorship expenses for the Early Education and Child Care Awards.¹²²⁷

Australian Family is constituted by Family Pack Services Pty Ltd and Paul Clancy Consulting Pty Ltd (formerly known as Australian Family Magazine Pty Ltd).¹²²⁸ Paul Clancy is the Managing Director of Australian Family. Jennifer Kernahan is the editor of the Australian Family Magazine and a shareholder in Family Pack Services Pty Ltd.¹²²⁹

Robert Clancy was the Head of Institutional Relations at CSF.¹²³⁰ Ms Kernahan is his wife, and Paul Clancy is his brother.

¹²²³ Exhibit 5.369, 16 June 2016, United Super Pty Ltd, ATFT Construction and Building Industry Superannuation Fund, Member and Employer Services Committee Agenda.

¹²²⁴ Exhibit 5.347, Undated Spreadsheet, Agreement Master List – FY19.

¹²²⁵ Exhibit 5.328, Witness statement of Peter Haysey, 3 August 2018, 7 [19].

¹²²⁶ Transcript, Peter Haysey, 15 August 2018, 5014.

¹²²⁷ Transcript, Peter Haysey, 15 August 2018, 5016.

¹²²⁸ Transcript, Peter Haysey, 15 August 2018, 5014.

¹²²⁹ Transcript, Peter Haysey, 15 August 2018, 5014–15.

¹²³⁰ Transcript, Peter Haysey, 15 August 2018, 4997.

Robert Clancy did not disclose to CSF the conflict raised by his wife's position until 2015.¹²³¹ He did not disclose the conflict raised by his brother's connection with Australian Family until July 2018, when the issue was raised in preparation for Mr Haysey's appearance at the Commission.¹²³²

After Mr Clancy disclosed the position with his wife, CSF sought to manage the conflict by requiring only the CEO of CSF, Frank Pegan, to manage the relationship between CSF and Australian Family. After an employee raised a concern, Mr Pegan told them that there was no potential for conflict as 'all negotiations with Australian Family are only with me'.¹²³³

But based on his review of CSF material, Mr Haysey told the Commission that he was not satisfied that the relationship between Australian Family and CSF had been entirely managed by Mr Pegan.¹²³⁴ Robert Clancy had had business meetings with Paul Clancy and other CSF employees, including Mr Pegan,¹²³⁵ and Robert Clancy purported to approve payments to Australian Family without authority.¹²³⁶ Robert Clancy also sent his brother and wife confidential CSF communications, and engaged in 'continuous' email communications with his brother about CSF tasks.¹²³⁷

At the time of Mr Haysey's evidence, the CSF Board had started a review of the relationship and Robert Clancy had been placed on leave.¹²³⁸ Robert Clancy's employment with CSF was eventually terminated, after CSF had conducted further investigations after the relevant hearings of the Commission.

¹²³¹ Transcript, Peter Haysey, 15 August 2018, 5015.

¹²³² Transcript, Peter Haysey, 15 August 2018, 5015.

¹²³³ Exhibit 5.238, Witness statement of Peter Haysey, 3 August 2018, Exhibit PJH-57 [CSF.0010.0001.0944].

¹²³⁴ Transcript, Peter Haysey, 15 August 2018, 5016.

¹²³⁵ Transcript, Peter Haysey, 15 August 2018, 5019.

¹²³⁶ Exhibit 5.238, Witness statement of Peter Haysey, 3 August 2018, 22 [122].

¹²³⁷ Transcript, Peter Haysey, 15 August 2018, 5020.

¹²³⁸ Transcript, Peter Haysey, 15 August 2018, 5017.

Use of corporate credit cards

The second issue concerning CSF's use of trust moneys arose out of Robert Clancy's use of his corporate credit card and the monitoring of his expenditure by CSF.

Between 2013 and 2016, Mr Clancy incurred over \$46,000 of unauthorised expenses in breach of the CSF Corporate Credit Card policy.¹²³⁹ An undated note – which Mr Haysey believed was given to Mr Clancy by the CSF's finance team in early 2016 – said that the expenditure on his corporate credit card had to be 'urgently' reviewed.¹²⁴⁰ After that review, Mr Clancy paid back the unauthorised expenses to CSF.¹²⁴¹ However, he continued to accrue new unauthorised expenses on his card.¹²⁴²

The board was not told about the 2016 review.¹²⁴³ The note was only found in Mr Clancy's drawer after he had been placed on leave shortly before Mr Haysey gave evidence.¹²⁴⁴ In evidence, Mr Haysey said he thought that after the 2016 review into Mr Clancy's credit card expenses, Mr Clancy's expenditure was reviewed and approved by more senior executives.¹²⁴⁵ Yet it appeared that in February 2017, Mr Clancy approved his own credit card expenditure.¹²⁴⁶

Mr Clancy's credit card use took place in the context of an undocumented but 'longstanding' practice at CSF, where senior executive staff used their corporate credit cards to pay for personal travel and other minor expenditure. This was contrary to internal policies, but provided it was reimbursed it appears to have been overlooked. Mr Haysey said that

¹²³⁹ Transcript, Peter Haysey, 15 August 2018, 5020; Exhibit 5.238, Witness statement of Peter Haysey, 3 August 2018, Exhibit PJH-62 [CSF.0010.0001.0593].

¹²⁴⁰ Exhibit 5.238, Witness statement of Peter Haysey, 3 August 2018, Exhibit PJH-61 [CSF.0010.0001.0839].

¹²⁴¹ Transcript, Peter Haysey, 15 August 2018, 5021.

¹²⁴² Transcript, Peter Haysey, 15 August 2018, 5021.

¹²⁴³ Transcript, Peter Haysey, 15 August 2018, 5021.

¹²⁴⁴ Transcript, Peter Haysey, 15 August 2018, 5020.

¹²⁴⁵ Transcript, Peter Haysey, 15 August 2018, 5022.

¹²⁴⁶ Transcript, Peter Haysey, 15 August 2018, 5022; Exhibit 5.247, 14 August 2018, Credit Card Expenditures, Clancy.

the practice had ended, and previous payments were part of the ongoing review.¹²⁴⁷

CSF told the Commission in its submission that Mr Clancy's employment had been terminated and that it intended to seek restitution in respect of the personal expenditure incurred by Mr Clancy that had not been repaid.¹²⁴⁸

11.3 What the case studies showed

11.3.1 AustralianSuper

Not all investments will perform well. Nor can a superannuation trustee guarantee the performance of investments. However, the trustee does promise its members that it will act in their best interests and exercise the same degree of care, skill and diligence as a prudent trustee. These are not impossible standards to satisfy even when an investment's performance is less than is desired. AustralianSuper's monitoring and management of its indirect investment in Pacific Hydro illustrates that this is so. Similarly, its prompt response to concerns raised by APRA as to the investments underlying cash products was consistent with a trustee discharging its duties.

AustralianSuper's spending on *The New Daily* and the 'Fox and Henhouse' campaign is undoubtedly more controversial. Spending on advertising, insofar as it seeks to maintain or increase scale by retaining existing members or attracting new ones or both, may be consistent with the sole purpose test. And just as not every investment will perform well, not every expenditure by a trustee on promotion will achieve the desired result.

AustralianSuper did not seek to defend the 'Fox and Henhouse' campaign solely on the basis that it was a conventional form of advertising that promoted the merits of industry funds to consumers. Mr Silk characterised the advertisement as being directed at protecting the existing default system and thereby maintaining industry funds as the most common default superannuation funds in Australia.

¹²⁴⁷ Transcript, Peter Haysey, 15 August 2018, 5021.

¹²⁴⁸ CSF, Module 5 Case Study Submission, 2 [10].

Not every form of political advertising by a superannuation fund will satisfy the trustee's obligations. Conversely, not every form of political advertising by a superannuation fund constitutes a failure to act in the best interests of members or a use of members' funds other than in satisfaction of the sole purpose test. Nice questions of judgment are required. The particular advertisement was not directed to AustralianSuper's particular position. It was, as Mr Silk said, directed to the interests of industry superannuation funds more generally. But AustralianSuper was only one of several contributors to the cost of the advertisement.

I am not persuaded that it was not open to AustralianSuper, as trustee, to conclude that legislative changes were possible and that, if made, those changes would adversely affect its members. This being so, I do not consider that it was shown that the expenditure may have contravened either the best interests or the sole purpose obligations.

I should add that while I have no doubt at all that judging what is and is not an appropriate use of members' funds for advertising will in many cases be difficult, I am not persuaded that some more prescriptive law should be made to provide some 'bright line' test. It is better that the tests be those that are now to be applied: best interests and sole purpose. And as a general rule I would expect that most trustees would rightly err on the side of caution. Especially will that be so if regulators properly monitor compliance with the obligations.

11.3.2 Cbus

As I have emphasised many times in this report, a superannuation trustee promises its members that it will act in their best interests and exercise the same degree of care, skill and diligence as a prudent trustee. Just as it must carefully choose how to spend members' money, it must also take reasonable steps to make sure that its spending achieves the desired results.

On the limited information available, the changes Cbus made to its 'partnership' arrangements after the 2015 report are an example of such steps. Having identified that it could not tell whether it was getting what it paid for, Cbus introduced process changes and initiated a review of the relevant program more broadly. That review appears to have led

to a more rigorous approach to its commercial relationships, not just with its shareholders but with other organisations as well.

11.3.3 CSF

Paragraph 8 of Prudential Standard SPS 521: Conflicts of Interest required CSF to have a conflicts management framework that ensured that the RSE licensee identified all potential and actual conflicts in the RSE licensee's business operations, and took all reasonably practicable actions to ensure that potential and actual conflicts were avoided or prudently managed.

CSF purported to manage the conflict raised by Ms Kernahan's positions at Australian Family by having only the CEO, Mr Pegan, manage the relationship. Robert Clancy's continued involvement in the relationship between Australian Family and CSF shows that the strategy was not effective. Further, CSF apparently did not even identify the conflict raised by Paul Clancy's position at Australian Family until asked about it by the Commission.

Both matters suggest that CSF may not have complied with the Prudential Standard. The matter not having been so far drawn to the attention of the regulator, I refer the relevant conduct to APRA, pursuant to paragraph (a) of the Commission's Terms of Reference for APRA to consider what action it should take.

Separately, the evidence suggested that Robert Clancy incurred significant personal expenses on his corporate credit card. Mr Haysey said that the CSF Board only became aware of a review of his expenses because a note was found in a drawer when responding to the Commission's enquiries. At least during one period, Mr Clancy approved his own expenses, and there was a 'longstanding practice' at CSF of using corporate cards for personal use in breach of internal policies.

CSF's corporate credit cards are funded from money ultimately received from members. Their use should be carefully monitored and controlled. CSF did not, or could not, ensure that was the case. Its failure to do so fell below community standards and expectations.

12 Payments from third party managed investment schemes

12.1 Background

Both IOOF and ANZ have subsidiaries that are RSE licensees. These RSE licensees operate ‘platforms’ for members of their superannuation funds. These ‘platforms’ let members choose where to invest their superannuation funds from a menu provided by the RSE licensee. Some of the options on that menu are managed investment schemes. A company that runs a registered managed investment scheme is known as a ‘responsible entity’ (RE). When an RSE licensee includes a managed investment scheme on its platform’s menu, the RE may pay a fee to the RSE Licensee or an entity related to the RSE licensee.

Under the **Future of Financial Advice** (FoFA) reforms, ‘volume-based shelf-space fees’ are banned in most circumstances.¹²⁴⁹ This is a fee paid by a fund manager (such as an RE) to a platform operator that is calculated on the basis of the number or value of the fund manager’s financial products included on the menu. Two exceptions to the ban are relevant. First, a reasonable fee for a service provided to the fund manager by the platform operator is not presumed to be a volume-based shelf-space fee. Second, volume-based shelf-space fees that existed before 1 July 2013 were grandfathered.

The Commission heard evidence from each of IOOF and ANZ about payments made by the REs of managed investment schemes to trustees within each of their respective groups. Mark Oliver, General Manager, Distribution, for IOOF Holdings gave evidence about IOOF. Mark Pankhurst, Head of Superannuation, Pensions and Investments for ANZ Wealth, gave evidence about ANZ.

¹²⁴⁹ Corporations Act s 964A.

12.2 Evidence

12.2.1 IOOF Investment Management

IOOF Investment Management Limited (IIML) is RSE licensee of the IOOF Portfolio Service superannuation fund (the Portfolio Service). Through the 'platform' provided by IIML, superannuation members can invest in particular managed investment schemes run by IIML or by third parties.¹²⁵⁰ IOOF Holdings Ltd, IIML's parent company, has 'platform services agreements' with some of these third party REs. Under those agreements, IOOF Holdings promises that its related entities (IIML, Questor, or Australian Executor Trustees) will provide 'administration and investment related services' to the RE.¹²⁵¹ In return, the RE makes payments to IOOF Holdings.¹²⁵²

The payments are calculated in two different ways, depending on when the contract was made. For contracts made before 1 July 2013, the payments are calculated according to the percentage of funds under management.¹²⁵³ For contracts made after that time, the payment is \$10 per member.¹²⁵⁴ The services to be provided under each type of contract are the same. Mr Oliver agreed that the fixed fee was introduced because FoFA banned most volume-based shelf space fees.¹²⁵⁵ He understood that the \$10 fee was a recovery of IOOF's process costs.¹²⁵⁶

The Commission asked IOOF to identify the amount of fees it received that was generated from investments of superannuation members' money. In the quarter ending March 2018, REs had paid total fees of \$2.317 million

¹²⁵⁰ Transcript, Mark Oliver, 10 August 2018, 4572.

¹²⁵¹ Exhibit 5.100, Fund Manager Deed IOOF Holdings and Aberdeen Asset Management Limited, 29 April 2010.

¹²⁵² Exhibit 5.100, Fund Manager Deed IOOF Holdings and Aberdeen Asset Management Limited, 29 April 2010, 5.

¹²⁵³ Transcript, Mark Oliver, 10 August 2018, 4573.

¹²⁵⁴ Transcript, Mark Oliver, 10 August 2018, 4573.

¹²⁵⁵ Transcript, Mark Oliver, 10 August 2018, 4573.

¹²⁵⁶ Transcript, Mark Oliver, 10 August 2018, 4574.

based on Portfolio Service members' investments.¹²⁵⁷ The amounts paid by individual external entities ranged from \$419 to \$186,034.¹²⁵⁸

The Commission asked IOOF whether it considered that the superannuation fund should receive the benefit of these payments. Mr Oliver answered a slightly different question. In his written statement, he gave evidence that IIML, the trustee of the fund, believed it should only receive these payments if it provides services to the REs of the managed investment schemes.¹²⁵⁹ In his oral evidence, Mr Oliver said that this was what IOOF's legal counsel had told him.¹²⁶⁰ He did not know 'directly' if the IIML Board had ever considered the issue.¹²⁶¹

It was not clear what actually happened to these payments. Mr Oliver gave evidence that IOOF Holdings passed on the payments to IIML as the 'platform operator'.¹²⁶² His only basis for this evidence was that his 'governance service colleagues' had told him.¹²⁶³ Yet this was not consistent with IIML's financial reports, which in the 2017 financial year showed payments from related entities of only \$154,498.¹²⁶⁴ Mr Oliver said he was not familiar with those reports, and could not explain the difference.¹²⁶⁵

12.2.2 OPC and Oasis

OnePath Custodians Pty Ltd (OPC) and Oasis also provide platforms that allow superannuation members to invest in managed investment schemes operated by third parties. In some cases, the REs of those managed

¹²⁵⁷ Exhibit 5.99, Witness statement of Mark Oliver, 26 July 2018, Annexure D.

¹²⁵⁸ Exhibit 5.99, Witness statement of Mark Oliver, 26 July 2018, Annexure D.
Note that IIML was recorded as having paid \$667,290 during the period.

¹²⁵⁹ Exhibit 5.99, Witness statement of Mark Oliver, 26 July 2018, 17 [40].

¹²⁶⁰ Transcript, Mark Oliver, 10 August 2018, 4579.

¹²⁶¹ Transcript, Mark Oliver, 10 August 2018, 4578.

¹²⁶² Transcript, Mark Oliver, 10 August 2018, 4579, 4582; Exhibit 5.99,
Witness statement of Mark Oliver, 26 July 2018, 17 [44].

¹²⁶³ Transcript, Mark Oliver, 10 August 2018, 4582.

¹²⁶⁴ Exhibit 5.102, IIML Financial Report, 30 June 2017, 28.

¹²⁶⁵ Transcript, Mark Oliver, 10 August 2018, 4580–2.

investment schemes make payments back to OPC, Oasis, OnePath Life or OnePath Funds Management (OPFM).¹²⁶⁶

Those payments are made under contracts that fit either a 'pre-FoFA' or 'post-FoFA' test.¹²⁶⁷ Under a 'pre-FoFA' contract, the payment is calculated as a percentage of funds under management.¹²⁶⁸ That is, the RE pays ANZ a rebate for each dollar invested in the managed investment scheme. The payment is described as a 'shelf space fee'.¹²⁶⁹ No ANZ company has to provide any service in return for the fee.¹²⁷⁰

The Commission also asked ANZ to identify the amount of fees it received that was generated from investments of superannuation members' money. For the year ending 30 September 2017, REs had paid OPC and Oasis more than \$13.7 million based on superannuation fund members' investments.¹²⁷¹ The amounts paid by individual entities ranged from \$489 to \$2,228,031.

Under 'pre-FoFA' contracts, none of the payments are given back to members.¹²⁷² The money is kept by ANZ. Mr Pankhurst's evidence was that the rebate payments are one of the things ANZ considers when setting the fees it charges to superannuation members.¹²⁷³ That is, investment management fees were one of the costs that formed part of the pricing model, and the rebates from REs reduced that cost.¹²⁷⁴ Mr Pankhurst did

¹²⁶⁶ At least in the case of OPFM, it was not clear which company received the payments: Transcript, Mark Pankhurst, 15 August 2018, 5039–40; Exhibit 2.95, Witness statement of Mark Pankhurst, 13 April 2018, Exhibit MJP-18 [ANZ.800.467.0007].

¹²⁶⁷ Transcript, Mark Pankhurst, 15 August 2018, 5042.

¹²⁶⁸ Transcript, Mark Pankhurst, 15 August 2018, 5043.

¹²⁶⁹ Exhibit 2.95, Witness statement of Mark Pankhurst, 13 April 2018, Exhibit MJP-18 [ANZ.800.467.0007 at .0025].

¹²⁷⁰ Exhibit 2.95, Witness statement of Mark Pankhurst, 13 April 2018, Exhibit MJP-18 [ANZ.800.467.0007].

¹²⁷¹ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, [158]. This amount excluded fixed payments and fee rebates that were passed back to the member.

¹²⁷² Transcript, Mark Pankhurst, 15 August 2018, 5045.

¹²⁷³ Transcript, Mark Pankhurst, 15 August 2018, 5044.

¹²⁷⁴ Transcript, Mark Pankhurst, 15 August 2018, 5044.

not suggest there was a direct correlation between the rebates received and the price charged. However, he also said that this type of arrangement was ‘antiquated’. Now, in many cases ANZ simply fixes a price and ‘there are no payments’.¹²⁷⁵ In the case of the new Oasis Wrap platform, the rebates are returned to members.¹²⁷⁶

Mr Pankhurst gave evidence that OPC and Oasis had not formally considered whether the relevant fund should receive the benefits of these payments.¹²⁷⁷ However, at its meeting in July 2018, the combined OPC and Oasis Board received a presentation about these payments.¹²⁷⁸ The board asked for further information, and commented that it will ‘need to clarify how it views these arrangements [under] the current and future structure’.¹²⁷⁹

12.3 What the case study showed

Four things should be observed about these arrangements.

The first is that the payments described above add up to significant amounts. If IOOF’s income for the March 2018 quarter were repeated for the rest of the year, the payments would be worth more than \$9 million annually. ANZ earned more than \$13.7 million from these payments in 2017. It is important to remember that these amounts are not total payments across the group. They are only the payments generated from superannuation investments.

The second is that, on the material available, it is not possible to say whether the amounts received from the RE are properly seen as either a fee for service or as cost recovery. In the case of IOOF, the payments were calculated as either a proportion of funds under management or a flat \$10 fee per member, depending on when the relevant agreement was made. Mr Oliver said that the \$10 amount represented IIML’s processing cost. If the payments made under the earlier contracts were in return for the same services, they would represent a significant windfall for IOOF.

¹²⁷⁵ Transcript, Mark Pankhurst, 15 August 2018, 5044.

¹²⁷⁶ Transcript, Mark Pankhurst, 15 August 2018, 5045.

¹²⁷⁷ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 73 [157].

¹²⁷⁸ Exhibit 5.254, Draft Minutes OnePath Custodians Meeting 26 July 2018, 13 August 2018.

¹²⁷⁹ Exhibit 5.254, Draft Minutes OnePath Custodians Meeting 26 July 2018, 13 August 2018.

In the case of ANZ, no entity in the ANZ group was even required to perform a service in return.

The third is that although this income is derived directly from members' money, there appeared to be no direct benefit to members. Mr Oliver could not explain, and the evidence did not reveal with any real clarity, where the money received by IOOF Holdings went. Mr Pankhurst said that ANZ considers those payments when setting its fees. But the payments appear to be merely one input among many into ANZ's pricing model.

The fourth is that the trustee has ultimate responsibility for this income. In the case of IOOF, I accept that IOOF Holdings (rather than IIML) is the contracting entity. But IIML is the trustee of the fund and decides where to invest its members' money. The evidence was that IIML was aware of the payments but had taken no steps in relation to them. In the case of ANZ, the trustee is itself a party to the agreements under which the payments are made.

Arrangements of this kind may raise two issues.

First, I do not accept that an independent trustee acting in the best interests of its members would allow other parties to receive large amounts of money directly generated from members' funds with nothing in return. I cannot say whether that is a proper description of what happened in these cases. If it is, it may well follow that the trustee has not complied with the covenant to act in the best interests of members.

The matter not having been so far drawn to the attention of the regulators, I refer the conduct of OPC, Oasis and IIML to APRA for its consideration of whether to take action.

The second issue relates to the duty to give priority to the interests of beneficiaries over the interests of others. Both APRA and ASIC told the Commission that payments of this kind could cause a conflict.¹²⁸⁰ They said the conflict could arise because it would be in the trustee's interest to invest funds to maximise payments, rather than maximise benefits to members.

¹²⁸⁰ ASIC, Module 5 Policy Submission, 6–7 [33]–[41]; APRA, Module 5 Policy Submission, 28–9 [85].

As a result, they said, a trustee should not receive such payments unless the payments were then passed on to members.

This risk may be less significant than it initially appears. Under 'platform' arrangements, the individual superannuation member selects which managed investment scheme to invest in. That is, to the extent that the payments relate to investments through a platform, the trustee has limited scope to direct investments to obtain larger payments. However, the trustee still has control over what schemes are available to members. A risk remains that these payments could inappropriately influence those selections. On the material available, I cannot say whether this has occurred. But the risk would be avoided if the payments were passed on to members.

I make one further observation. It is troubling that in both organisations, the trustee appeared to have little awareness or understanding of these payments. The Commission heard that after the Commission enquired about this topic, the boards of OPC and Oasis asked for a briefing.¹²⁸¹ Yet the information provided to the board in response was, according to Mr Pankhurst, inaccurate. Similarly, it seems that the board of IIML may not have considered the issue. What is more, even after the Commission's enquiries it remains unclear what happens to the payments made to IOOF Holdings. It should not be the case that trustees of large superannuation funds, forming part of large and sophisticated financial groups, have so little knowledge of what happens to income generated from members' investments.

13 Fees for no service

13.1 Background

Each of the case studies concerning Colonial First State (CFS), NAB and AMP included consideration of trustees charging fees for services that were not provided.

¹²⁸¹ Transcript, Mark Pankhurst, 15 August 2018, 5039; Exhibit 5.254, Draft Minutes OnePath Custodians Meeting 26 July 2018, 13 August 2018.

The Commission received evidence in three other case studies that raised similar issues. The three cases were:

- State Super Financial Services Australia Limited (StatePlus), now a subsidiary of FSS Trustee Corporation (FTC).¹²⁸² The Commission received a written statement from Mark Lennon, a director of FTC and StatePlus, in relation to this case study.
- Asgard Capital Management Limited (Asgard) and BT Funds Management Limited (BT), both part of the Westpac Group. The Commission received a written statement from Melinda Howes, Executive Director, Superannuation Boards and General Manager – Superannuation, BT Financial Group in relation to this case study.
- OnePath Custodians Pty Ltd (OPC), a subsidiary of ANZ. The Commission received written statements from Mark Pankhurst, Head of Superannuation, Pensions and Investments for ANZ Wealth, and Peter Mullin, a director of OPC, in relation to this case study.

13.2 Evidence

13.2.1 StatePlus

StatePlus is the RSE licensee for the StatePlus Fixed Term Pension Plan and the StatePlus Retirement Fund.¹²⁸³ As at 30 June 2017, the funds had, respectively, \$7.6 million under management in respect of 632 members and \$17.228 billion under management in respect of 74,739 members.¹²⁸⁴

In June 2016, StatePlus was purchased by a subsidiary of FTC. After the purchase, FTC performed a review of StatePlus's business practices and its provision of service to members.¹²⁸⁵

¹²⁸² Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 6 [38], 10 [54].

¹²⁸³ Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 5 [29]–[30].

¹²⁸⁴ Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 17–18 [92].

¹²⁸⁵ Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 135 [527].

That review found that from April 2013, StatePlus told some members who had received written advice from a financial adviser that StatePlus would invite them to an annual review with a financial planner.¹²⁸⁶ However, StatePlus's advice procedures were not updated to ensure that all relevant members received the invitation. Some members with balances under \$150,000 did not receive an invitation to receive an annual review. Others received an invitation, but only on a 14 month cycle (instead of a 12 month one). The cost of the annual review was included in the management fee paid by the member.¹²⁸⁷

StatePlus reported the breach to ASIC in May 2017.¹²⁸⁸ Since then, in consultation with ASIC, StatePlus has started to compensate affected members.¹²⁸⁹ At the time of Mr Lennon's statement in August 2018, 12,269 members had been paid compensation.¹²⁹⁰ StatePlus forecast that the total cost of project expenses and fee repayments will not exceed \$92 million.¹²⁹¹

13.2.2 OPC

OPC is the RSE licensee of the OnePath Master Fund, which has over \$36 billion in funds under management and over 949,000 member accounts.¹²⁹²

In October 2014, an internal team noticed that money was accumulating in a 'dummy' account within OPC. ANZ logged an incident report and began an investigation.¹²⁹³

¹²⁸⁶ Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 135–6 [530]–[531].

¹²⁸⁷ Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, Exhibit ML-193 [STS.5003.0001.1284].

¹²⁸⁸ Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 136 [532]; Exhibit ML-193 [STS.003.0001.1284].

¹²⁸⁹ Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 156 [553], 157 [557].

¹²⁹⁰ Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 155 [550].

¹²⁹¹ Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 157 [557].

¹²⁹² Exhibit 5.330, Witness statement of Peter Mullin, 25 July 2018, 10 [29].

¹²⁹³ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 103 [279].

The investigation found that adviser service fees (ASFs) were being deducted from some members' accounts after those accounts were no longer allocated to an adviser. This happened when staff did not properly follow a two-step process to stop adviser payments.¹²⁹⁴ OPC eventually established that this problem had been occurring since 2003, and that 2,640 members were affected. It found that it had wrongly deducted \$1,018,448 from those members' accounts.¹²⁹⁵

In February 2015, OPC reported the breaches to ASIC and APRA.¹²⁹⁶ Between March and September 2015, OPC communicated with ASIC and developed a remediation program.¹²⁹⁷ In November 2015, ANZ engaged an independent consultant to review its proposed remediation program.¹²⁹⁸ ANZ finished compensating all customers in August 2016.¹²⁹⁹

OPC engaged Ernst and Young to assess its processes, business rules and controls in respect of ASFs across OPC and ANZ's Pensions & Investments operations more broadly.¹³⁰⁰ With the exception of recommendations relating to the integration of the control environment of the ANZ Financial Planning and aligned dealer group businesses, which are being separated from ANZ's systems as part of the IOOF transaction, all recommendations have been implemented.¹³⁰¹

13.2.3 Westpac

This case study concerned some 'investor-directed portfolio service' products, and similar products, administered by Asgard, and some superannuation products of which BT was the RSE licensee.

¹²⁹⁴ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 98–9 [251]–[253].

¹²⁹⁵ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 99 [255].

¹²⁹⁶ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 101 [267].

¹²⁹⁷ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 102 [270].

¹²⁹⁸ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 102 [272].

¹²⁹⁹ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 102 [277].

¹³⁰⁰ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 103 [280].

¹³⁰¹ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 103 [282].

After 1 July 2014, the fee structure of these products changed. Under the new structure, an advice fee was collected by Asgard or BT as a separate fee, rather than being included in an administration fee.¹³⁰² After this structure was introduced, some customers were charged advice-related fees even though they were no longer receiving advice. The wrongly charged fees were retained by Asgard or BT.¹³⁰³

In October 2016, a customer complained about being charged an advice fee after having asked to remove their financial adviser from their account. Westpac conducted an investigation into the issue, which finished in February 2017.¹³⁰⁴ It found that the root causes of the error were insufficient procedures and inconsistent processing of the removal or reduction (as applicable) of the relevant fees either by relevant employees or by a third party service provider.¹³⁰⁵

Westpac notified ASIC of the issue on 17 July 2017.¹³⁰⁶ A remediation process was agreed in December 2017¹³⁰⁷ and completed in March 2018.¹³⁰⁸ 767 customers were affected.¹³⁰⁹ In total, \$634,490 was paid to those customers, comprising reimbursement of the fees incorrectly charged and compensatory interest.¹³¹⁰

13.3 What the case study showed

In each case, members were charged fees for services that were not provided because of failures in the trustee's systems. StatePlus did not update its procedures. OPC failed to follow its procedures. Asgard and BT

¹³⁰² Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 4 [19].

¹³⁰³ Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 4 [21].

¹³⁰⁴ Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 5 [27].

¹³⁰⁵ Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 5 [28].

¹³⁰⁶ Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 7 [38], Exhibit MSH1-5 [WBC.529.001.0012].

¹³⁰⁷ Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 8 [45].

¹³⁰⁸ Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 9 [46].

¹³⁰⁹ Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 4 [22].

¹³¹⁰ Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 4 [22].

had both inadequate procedures and inconsistent processing. As a result, each trustee took money from members to which it was not entitled. In each case the conduct continued for several years. In the case of OPC, it continued for over a decade.

As I said in connection with home loans in the *Interim Report*, processing errors are failures by entities to make proper provision in their systems to charge customers only what the customer has agreed to pay. Entities should not sell what they cannot deliver.¹³¹¹

Each of the three entities acknowledged that its actions constituted misconduct.¹³¹² Westpac specifically acknowledged that its conduct may have breached its obligations under section 912A of the Corporations Act.¹³¹³ I agree. In my view, the conduct of each entity may have breached section 912A(1)(a) of the Act, in that the trustee failed to do all things necessary to ensure that the financial services covered by its Australian financial services licence were provided efficiently, honestly and fairly. Each matter having already been reported to ASIC, it is a matter for it to decide what, if any, further action should be taken.

14 MySuper and other retail groups

14.1 Background

Each of the case studies concerning Colonial First State, IOOF and AMP included consideration of whether the interests of members – having their superannuation invested in a simple, low-cost product – were subjugated to the interests of the relevant retail group or its associated financial advisers – having members remain invested in higher fee-paying products.

Two other case studies raised similar issues.

¹³¹¹ FSRC, *Interim Report*, September 2018, Vol 1, 67.

¹³¹² FTC, *Submission*, 29 January 2018, 4 [3.7]; ANZ, *ANZ Submission in Response to the Commission's Letters of 15 December 2017*, 29 January 2018, 12 [5.31], 15 [5.41]; Westpac, *Module 5 Case Study Submission*, 1 [2].

¹³¹³ Westpac, *Module 5 Case Study Submission*, 1 [2].

14.2 Evidence

14.2.1 Aon Hewitt

The first concerned Aon Hewitt Financial Advice Limited (Aon Hewitt), which offers financial advice services. It has 185 financial advisers, 149 of whom are authorised representatives of Aon Hewitt. Aon Hewitt is part of the Aon Group, which provides financial advice, insurance, and other professional services.

Three of Aon Hewitt's advisers switched clients out of their existing default superannuation product, and into a choice product, before 30 June 2017. The timing was significant, because RSE licensees were required to transfer accrued default amounts to a MySuper default option by 1 July 2017. By switching their clients to a choice product, the advisers avoided those funds being transferred. One consequence was that the financial advisers remained entitled to receive trailing commissions. Yet it was not clear that these clients had provided informed consent to the switch. It appeared that many had not been provided with a Statement of Advice (SOA) or Financial Services Guide (FSG), or any advice at all.

The Commission received a statement of evidence from Mr Jayson Walker, the General Manager of Aon Hewitt, about this case study.¹³¹⁴

The first financial adviser wrote to 331 clients on 18 August 2016 as follows:¹³¹⁵

[W]e are proposing that your existing super and future contributions be invested in your existing AON Master Trust *Balanced Growth – Active* investment option. This balanced option helps to ensure that your super is not invested too aggressively nor too defensively, and that your super is not exposed to excessive risks.

...

¹³¹⁴ Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018.

¹³¹⁵ Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, Exhibit 2.2, Appendix A (emphasis in original); see also Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 3 [22]–[24].

What do I need to do?

If you are happy to have your existing MySuper balance and future contributions invested in your AON Master *Balanced Growth – Active* investment option, no further action is required from you. We will do all the work for you to ensure this happens. However, if you wish to leave your Aon MySuper account unchanged, please contact us within 30 days from the date of this letter.

The adviser did not provide any SOA or FSG to those clients, either with the letter or otherwise. There was no indication on the clients' files that they had been given any advice about whether switching was in their best interests. There was nothing to suggest the clients had given informed consent to switch to the choice product. Nevertheless, the first financial adviser switched all 331 clients to a choice product.¹³¹⁶

The second and third financial advisers both worked for the same corporate group. Again, it appears that these advisers switched clients to a choice product without providing an SOA or an FSG. Aon Hewitt's investigation could not find sufficient evidence of informed consent.¹³¹⁷

Initially, in its breach report to ASIC on 27 March 2018, Aon Hewitt said that the conduct had affected 500 clients of those financial advisers.¹³¹⁸ Since then, Aon Hewitt has undertaken further analysis and is still determining the number of clients who may have been affected.¹³¹⁹ On the state of the evidence, I cannot be satisfied of the precise number of clients of the second and third advisers who may have been affected.

The conduct of each of the three financial advisers only came to Aon Hewitt's attention when it was issued with notices by ASIC pursuant to section 33 of the ASIC Act in late 2017. Aon Hewitt then commenced

¹³¹⁶ Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 19 [133].

¹³¹⁷ Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 5 [34].

¹³¹⁸ Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, Exhibit JW-2 (Tab 2.2) [AHF.001.001.1373].

¹³¹⁹ Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 19 [134]–[135].

an investigation. As a result of that investigation, Aon Hewitt lodged a breach report with ASIC in relation to the three advisers.¹³²⁰

Aon Hewitt is now in the process of designing its review and remediation program. It intends to compensate clients for any loss suffered by reason of differences in fees and costs payable and investment returns.¹³²¹ Aon Hewitt acknowledged before the Commission,¹³²² and has acknowledged to ASIC,¹³²³ that it is liable to compensate clients who suffered loss as a result of breaches by the three financial advisers.¹³²⁴

14.2.2 Mercer Superannuation

The second case study involved Mercer Superannuation (Australia) Limited (Mercer Superannuation), the RSE licensee of the Mercer Super Trust (the Mercer Fund) and three other superannuation funds.¹³²⁵

The Mercer Fund is divided into four divisions: the Corporate Superannuation Division, the Personal Superannuation Division, the Mercer Retail Division and the Mercer Allocated Pension Division (the Pension Division).¹³²⁶ This case study related to the Pension Division, which in June 2018 had 3,143 members and funds under management of \$1.038 billion.¹³²⁷

The case study concerned statements made in an internal email, which suggested that Mercer Superannuation was deliberately making it difficult for its members to access a new, lower fee structure.

Three written statements of Benjamin Walsh, Mercer Superannuation's Executive Director, were tendered in relation to the case study.

¹³²⁰ Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, Exhibit JW-2 (Tab 2.2) [AHF.001.001.1373].

¹³²¹ Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 19 [136]–[137].

¹³²² Aon Hewitt, Module 5 Case Study Submission, 2 [10].

¹³²³ Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 20 [139]–[142].

¹³²⁴ Corporations Act ss 917A, 917B and 917F.

¹³²⁵ Exhibit 5.333, Witness statement of Benjamin Walsh, 30 July 2018, 1 [1], 2 [7].

¹³²⁶ Exhibit 5.333, Witness statement of Benjamin Walsh, 30 July 2018, 3 [10].

¹³²⁷ Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 1–2 [4].

In 2013, Mercer Superannuation was preparing for the commencement of FoFA and the Stronger Super reforms. In February, the Mercer Superannuation Board resolved that new fee structures would be introduced in respect of members who joined the Pension Division from 30 June 2013. Trailing commissions would not be paid under these new structures. Existing arrangements, which did allow the payment of trailing commissions, would be grandfathered.¹³²⁸

In June 2013, the board delayed the application of the new fee structures to 1 January 2014 so that the change of fees would align with other changes being made because of the introduction of MySuper.¹³²⁹

As part of the changes, Mercer staff were considering what process to follow where a Pension Division member wanted to access the new fee structure. An internal email chain showed that one staff member thought members should close their existing account and open a new one. Another staff member replied that doing so would be 'a lot of work and totally unnecessary'.¹³³⁰

Stephen Partridge was the Fund Product Leader at the time. On 12 December 2013, he replied to those emails as follows:¹³³¹

Part of the logic here is that we want to protect our existing APD [Pension Division] revenue as much as possible.

Accordingly we do not intend to advertise the new lower fees to existing APD members and we don't want to make it easy for them to (a) find out about the new lower fees and (b) access them.

¹³²⁸ Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 5 [20]; Exhibit 5.335, Witness statement of Benjamin Walsh, Exhibit BJCW-116 [MER.501.001.3068 at .3072].

¹³²⁹ Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 5–6 [22]; Exhibit 5.335, Witness statement of Benjamin Walsh, Exhibit BJCW-119 [MER.510.001.0835 at .0845].

¹³³⁰ Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 8–9 [34]; Exhibit 5.335, Witness statement of Benjamin Walsh, Exhibit BJCW-130 [MER.003.001.0638].

¹³³¹ Exhibit 5.335, Witness statement of Benjamin Walsh, Exhibit BJCW-130 [MER.003.001.0638] (emphasis added).

However, anyone who wants can take out a new allocated pension and we cannot stop existing members doing this.

APD members who have a Mercer adviser who is acting in the [members'] best interests will likely initiate this also.

There are some delicate trustee fiduciary issues involved in this decision also.

If we allow existing members to simply apply to have their fees reduced while remaining in the same account with nothing else changing, then Mercer Superannuation is probably obligated to inform existing members of this, which we do not want to do.

I am aware that operationally this is painful and costly, but it is much less costly for the business than advising all the existing members and have most of them apply to have their fees reduced.

This email formed part of a story on *Four Corners* broadcast by the ABC on 26 March 2018.¹³³² After the story aired, Mercer Superannuation investigated the email and the way it had communicated with Pension Division members after the introduction of the new pricing structure.¹³³³

Mercer Superannuation found that while some members would have paid lower fees if the new pricing structure was applied to their accounts, there were other members whose fees would have increased if that new pricing structure had been applied to their accounts.

On 23 July 2018, the board of Mercer Superannuation made an in-principle decision to:¹³³⁴

- Align the pricing of all members of the Pension Division, regardless of whether they joined before or after 1 January 2014. This would be done

by introducing a new pricing structure for the Pension Division from a nominated future date (provisionally, 1 January 2019).

¹³³² Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 10 [40].

¹³³³ Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 11 [43].

¹³³⁴ Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 11 [43]; Exhibit 5.335, Witness statement of Benjamin Walsh, Exhibit BCJW-136 [MER.547.001.001 at .0030], Exhibit BJCW-137 [MER.300.011.0005].

- Provide a 'goodwill allowance' to members of the Pension Division as at 31 December 2013. This allowance would be the difference between their actual account balance on a nominated date (for example, 31 December 2018) and the amount their account balance would have been if Pension Division fees from 1 January 2014 had been capped at 1.5%.

14.3 What the case study showed

14.3.1 Aon Hewitt

On the limited material I have, it may be that the advisers concerned may have breached each of sections 941B(1), 946A(1) and 961B of the Corporations Act on each occasion a switch was made, if the switch was made without the client's informed consent, by, respectively, failing:

- to provide an SOA;
- to provide an FSG; and
- to act in the best interests of the client.

Not having heard the advisers' side of the story, I cannot, and do not, say whether that is so.

Each of the relevant obligations applies to the 'providing entity' or 'provider'. Insofar as section 961B(1) of the Corporations Act is concerned, not consulting with a client at all, or merely informing a client of a chosen course without consulting with him or her could constitute a breach of the section.¹³³⁵ But, as I say, I make no finding.

Instead, the question is whether Aon Hewitt itself may have breached these or other provisions of the financial services laws. In its submissions, it contended, by reference to the wording of each of section 941B(1), 946A(1) and 961B of the Corporations Act, that those provisions only apply to the 'providing entity' or 'provider' of the relevant advice and that it was not the

¹³³⁵ Cf Aon Hewitt, Module 5 Case Study Submission, 2 [8].

providing entity or provider that was engaged in the conduct described here. I agree.

Nevertheless Aon Hewitt would be liable under the Corporations Act, sections 917A, 917B and 917F, to compensate the affected clients if the conduct of the three advisers was not lawful. Aon Hewitt was right to acknowledge that this is the case, and it is right to have committed itself to a program of compensation. The supervision of that compensation program is a matter for ASIC.

14.3.2 Mercer Superannuation

Mercer Superannuation conceded that the instructions recorded in the email – that Mercer Superannuation should not make it easy for members to find out about or access lower fees – was conduct that fell below community standards and expectations.¹³³⁶ I agree.

Retail trustees often emphasise to regulators, the Commission and others, the importance of managing conflicts. But when it comes to superannuation, conflicts must not just be ‘managed’ – trustees have an overriding obligation to prefer the interests of beneficiaries. In these cases, financial advisers (in the case of Aon Hewitt) and the trustee (in the case of Mercer Superannuation) might not have done so.

15 Regulatory responses

15.1 ASIC

15.1.1 Approach to regulation

Peter Kell, Deputy Chairman of ASIC, told the Commission that ASIC’s regulatory aim is to have a superannuation system that delivers good outcomes for consumers.¹³³⁷ He said that ASIC is concerned with the fair

¹³³⁶ Mercer, *Royal Commission into the Banking, Superannuation & Financial Services Industry*, 3 August 2018, 1.

¹³³⁷ Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 2 [4].

treatment of consumers and reducing poor conduct,¹³³⁸ and that it takes a risk-based approach, focused on acting where consumers might be harmed.¹³³⁹

Mr Kell said that ASIC believes general deterrence in the superannuation industry is important.¹³⁴⁰ This is because of the large amount of money involved and the importance of superannuation to consumers.¹³⁴¹ He said that ASIC believes that litigation is a 'critical part' of general deterrence,¹³⁴² though deterrence can also be achieved through other methods, such as administrative orders and licence conditions.¹³⁴³

Under the ASIC Act and Corporations Act, ASIC can bring a range of court proceedings against superannuation trustees or their directors. For example, ASIC can bring civil penalty proceedings against a trustee for making false or misleading statements to its members.¹³⁴⁴ Similarly, it can bring civil penalty proceedings if directors of a trustee fail to act in good faith, or engage in unconscionable conduct.¹³⁴⁵

Mr Kell conceded that ASIC had not, in fact, brought many court proceedings regarding superannuation.¹³⁴⁶ He said that this was not due to any confusion about the division of regulatory responsibility between ASIC and APRA, but because there were some parts of the SIS Act that ASIC was not responsible for.¹³⁴⁷ ASIC is prepared to take on a greater role as a conduct regulator for RSE licensees, but considers it would need additional

¹³³⁸ Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 2 [4].

¹³³⁹ Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 7 [22].

¹³⁴⁰ Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 43 [154].

¹³⁴¹ Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 43 [154].

¹³⁴² Transcript, Peter Kell, 17 August 2018, 5260.

¹³⁴³ Transcript, Peter Kell, 17 August 2018, 5260.

¹³⁴⁴ ASIC Act ss 12DB, 12GBA and 12GBC(1).

¹³⁴⁵ ASIC Act ss 12CA, 12CB, 12GBA and 12GBC(1); Corporations Act ss 181(1), 1317E(1) and 1317J(1); Transcript, Peter Kell, 17 August 2018, 5261.

¹³⁴⁶ Transcript, Peter Kell, 17 August 2018, 5261.

¹³⁴⁷ Transcript, Peter Kell, 17 August 2018, 5262.

powers to do so.¹³⁴⁸ By way of example, Mr Kell said that ASIC might be prepared to take action against a trustee for breach of the sole purpose test under such an expanded role.¹³⁴⁹

One of ASIC's other enforcement tools is the power to accept enforceable undertakings (EUs). Mr Kell said that ASIC will consider an EU where it can get better or different outcomes as compared to a court proceeding.¹³⁵⁰ However, part of the 'threshold test' for using an EU was whether ASIC was otherwise prepared to go to court.¹³⁵¹ He said that using EUs without being prepared to go to court would mean the tool would not have 'credibility'.¹³⁵²

15.1.2 Fees for no service

Mr Kell said that the fees for no service project was a significant undertaking. The project involved 27 investigations across 31 licensees, and the collection of more than 2.5 million documents.¹³⁵³ ASIC had imposed banning orders, a licence condition, and accepted EUs, though at the time of Mr Kell's evidence it had not commenced any proceedings.¹³⁵⁴ In implementing the project, he said that ASIC had given priority to remediating customers. The estimated compensation bill at the time of Mr Kell's evidence was \$850 million, though he said the total compensation amount could be more than \$1 billion.¹³⁵⁵

At that time, Mr Kell said that ASIC had only considered remediation due to consumers. It had not assessed what profits the entities had made by charging fees for no service. Mr Kell's evidence was that ASIC would consider the issue, but so far had been focused on 'the main game, getting money back into the pockets of consumers'. In this context, Mr Kell

¹³⁴⁸ Exhibit 5.318, Statement of Peter Kell, 13 August 2018, 56 [203].

¹³⁴⁹ Transcript, Peter Kell, 17 August 2018, 5262.

¹³⁵⁰ Transcript, Peter Kell, 17 August 2018, 5251.

¹³⁵¹ Transcript, Peter Kell, 17 August 2018, 5250–1.

¹³⁵² Transcript, Peter Kell, 17 August 2018, 5250.

¹³⁵³ Transcript, Peter Kell, 17 August 2018, 5254.

¹³⁵⁴ Transcript, Peter Kell, 17 August 2018, 5254.

¹³⁵⁵ Transcript, Peter Kell, 17 August 2018, 5254.

said that ASIC had publicly argued in favour of a disgorgement power, so that it could deal with the money entities make from misconduct.¹³⁵⁶

Mr Kell agreed that another way of deterring entities from this sort of misconduct was to commence proceedings and obtain large civil penalties that deprived entities of their profit. In respect of the fees for no service conduct, he said that ASIC was ‘certainly alert’ to the risk of limitation periods expiring, and that ‘you will expect to see’ ASIC commence proceedings.¹³⁵⁷ In September 2018, three weeks after Mr Kell gave evidence, ASIC filed proceedings against NAB’s two superannuation trustees for charging fees for no service. I have said more about the subject of fees for no service in the body of this report.

15.1.3 Grandfathered commissions

In 2016, NULIS wrote to ASIC about grandfathered commissions. It thought that it should be allowed to continue paying grandfathered commissions to advisers, and planned to do so.¹³⁵⁸ Mr Kell said that internally ASIC thought that the law was uncertain and involved complex legal issues.¹³⁵⁹ As a result, ASIC replied noting NULIS’s view and that it did not seek a ‘no action’ letter from ASIC. ASIC did not take any further action.¹³⁶⁰ Mr Kell said that, in hindsight, ASIC should have considered whether continuing grandfathered commissions satisfied a ‘best interests test’. At a broader level, his evidence was that ‘the entire [grandfathering] provision is not in the interests of consumers’.¹³⁶¹ It was initially ‘depicted as a transition issue’, but was ‘actually an extremely expansive provision’. He said that grandfathering generated conflicts of interests and unnecessary costs, and while ASIC

¹³⁵⁶ Transcript, Peter Kell, 17 August 2018, 5255.

¹³⁵⁷ Transcript, Peter Kell, 17 August 2018, 5255–6.

¹³⁵⁸ Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, Exhibit PK-151 [ASIC.0800.0011.3312].

¹³⁵⁹ Transcript, Peter Kell, 17 August 2018, 5257; Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, Exhibit PK-150 [ASIC.0800.0012.1761].

¹³⁶⁰ Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, Exhibit PK-151 [ASIC.0800.0011.3312]; Transcript, Peter Kell, 17 August 2018, 5256.

¹³⁶¹ Transcript, Peter Kell, 17 August 2018, 5258.

can and should look at individual cases, the matter should be dealt with at a policy level.¹³⁶²

15.1.4 Transfer of ADAs

Mr Kell also gave evidence that in ASIC's view, there was no systemic problem with the default transfer process following the introduction of MySuper.¹³⁶³ However, he said that ASIC's work around the transition of accrued default amounts (ADAs) to MySuper products had been focussed on a specific project where advisers had tried to avoid transitioning their clients to MySuper. He said that ASIC had not found large numbers of advisers engaging in misconduct, but had not considered the transfer of ADAs through 'the broader prism' of trustees and wealth management firms.¹³⁶⁴ In light of the evidence heard by the Commission, he considered that 'more broadly there is a systemic issue'.¹³⁶⁵

15.1.5 Branch selling program

As described earlier, between 2012 and 2018 ANZ sold its Retail Smart Choice Super product through its bank branches. Timothy Mullaly, Senior Executive Leader of the ASIC Financial Services Enforcement team, told the Commission that ASIC was concerned that this sales process might involve personal financial advice, which would breach the law.¹³⁶⁶

In the middle of 2014, ASIC started surveillance of ANZ's distribution practices. Its investigation into the superannuation selling practices of ANZ, as well as those of CBA and Westpac, became part of a broader project within ASIC called the Wealth Management Project.¹³⁶⁷ In May 2015, the Wealth Management Project Board set a target to issue civil penalty

¹³⁶² Transcript, Peter Kell, 17 August 2018, 5258.

¹³⁶³ Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 30 [110].

¹³⁶⁴ Transcript, Peter Kell, 17 August 2018, 5259.

¹³⁶⁵ Transcript, Peter Kell, 17 August 2018, 5259.

¹³⁶⁶ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 2 [7].

¹³⁶⁷ Transcript, Timothy Mullaly, 17 August 2018, 5225–6.

proceedings against one of the three banks by the end of October 2015.¹³⁶⁸ In July 2015, the target date changed to November 2015.¹³⁶⁹ However, by the end of November 2015, ASIC had still not issued a proceeding. Mr Mullaly said that was because investigations were continuing, and ASIC still needed to get more evidence and advice.¹³⁷⁰

In December 2016 ASIC sent a 'position paper' to ANZ. That position paper said ASIC suspected that the distribution processes were against the law.¹³⁷¹ ANZ and ASIC also met to discuss ASIC's concerns.¹³⁷² In February 2017, ANZ sent a position paper in response.¹³⁷³ It denied breaching the law. It did not offer to change its conduct, or stop engaging in the conduct. It did not suggest any other way to resolve ASIC's concerns.

On 10 May 2017, ASIC sent ANZ a draft court pleading.¹³⁷⁴ It told ANZ that it would commence proceedings by 15 May 2017, and asked whether ANZ would make any admissions.¹³⁷⁵ Mr Mullaly said that this was intended to show ANZ that ASIC was 'serious' and would go to court if the matter did not resolve.¹³⁷⁶ But despite its stated intention to commence proceedings, ASIC was willing to resolve the matter with an EU. He said that while ASIC was prepared to go to court if it did not get the outcome it wanted,

¹³⁶⁸ Transcript, Timothy Mullaly, 17 August 2018, 5227; Exhibit 5.312, 20 May 2015, Papers for the Wealth Management Project Board Meeting of 20 May 2015, 43.

¹³⁶⁹ Exhibit 5.313, 2 July 2015, Papers for the Wealth Management Project Board Meeting of 2 July 2015, 4.

¹³⁷⁰ Transcript, Timothy Mullaly, 17 August 2018, 5227–30.

¹³⁷¹ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 7 [26]; Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-5 [ASIC.0041.0003.2762].

¹³⁷² Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 8 [27].

¹³⁷³ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-3 [ASIC.0041.0006.0051].

¹³⁷⁴ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-7 [ASIC.0041.0001.7094].

¹³⁷⁵ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-6 [ASIC.0041.0001.7093].

¹³⁷⁶ Transcript, Timothy Mullaly, 17 August 2018, 5233.

ASIC actually thought an EU would be a better outcome than commencing proceedings.¹³⁷⁷

On 12 May 2017, ANZ replied and suggested a meeting.¹³⁷⁸ On 15 May 2017, ANZ's Group General Counsel emailed Mr Mullaly asking for 'one final chat' before ASIC commencing proceedings.¹³⁷⁹ Mr Mullaly said this showed that ASIC had 'got their attention'.¹³⁸⁰ As a result, ASIC did not commence proceedings.¹³⁸¹

By the end of May 2017, ANZ told ASIC that it was prepared to accept an EU.¹³⁸² In October 2017, ASIC gave ANZ a draft EU.¹³⁸³ ANZ and ASIC then negotiated the terms of the EU for 10 months.¹³⁸⁴ As part of those negotiations, ANZ and ASIC had to agree exactly what ANZ would stop doing. Mr Mullaly said that ANZ tried to narrow the conduct that would be prohibited.¹³⁸⁵ ASIC also wanted to include contextual information about how many superannuation accounts had been opened, and how much money had been contributed to those accounts.¹³⁸⁶ ANZ did not want to include that information,¹³⁸⁷ and ASIC agreed to delete it.¹³⁸⁸ The final EU was signed

¹³⁷⁷ Transcript, Timothy Mullaly, 17 August 2018, 5232–3.

¹³⁷⁸ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-8 [ASIC.0041.0001.7107].

¹³⁷⁹ Exhibit 5.314, 15 May 2017, Email from Mr Santamaria to Mr Mullaly.

¹³⁸⁰ Transcript, Timothy Mullaly, 17 August 2018, 5234.

¹³⁸¹ Transcript, Timothy Mullaly, 17 August 2018, 5234.

¹³⁸² Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 8 [34]; Transcript, Timothy Mullaly, 17 August 2018, 5238.

¹³⁸³ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 12–13 [56].

¹³⁸⁴ Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 12 [54].

¹³⁸⁵ Transcript, Timothy Mullaly, 17 August 2018, 5237–9.

¹³⁸⁶ Transcript, Timothy Mullaly, 17 August 2018, 5241; Exhibit 5.377, 25 January 2018, ANZ Smart Choice – Terms of draft EU – Comparison, 3 [2.9].

¹³⁸⁷ Exhibit 5.379, 28 March 2018, Letter from Allens to ASIC, 2.

¹³⁸⁸ Exhibit 5.380, 15 May 2018, Letter from ASIC to Allens, 2.

on 4 July 2018, and accepted by ASIC the next day. ANZ had to stop the distribution process within 45 days of the EU.¹³⁸⁹

Mr Mullaly said ASIC's main concern was stopping the conduct.¹³⁹⁰ He said the EU process meant the conduct stopped in a 'very timely way'.¹³⁹¹ He said that if they had gone to court in May 2017, there was 'no guarantee ... that we would be anywhere near resolving the matter'.¹³⁹² He said that ASIC had considered seeking a court injunction to stop the conduct, but decided it would be 'futile'.¹³⁹³ Mr Mullaly also thought that the EU gave ASIC a better result than they could get from a court order. He said those better results included 'the cessation of the conduct; the precise specification of what ANZ 'could not do'; and the implementation of a monitoring process'.¹³⁹⁴

15.2 APRA

APRA is Australia's prudential regulator, with responsibility for banking, insurance and superannuation.¹³⁹⁵ Among other things, it regulates RSE licensees and has the general administration of important parts of the SIS Act.¹³⁹⁶ Helen Rowell, Deputy Chairman of APRA, told that Commission that APRA is concerned with making sure that RSE licensees can meet their financial promises to their members 'within a stable, efficient and competitive financial system'.¹³⁹⁷ ASIC also regulates RSE licensees, but is mainly concerned with their relationship with consumers.¹³⁹⁸

¹³⁸⁹ Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221 [ANZ.800.870.0001 at .0006, cl 3.6].

¹³⁹⁰ Transcript, Timothy Mullaly, 17 August 2018, 5234, 5242.

¹³⁹¹ Transcript, Timothy Mullaly, 17 August 2018, 5234.

¹³⁹² Transcript, Timothy Mullaly, 17 August 2018, 5235.

¹³⁹³ Transcript, Timothy Mullaly, 17 August 2018, 5235.

¹³⁹⁴ Transcript, Timothy Mullaly, 17 August 2018, 5240.

¹³⁹⁵ Transcript, Helen Rowell, 17 August 2018, 5163.

¹³⁹⁶ SIS Act s 6.

¹³⁹⁷ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 5 [46].

¹³⁹⁸ Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 2 [4].

15.2.1 Approach to regulation

Mrs Rowell said that APRA's approach to regulation is 'principles based' and 'risk based'.¹³⁹⁹ This approach is consistent with the Federal Government's Statement of Expectations, which sets out the Federal Government's view on APRA's roles and responsibilities.¹⁴⁰⁰ Mrs Rowell said that 'principles based' regulation means that it focuses on outcomes. It allows regulated entities to choose how to comply with high level principles, rather than controlling them with detailed prescription.¹⁴⁰¹ 'Risk based' regulation means that APRA focuses on areas of high risk or impact. That means smaller or lower risk entities get less attention than larger or higher risk entities.¹⁴⁰² Mrs Rowell said that APRA's focus is on making sure superannuation entities can meet their promises and obligations to members.¹⁴⁰³

As part of its 'principles-based' regulation, APRA issues Prudential Standards. The Prudential Standards set principles-based objectives to support compliance with the law.¹⁴⁰⁴ As Mrs Rowell put it, the Prudential Standards 'elaborate on the high level requirements' in the legislation.¹⁴⁰⁵ RSE licensees must comply with these standards. There are five prudential standards specific to superannuation, and six prudential standards that cover superannuation and other APRA-regulated industries.¹⁴⁰⁶ APRA also publishes non-binding guidance to help entities understand its requirements.¹⁴⁰⁷

¹³⁹⁹ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 2 [23].

¹⁴⁰⁰ Exhibit 5.443, Undated, Statement of Expectations – Australian Prudential Regulation Authority.

¹⁴⁰¹ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 2–3 [24].

¹⁴⁰² Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 3 [25].

¹⁴⁰³ Transcript, Helen Rowell, 17 August 2018, 5174.

¹⁴⁰⁴ Transcript, Helen Rowell, 17 August 2018, 5163.

¹⁴⁰⁵ Transcript, Helen Rowell, 17 August 2018, 5163.

¹⁴⁰⁶ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 7–8 [61]–[62].

¹⁴⁰⁷ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 7 [59].

APRA considers that the assessment of prudent conduct and risk management is ‘nuanced and intentionally directed to processes and outcomes’ rather than questions of compliance or breach.¹⁴⁰⁸

As a prudential regulator, APRA tries to improve outcomes for members and standards of practice. It considers this approach to be quite different ‘from other regulators with the mandate to enforce compliance with legislation after a violation has occurred’.¹⁴⁰⁹

15.2.2 Supervision and enforcement

As part of its regulatory role, APRA supervises RSE licensees. Each RSE licensee has a nominated supervisor within APRA, who is expected to have in-depth knowledge of the entity.¹⁴¹⁰ Large entities may have a team of supervisors.¹⁴¹¹ The supervisors do various kinds of supervision activities. These can include ‘prudential reviews’, which are detailed assessments of selected practices or procedures, as well as regular meetings with senior executives and other staff.¹⁴¹²

APRA aims to be ‘forward looking and consultative’ in its supervision.¹⁴¹³ If it detects problems, it prefers to work with the entity to resolve those problems.¹⁴¹⁴ It is focused on pre-emptive steps, rather than reacting to problems and taking formal enforcement action.¹⁴¹⁵ Mrs Rowell’s evidence was that in APRA’s experience it has ‘generally not had to pursue or resort to litigation’, given other options such as increased supervision and enforcement action, and the availability of voluntary undertakings.¹⁴¹⁶

¹⁴⁰⁸ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 3 [32].

¹⁴⁰⁹ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 3 [27].

¹⁴¹⁰ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 10 [78].

¹⁴¹¹ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 10 [78].

¹⁴¹² Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 14 [101].

¹⁴¹³ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 6 [53].

¹⁴¹⁴ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 37–8 [249]–[250].

¹⁴¹⁵ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 35 [230].

¹⁴¹⁶ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 4 [39].

However, APRA does have a range of enforcement options. From 2003 to 2008, APRA could disqualify a person from acting as a trustee or responsible officer of a superannuation fund. It disqualified 133 people during that time.¹⁴¹⁷ In 2008 the law changed, and APRA now has to apply to the Federal Court for a disqualification order. When Mrs Rowell gave evidence, APRA had applied to disqualify one person, a director of Trio Capital.¹⁴¹⁸ That proceeding resolved with an EU. APRA has accepted 13 EUs from individuals instead of commencing proceedings to disqualify. Each of these individuals was associated with Trio.¹⁴¹⁹

No corporate trustee has given APRA an EU regarding a superannuation matter in the last 10 years.¹⁴²⁰ APRA has never commenced a civil proceeding for breach of the 'sole purpose test' in section 62 of the SIS Act. When Mrs Rowell gave evidence, APRA had never formed the view that an RSE licensee was not acting in the best interests of members. Other than those mentioned above, it had not started any other court proceeding about superannuation in the past 10 years.¹⁴²¹

It is important to note, therefore, an event that happened after the Commission received Mrs Rowell's evidence. As I have recorded in the section dealing with the IOOF Holdings Ltd group of companies, and as discussed further below, on 6 December 2018 APRA commenced proceedings in the Federal Court against five individuals, IOOF Investment Management Ltd (IIML) and Questor Financial Services Pty Ltd (Questor).¹⁴²² By those proceedings, APRA seeks seeks disqualification orders under section 126H of the SIS Act. It also seeks declarations that IIML, Questor and certain individuals had breached their duties as trustees and contravened various provisions of the Act.

¹⁴¹⁷ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 44 [288].

¹⁴¹⁸ Transcript, Helen Rowell, 17 August 2018, 5167.

¹⁴¹⁹ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 45 [297].

¹⁴²⁰ Transcript, Helen Rowell, 17 August 2018, 5178.

¹⁴²¹ Transcript, Helen Rowell, 17 August 2018, 5169.

¹⁴²² *APRA v Christopher Francis Kelaher & Ors*, NSD 2274/2018.

APRA does not publicly identify entities who have engaged in particular conduct, except through EUs.¹⁴²³ However, it does not think that public disclosure is needed to achieve general deterrence.¹⁴²⁴ APRA believes it is more important to make sure RSE licensees are aware of issues and practices of concern to it.¹⁴²⁵ Therefore it communicates with the industry generally, including through reports, letters and speeches, and with entities individually, through its regular supervision activities.¹⁴²⁶ APRA considers that its approach to general deterrence is effective, and ‘regulated entities know that APRA will take action to enforce its standards if it must’.¹⁴²⁷

In dealing with individual cases, Mrs Rowell said that APRA prefers to take a ‘behind the scenes’ approach.¹⁴²⁸ This is because APRA is concerned that negative publicity about a fund can harm members.¹⁴²⁹ Where public concerns are raised, members or employers might seek to withdraw their funds, which in turn could create liquidity and asset valuation issues that could reduce the value members get from their superannuation investments. APRA considers this issue when deciding whether or not to take enforcement action.¹⁴³⁰

15.2.3 Fees for no service

Mrs Rowell said that APRA was aware of ASIC’s investigation into the fees for no service issue.¹⁴³¹ APRA had not decided whether to take any action against trustees for breach of the sole purpose test. It did not want to ‘intervene in ASIC’s process’, even though APRA, not ASIC, is responsible

¹⁴²³ Transcript, Helen Rowell, 17 August 2018, 5178.

¹⁴²⁴ Transcript, Helen Rowell, 17 August 2018, 5178.

¹⁴²⁵ Transcript, Helen Rowell, 17 August 2018, 5178.

¹⁴²⁶ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 33–4 [220]; Transcript, Helen Rowell, 17 August 2018, 5178.

¹⁴²⁷ Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 34 [221].

¹⁴²⁸ Transcript, Helen Rowell, 17 August 2018, 5179.

¹⁴²⁹ Transcript, Helen Rowell, 17 August 2018, 5179.

¹⁴³⁰ Transcript, Helen Rowell, 17 August 2018, 5179.

¹⁴³¹ Transcript, Helen Rowell, 17 August 2018, 5180.

for addressing contraventions of the sole purpose test under the SIS Act.¹⁴³² Mrs Rowell said that APRA would consider ‘at an appropriate point’ whether to take further action.¹⁴³³ APRA had not decided when that point would be. Mrs Rowell was not sure whether there was a limitation period for prosecuting a breach of the sole purpose test.¹⁴³⁴

Mrs Rowell did say that, as a general proposition, APRA would be concerned if an RSE licensee did not have appropriate monitoring systems in place, including monitoring whether advice had been provided in exchange for fees paid out of superannuation.¹⁴³⁵ She said that APRA supervisors had been engaging with individual entities to understand those issues.¹⁴³⁶

Something more should be said about two particular cases: Colonial First State (CFS) and the transfer of members to MySuper, and IOOF.

15.2.4 CFS and the transition of members to MySuper products by retail fund trustees

From 1 January 2014, superannuation trustees had to pay new default contributions into a MySuper account. Before the change came into effect, APRA reminded RSE licensees of their obligations, and that failing to comply was an offence under section 29WA(3) of the SIS Act.¹⁴³⁷ APRA’s expectation was that RSE licensees would have systems in place to comply with the provision from 1 January 2014.¹⁴³⁸

As I have explained earlier, in February 2014, CBA’s subsidiary Colonial First State Investments Limited (CFSIL) told APRA that it may have breached section 29WA. This was because some members of its FirstChoice Personal Super product had received contributions into

¹⁴³² Transcript, Helen Rowell, 17 August 2018, 5181.

¹⁴³³ Transcript, Helen Rowell, 17 August 2018, 5181–2.

¹⁴³⁴ Transcript, Helen Rowell, 17 August 2018, 5181.

¹⁴³⁵ Transcript, Helen Rowell, 17 August 2018, 5182.

¹⁴³⁶ Transcript, Helen Rowell, 17 August 2018, 5183.

¹⁴³⁷ Transcript, Helen Rowell, 17 August 2018, 5186.

¹⁴³⁸ Transcript, Helen Rowell, 17 August 2018, 5186.

a non-MySuper product. APRA told CFS that it needed to fix the problem 'in the short term', or else APRA might take enforcement action.¹⁴³⁹ CFS's breach notification to APRA said approximately 13,000 members were affected.¹⁴⁴⁰

As part of engaging with APRA, CFSIL provided its proposal to address the breaches. It told APRA that it had started calling affected members to get an investment direction. One call script it used said that CFS was 'required to confirm the investment options into which you would like your superannuation contributions paid'.¹⁴⁴¹ That statement was not accurate. CFS was not 'required' to make any such confirmation. Rather, if CFS did not receive an investment direction it had to pay contributions into a MySuper account. In evidence, Ms Elkins of CBA said that the script was misleading,¹⁴⁴² although in submissions CFS did not agree.¹⁴⁴³ Ms Elkins also said that the script was not balanced, because it was focused on keeping members in their investment option.¹⁴⁴⁴ When asked about the script, Mrs Rowell said that it 'did not provide complete information to the member'. When asked if that was acceptable, Mrs Rowell said that it was 'not desirable'. She said it would be 'preferable if there was complete disclosure to members'.¹⁴⁴⁵

After receiving the proposal, APRA asked for some further information but otherwise told CFS that it was acceptable.¹⁴⁴⁶ CFSIL continued to receive contributions in breach of section 29WA for more than two years. Every few months, CFS would provide an update to APRA. In its update number 24, on 13 September 2017, CFSIL told APRA that it had resolved the final

¹⁴³⁹ Exhibit 5.299, 14 March 2014, Letter APRA to CFSIL.

¹⁴⁴⁰ Exhibit 5.184, 19 March 2014, Breach Notice Colonial First State Investment to APRA.

¹⁴⁴¹ Exhibit 5.187, 26 March 2014, Email CBA to APRA and Attached Call Script.

¹⁴⁴² Transcript, Linda Elkins, 14 August 2018, 4888.

¹⁴⁴³ CBA, Module 5 Case Study Submission, 22 [58].

¹⁴⁴⁴ Transcript, Helen Rowell, 17 August 2018, 4888.

¹⁴⁴⁵ Transcript, Helen Rowell, 17 August 2018, 5196.

¹⁴⁴⁶ Exhibit 5.190, 29 April 2014, Letter, APRA to Elkins.

tranche of contributions it had received in breach of section 29WA.¹⁴⁴⁷ APRA subsequently considered the matter closed.¹⁴⁴⁸

APRA did not take any formal enforcement action. This was because CFS had agreed to a process in consultation with APRA to address the issues, and APRA was satisfied that the process had been followed.¹⁴⁴⁹

More generally, Mrs Rowell agreed that it was typically in the interests of retail trustees to keep members in choice products rather than moving them into MySuper, due to the higher fees and commissions attached to choice products.¹⁴⁵⁰ However, she said that did not necessarily mean that it was not in members' best interests. Her evidence was that the payment of commission, for example, could not be 'looked at in isolation'. More analysis was required to assess whether there was a member interest issue.¹⁴⁵¹ APRA had not done a general project to evaluate whether retail trustees had acted in their own financial interests at the expense of members' interests when transferring ADAs to MySuper.¹⁴⁵² She was not aware of APRA giving that issue any internal consideration.

15.2.5 IOOF

Throughout 2015, APRA was communicating with IOOF about various issues. In September 2015, it told IOOF that '[g]iven the size and complexity of IOOF, the number and range of prudential matters raises concerns for APRA'.¹⁴⁵³ In late 2015 and early 2016, it made a number of recommendations to IOOF including that IOOF restructure its APRA-

¹⁴⁴⁷ Exhibit 5.195, 21 September 2017, Email, APRA to Colonial First State Concerning Section 29WA Update Number 24.

¹⁴⁴⁸ Exhibit 5.195, 21 September 2017, Email, APRA to Colonial First State Concerning Section 29WA Update Number 24.

¹⁴⁴⁹ Transcript, Helen Rowell, 17 August 2018, 5188–90; APRA, Module 5 Case Study Submission, 14 [62].

¹⁴⁵⁰ Transcript, Helen Rowell, 17 August 2018, 5193–4.

¹⁴⁵¹ Transcript, Helen Rowell, 17 August 2018, 5194–5.

¹⁴⁵² Transcript, Helen Rowell, 17 August 2018, 5195.

¹⁴⁵³ Exhibit 5.104, 15 September 2015, Letter APRA to IOOF Holdings, 4.

regulated entities to reduce the number of common directors,¹⁴⁵⁴ and consider establishing an 'Office of the Trustee' to improve oversight.¹⁴⁵⁵ IOOF told APRA it would review its governance frameworks 'as a priority'.¹⁴⁵⁶

Stephen Glenfield, General Manager, Specialised Institutions Division of APRA, told that Commission that despite this, APRA's supervision team continued to have concerns. In March, after a meeting with the board, an internal file note again commented that IOOF appeared to favour its shareholders above its members. The note also said that IOOF often took a legalistic approach to 'shield IOOF from obligations which may be in members' best interests'.¹⁴⁵⁷ In July, IOOF told APRA it would appoint two new independent directors to the boards of its APRA regulated entities. APRA's supervision team told Mr Glenfield this had been done to 'appease' APRA, and that IOOF 'did not intend to engage in genuine and critical consideration' about its governance.¹⁴⁵⁸

In December 2016, APRA wrote to Questor about the CMT over-distribution discussed above. It said that Questor's use of the general reserve to compensate members was inappropriate, and that Questor had not effectively identified and managed conflicts of interest and duty.¹⁴⁵⁹ APRA said that Questor should immediately replenish the general reserve, and that a failure to do so would 'escalate APRA's concerns'.¹⁴⁶⁰ IOOF replied in April 2017. It said that Questor's behaviour had been appropriate, and that the 'so-called pub test, which in these circumstances is a proxy for

¹⁴⁵⁴ Exhibit 5.106, 21 December 2015, Letter APRA to IOOF Holdings, 5.

¹⁴⁵⁵ Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, Exhibit SG-1-26 [APRA.0002.0004.1315].

¹⁴⁵⁶ Exhibit 5.367, 21 July 2016, Memorandum, IOOF Group Status of Governance Review.

¹⁴⁵⁷ Transcript, Stephen Glenfield, 17 August 2018, 5206; Exhibit 5.303, 24 March 2016, File Note of Meeting between APRA and IOOF.

¹⁴⁵⁸ Exhibit 5.376, 21 July 2016, APRA Memorandum Regarding IOOF Group, 2.

¹⁴⁵⁹ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 18) [IFL.0006.0003.4087].

¹⁴⁶⁰ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 19) [IFL.0006.0003.4093].

members' best interests' had been passed.¹⁴⁶¹ In evidence, Mr Glenfield agreed that the 'pub test' was not a way of explaining the best interests duty.¹⁴⁶²

Despite this, APRA decided not to take any further action. This was partly because APRA's internal legal advice said the likelihood of success in a proceeding was 'less than clear cut'. It was also partly because APRA could not direct IOOF to replenish the reserve.¹⁴⁶³ Mr Glenfield thought Questor's behaviour was a symptom of IOOF's structural issues, and the most important thing was to get the structure right.¹⁴⁶⁴ When deciding whether or not to start a court proceeding, Mr Glenfield thought about the effect of any action on IOOF. He did not think about issues of general deterrence across the industry.¹⁴⁶⁵

In June 2017, the supervision team gave Mr Glenfield another memorandum. It said that the IOOF Board 'fundamentally misunderstood' the duty to prioritise the interests of superannuation members.¹⁴⁶⁶ It also said that IOOF directors had difficulty identifying conflicts with related parties and were 'resistant to detailed documentation' about conflict management.¹⁴⁶⁷ The supervision team was concerned that the IOOF Board might not be fit and proper to be superannuation trustees. They recommended that APRA consider this issue further.¹⁴⁶⁸

¹⁴⁶¹ Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 19) [IFL.0006.0003.4093].

¹⁴⁶² Transcript, Stephen Glenfield, 17 August 2018, 5210.

¹⁴⁶³ Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, 24–5 [109].

¹⁴⁶⁴ Transcript, Stephen Glenfield, 17 August 2018, 5220.

¹⁴⁶⁵ Transcript, Stephen Glenfield, 17 August 2018, 5220.

¹⁴⁶⁶ Exhibit 5.307, 13 August 2018, Memorandum to Mr Glenfield of 14 June 2017 Concerning IOOF Prudential Review.

¹⁴⁶⁷ Exhibit 5.307, 13 August 2018, Memorandum to Mr Glenfield of 14 June 2017 Concerning IOOF Prudential Review.

¹⁴⁶⁸ Exhibit 5.307, 13 August 2018, Memorandum to Mr Glenfield of 14 June 2017 Concerning IOOF Prudential Review.

After meeting with the board, APRA sent IOOF another letter. That letter said that IOOF's understanding of its obligations under the SIS Act was wrong. It said APRA 'required' IOOF to comply with those obligations.¹⁴⁶⁹ It took no other formal action.

In October 2017, IOOF announced that it was buying some of ANZ's business, including its superannuation funds.¹⁴⁷⁰ In March 2018, APRA wrote to IOOF. It had 'continued concerns' about conflicts.¹⁴⁷¹ It thought IOOF's management of conflicts was 'inadequate'. It also thought the boards were inherently conflicted because of IOOF's structure.¹⁴⁷² On 19 June 2018, APRA told IOOF that four 'minimum changes' were necessary. Those were to:

- split the RSE licensee and responsible entity (RE) functions;
- appoint an independent chair to lead a majority independent board;
- establish a dedicated support function; and
- consolidate the RSE licensees and REs after the ANZ acquisition.¹⁴⁷³

On 1 August 2018, the IOOF Holdings Board decided to accept three of the four changes. It would appoint an independent chair to the IIML Board and replace Mr Kelaher with an independent director.¹⁴⁷⁴ It would also investigate separating the RSE licensee and the RE, potentially as a result of the acquisition of the ANZ wealth entities by IOOF.¹⁴⁷⁵ However,

¹⁴⁶⁹ Exhibit 5.124, 15 August 2017, Letter APRA to IOOF.

¹⁴⁷⁰ Transcript, Stephen Glenfield, 17 August 2018, 5218.

¹⁴⁷¹ Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, Exhibit SG-1-23 [APRA.0002.0007.2874].

¹⁴⁷² Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, Exhibit SG-1-23 [APRA.0002.0007.2874].

¹⁴⁷³ Transcript, Christopher Kelaher, 10 August 2018, 4604; Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, Exhibit SG-1-16 [APRA.0002.0007.3219].

¹⁴⁷⁴ Transcript, Christopher Kelaher, 10 August 2018, 4606.

¹⁴⁷⁵ Transcript, Christopher Kelaher, 10 August 2018, 4606.

at that time, IOOF did not agree to establish a dedicated support function. IOOF formally told APRA of its decision on 14 August 2018.¹⁴⁷⁶

In evidence, Mr Glenfield agreed that Mr Kelaher, the Managing Director of IOOF, did not think there were legitimate concerns about IOOF's governance. Mr Glenfield said APRA's intervention with IOOF was an 'ongoing matter'. He said that a successful intervention from his perspective would involve splitting the RSE licensee and RE functions, with a fully independent board of the RSE licensee acting in the best interests of the members.¹⁴⁷⁷

On 4 September 2018, after the Commission's hearings into superannuation had concluded, APRA wrote to IOOF. Among other things, it asked the IIML Board to reconsider the decision not to replenish the CMT general reserve. On 27 September 2018, the IIML Board resolved to replenish the IPS Fund's general reserve by the same amount that was used to compensate members of the CMT.¹⁴⁷⁸

On 20 September 2018, IOOF agreed to implement a 'managed action plan' set out by APRA, 'subject to some comments on timing and approach'.¹⁴⁷⁹ Among other things, that plan included a number of further governance changes and the establishment of a dedicated support function.¹⁴⁸⁰

As I have recorded in the section dealing with IOOF, on 6 December 2018 APRA commenced proceedings in the Federal Court against IIML, Questor, Mr Kelaher, and four other individuals holding senior positions at IOOF.¹⁴⁸¹

¹⁴⁷⁶ Exhibit 5.308, 14 August 2018, Letter IOOF to APRA.

¹⁴⁷⁷ Transcript, Stephen Glenfield, 17 August 2018, 5220.

¹⁴⁷⁸ Exhibit 5.440, 30 October 2018, EF 27.9.18 signed.

¹⁴⁷⁹ Letter APRA to King & Wood Mallesons, 6 December 2018, 7
<www.apra.gov.au/sites/default/files/show_cause_notice.pdf>.

¹⁴⁸⁰ Letter APRA to King & Wood Mallesons, 6 December 2018, 6–7
<www.apra.gov.au/sites/default/files/show_cause_notice.pdf>.

¹⁴⁸¹ *APRA v Christopher Francis Kelaher & Ors*, NSD 2274/2018.

It also sent IOOF a 'show cause' letter setting out its intention to direct IIML to comply with its RSE licence, and to impose additional conditions on the licences of IIML and two other IOOF subsidiaries.¹⁴⁸²

As I have also explained in the section dealing with IOOF, I make no comment or findings about the matters referred to in the documents filed by APRA. For that same reason, I make no comment on APRA's response to those matters over a period of more than three years.

In general, I would observe that the conduct that a regulator tolerates crystallises the meaning and effect of the standards it sets.

¹⁴⁸² Letter APRA to King & Wood Mallesons, 6 December 2018, 1 <www.apra.gov.au/sites/default/files/show_cause_notice.pdf>.

Case studies: Insurance

Introduction

In its sixth round of hearings, the Commission examined the insurance industry. It did so by reference to case studies involving all stages of the insurance process:

- the design of insurance products was considered in the CommInsure and IAG case studies;
- the sale of life insurance products was considered in the ClearView and Freedom case studies;
- the sale of general insurance products was considered in the Allianz, IAG and AAI (AAMI's Complete Replacement Cover policy) case studies;
- the handling of life insurance claims was considered in the CommInsure and TAL case studies; and
- the handling of general insurance claims made by policyholders affected by natural disasters was considered in the Youi case study, and in both AAI case studies.

Issues connected with **group life insurance** policies taken out through superannuation were also considered through two case studies. Product design, particularly key definitions and exclusions, and claims handling issues were considered in the REST case study. The AMP case study considered the appropriateness of default settings, the availability of insurance in MySuper products, premium deduction practices and supervisory issues arising from **vertical integration**.

The case studies also raised broader questions about a number of themes, including the appropriateness of the current regulatory regime and the adequacy of insurers' compliance frameworks.

1 ClearView

1.1 Background

This case study concerned the direct sale of life insurance by ClearView Life Assurance Limited (ClearView), and ClearView's engagement with the Australian Securities and Investments Commission (ASIC) in respect of its sales practices. The Commission heard evidence from Mr Gregory Martin, the Chief Actuary and Chief Risk Officer of ClearView Wealth Limited, the ultimate holding company of ClearView.¹

1.2 Evidence

Prior to 2011, ClearView operated as a 'captive insurer', selling life insurance products to customers of the corporate group of which it formed part – most recently, Bupa.² By 2013, ClearView had expanded into a 'more substantial and professional direct life insurance business', and was selling policies to non-Bupa sourced customers.³ At that time, ClearView established a sales centre in Parramatta.⁴ In 2014, ClearView expanded its direct life insurance operations by investing in an outsourced Melbourne-based sales centre called YourInsure.⁵ ClearView closed this business in late 2015.⁶

For the period that ClearView was directly selling life insurance, ClearView sold a range of life insurance products through outbound telephone sales, including life cover, trauma cover, funeral cover and accidental death

¹ Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 1 [1].

² Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 2 [12].

³ Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 3–4 [24].

⁴ Transcript, Gregory Martin, 10 September 2018, 5308–9.

⁵ Transcript, Gregory Martin, 10 September 2018, 5309.

⁶ Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 4 [25].

cover.⁷ At the time of the sixth round of hearings, ClearView was continuing to sell a number of similar products through its retail channel.⁸

During 2015 and 2016, ClearView had made changes to its business to target more affluent customers.⁹ By mid-2016, ClearView had decided to revise its operating model by moving from a ‘high volume, low value’ model involving emotional sales pitches and above-market pricing, to a ‘lower volume, higher value’ model, in which products were pitched using both emotional and rational arguments and sold at market price.¹⁰ Mr Martin accepted that, for the period that ClearView was operating under the former model, the life insurance products that ClearView sold in its outbound telephone sales were more expensive and of lower value than the products they were selling to more affluent people through other channels.¹¹ ClearView ceased direct sales of life insurance in mid-2017, for reasons that are discussed below.¹²

1.2.1 Accidental death policies

One of the products that ClearView sold through its direct life insurance business, and which it continued to sell through its retail channel at the time of the hearings, is accidental death cover.¹³ Accidental death policies pay out upon a person’s death where that death is due to an accident.¹⁴ At least at the time of the hearings, ClearView’s practice in its adviser sales channel had been to always offer an accidental death policy to a customer whose application for life cover was declined for medical reasons.¹⁵

⁷ Transcript, Gregory Martin, 10 September 2018, 5319–20.

⁸ Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 4 [28]–[29].

⁹ Transcript, Gregory Martin, 10 September 2018, 5311.

¹⁰ Transcript, Gregory Martin, 10 September 2018, 5314–17.

¹¹ Transcript, Gregory Martin, 10 September 2018, 5318.

¹² Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 4 [27].

¹³ Transcript, Gregory Martin, 10 September 2018, 5320–1; Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 4 [28].

¹⁴ Transcript, Gregory Martin, 10 September 2018, 5320.

¹⁵ Transcript, Gregory Martin, 10 September 2018, 5322–4.

Mr Martin said that he was aware of ASIC's view that accidental death policies offer a very limited benefit to consumers.¹⁶ He accepted that the number of claims made under ClearView accidental death policies was low compared to the number of policies sold.¹⁷ He also accepted that the claims ratio for accidental death policies was low:¹⁸ the ratio of claims paid out to premiums collected over the last five years was 26%,¹⁹ and in 2014, the ratio was 1%.²⁰ Asked whether ClearView would continue to sell such products in light of ASIC's views,²¹ Mr Martin said that ClearView had not yet reached a position on this, but that if ASIC and society would like ClearView to stop offering the product, it would do so.²²

1.2.2 ASIC engagement – anti-hawking

In April 2016, ASIC raised concerns with ClearView about unsolicited telephone sales conducted in breach of the requirements of the *Corporations Act 2001* (Cth) (the Corporations Act).²³ ASIC's concerns related to whether ClearView's sales were properly characterised as either 'solicited' or 'unsolicited' sales, and, if the latter, whether they met the requirements in section 992A(3) of the Corporations Act, the '**anti-hawking provision**'.²⁴ In December 2016, ASIC and ClearView participated in a conference call in which ASIC raised multiple concerns about possible contraventions of the anti-hawking provision, a criminal offence provision.²⁵

¹⁶ Transcript, Gregory Martin, 10 September 2018, 5325.

¹⁷ Transcript, Gregory Martin, 10 September 2018, 5322.

¹⁸ Transcript, Gregory Martin, 10 September 2018, 5321–2.

¹⁹ Transcript, Gregory Martin, 10 September 2018, 5322.

²⁰ Transcript, Gregory Martin, 10 September 2018, 5322.

²¹ Transcript, Gregory Martin, 10 September 2018, 5325–6.

²² Transcript, Gregory Martin, 10 September 2018, 5326.

²³ Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 63 [362]; Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, Exhibit GCM-51 [CVW.6000.0001.0843].

²⁴ Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 63 [362]; Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, Exhibit GCM-51 [CVW.6000.0001.0843].

²⁵ Transcript, Gregory Martin, 10 September 2018, 5335.

These included concerns that ClearView did not always provide a product disclosure statement (PDS) to customers before they became bound to acquire the product, that customers were not always offered the opportunity to have information contained in the PDS read to them, and that customers were not always offered an opportunity to be placed on the Do Not Call Register.²⁶ Later that month, ClearView lodged a breach notification with ASIC in relation to likely non-compliance with the anti-hawking provision over a period of about two years.²⁷ The breach notification did not specify the number of calls estimated to have been affected.²⁸

Following this, ASIC and ClearView exchanged correspondence about the number of calls affected, and about the ways in which those calls were affected.²⁹ Most significantly for present purposes, in January 2017, ClearView acknowledged to ASIC that some calls that it made in respect of particular campaigns were properly characterised as ‘unsolicited’.³⁰ In April 2017, ASIC told ClearView that it regarded further categories of calls to be ‘unsolicited’.³¹ After receiving this indication, ClearView told ASIC that it estimated that over 260,000 customers had received calls in circumstances where ClearView could not verify that it had met the requirements of the anti-hawking provision.³² Following further investigation, by early May 2017, ClearView estimated that it may have breached the anti-hawking provision up to 303,000 times.³³

Mr Martin accepted that by February 2017 there were concerns within the ClearView Direct business about breaches of the anti-hawking provisions, and about the way that those breaches were being escalated

²⁶ Transcript, Gregory Martin, 10 September 2018, 5335–6.

²⁷ Transcript, Gregory Martin, 10 September 2018, 5336.

²⁸ Transcript, Gregory Martin, 10 September 2018, 5336.

²⁹ Transcript, Gregory Martin, 10 September 2018, 5337–42.

³⁰ Transcript, Gregory Martin, 10 September 2018, 5337–8.

³¹ Transcript, Gregory Martin, 10 September 2018, 5340.

³² Transcript, Gregory Martin, 10 September 2018, 5341.

³³ Transcript, Gregory Martin, 10 September 2018, 5343; cf ClearView, Module 6 Case Study Submission, 4 [11].

and responded to within the organisation:³⁴ the breaches were not being treated as material matters that required escalation and consideration.³⁵

1.2.3 ASIC engagement – pressure selling

In March 2017, ASIC raised additional concerns with ClearView about pressure selling and mis-selling conduct.³⁶ After reviewing the transcripts of 42 sales calls from the second half of 2015, ASIC formed the view that ClearView's sales practices may be unfair or manipulative, and may pressure consumers to purchase a policy.³⁷ Mr Martin accepted that these calls involved highly problematic sales practices,³⁸ and that some involved misleading or deceptive conduct and unconscionable conduct.³⁹

The problematic sales practices identified by ASIC and Mr Martin included, but were not limited to:

- First, misrepresentations about what customers were committing to purchase. ASIC was concerned that ClearView sales agents used language that made it unclear that customers were committing to purchase a policy.⁴⁰
- Second, misrepresentations or omissions about payment arrangements, including not explaining to customers precisely when their first premium would be due,⁴¹ and failing to quote prices aligned with the frequency

³⁴ Transcript, Gregory Martin, 10 September 2018, 5345.

³⁵ Transcript, Gregory Martin, 10 September 2018, 5345.

³⁶ Transcript, Gregory Martin, 10 September 2018, 5346.

³⁷ Transcript, Gregory Martin, 10 September 2018, 5346.

³⁸ Transcript, Gregory Martin, 10 September 2018, 5349.

³⁹ Transcript, Gregory Martin, 10 September 2018, 5354.

⁴⁰ Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, Exhibit GCM-53 [CVW.6000.0001.0848 at .0852]; Transcript, Gregory Martin, 10 September 2018, 5346.

⁴¹ Transcript, Gregory Martin, 10 September 2018, 5348.

with which premiums would be deducted, so as to underemphasise the extent of the customer's financial liability.⁴²

- Third, other forms of misrepresentation, including that a customer's premiums would never go up with age, despite ClearView retaining the right to unilaterally vary premiums,⁴³ and about the terms or application of the policies.⁴⁴
- Fourth, sales agents continued to attempt to sell policies, despite a customer indicating that they wished to read over ClearView's documentation or consult with a partner or friend.⁴⁵ Mr Martin accepted that this was done because ClearView Direct did not want to give people time to reflect upon their purchase,⁴⁶ because they might then decide that they did not want or need the product.⁴⁷
- Fifth, and in a similar vein, sales agents collected customers' personal information, including bank details, before the customer had confirmed their agreement to proceed with the purchase.⁴⁸

Mr Martin accepted that the issues identified in the 42 calls were representative of what he termed 'almost endemic' compliance issues within ClearView Direct for a number of years.⁴⁹ ClearView struggled with such systemic issues in 2016 and in 2017 during the period of its engagement with ASIC.⁵⁰ As at February 2017, one quarter of all monitored calls by

⁴² Transcript, Gregory Martin, 10 September 2018, 5348.

⁴³ Transcript, Gregory Martin, 10 September 2018, 5348–9.

⁴⁴ Transcript, Gregory Martin, 10 September 2018, 5349.

⁴⁵ Transcript, Gregory Martin, 10 September 2018, 5349.

⁴⁶ Transcript, Gregory Martin, 11 September 2018, 5387.

⁴⁷ Transcript, Gregory Martin, 11 September 2018, 5387.

⁴⁸ Transcript, Gregory Martin, 10 September 2018, 5349.

⁴⁹ Transcript, Gregory Martin, 10 September 2018, 5358.

⁵⁰ Transcript, Gregory Martin, 10 September 2018, 5358.

ClearView sales agents involved a breach of ClearView's quality assurance requirements.⁵¹ Mr Martin agreed that this was completely unacceptable.⁵²

Mr Martin accepted that there were at least three causes of these systemic compliance issues:

- The first was ClearView's remuneration structure.⁵³ Mr Martin accepted that ClearView's commission structure was a contributor to inappropriate behaviour,⁵⁴ as it incentivised aggressive sales tactics with the aim of making as many sales as possible at whatever cost.⁵⁵
- The second was a culture within ClearView Direct that tolerated aggressive sales tactics at the cost of compliance.⁵⁶ This was apparent in ClearView's training practices. Sales agents were trained to engage in unfair sales practices,⁵⁷ including through aggressive objection handling approaches.⁵⁸ The overarching approach was 'sell at all costs', which Mr Martin accepted was reflective of ClearView Direct's broader culture.⁵⁹ The prioritisation of sales over compliance was also evident in communications relating to at least one proposed incentives program, which the Head of Direct Sales considered was necessary to stimulate the team and revive the 'cultural pulse',⁶⁰ and which he proposed badging as a 'training [and] educational trip' in order to circumvent the **conflicted remuneration** provisions in the Corporations Act.⁶¹

⁵¹ Transcript, Gregory Martin, 10 September 2018, 5357; Exhibit 6.46, February 2017, Risk and Compliance Committee February 2017 Results, 3.

⁵² Transcript, Gregory Martin, 10 September 2018, 5357.

⁵³ Transcript, Gregory Martin, 10 September 2018, 5358.

⁵⁴ Transcript, Gregory Martin, 10 September 2018, 5359.

⁵⁵ Transcript, Gregory Martin, 10 September 2018, 5359.

⁵⁶ Transcript, Gregory Martin, 10 September 2018, 5358–9.

⁵⁷ Transcript, Gregory Martin, 10 September 2018, 5373.

⁵⁸ Transcript, Gregory Martin, 10 September 2018, 5373.

⁵⁹ Transcript, Gregory Martin, 11 September 2018, 5387.

⁶⁰ Transcript, Gregory Martin, 11 September 2018, 5388.

⁶¹ Transcript, Gregory Martin, 11 September 2018, 5388–90.

- The third was that there were large deficiencies in ClearView Direct's quality assurance and compliance program.⁶² As just one example, only 10 of the 42 calls provided to ASIC had been previously reviewed by ClearView's Quality Assurance team, and only a small number of those had failed that process.⁶³ Mr Martin accepted that when the legal team had subsequently reviewed those calls, they had taken a different view as to the number of calls that involved problematic behaviour.⁶⁴ More broadly, Mr Martin accepted that there was insufficient division between ClearView's sales team and its quality assurance function,⁶⁵ and that there was a lack of specific legal and compliance experience, particularly in the Direct business.⁶⁶

1.2.4 Resolution and closure of the Direct business

ClearView and ASIC negotiated to resolve ASIC's investigation into the anti-hawking and mis-selling issues.⁶⁷ Those terms required ClearView to undertake a remediation program in respect of over 32,000 policies sold by ClearView between 2014 and mid-2017.⁶⁸ Excluding 6,000 policies that were cancelled from inception, ClearView anticipated providing a full or partial refund of premiums, bank fees and interest to approximately 8,200 customers, and a 'Review Offer' to approximately 16,000 customers.⁶⁹ If customers opt into the 'Review Offer', ClearView is to review the call in which the customer was sold their policy, and assess whether a refund

⁶² Transcript, Gregory Martin, 10 September 2018, 5358.

⁶³ Transcript, Gregory Martin, 10 September 2018, 5349–50.

⁶⁴ Transcript, Gregory Martin, 10 September 2018, 5353.

⁶⁵ Transcript, Gregory Martin, 11 September 2018, 5393–4.

⁶⁶ Transcript, Gregory Martin, 11 September 2018, 5396.

⁶⁷ Transcript, Gregory Martin, 11 September 2018, 5398.

⁶⁸ Transcript, Gregory Martin, 11 September 2018, 5398–9.

⁶⁹ Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 63 [358]; see also Transcript, Gregory Martin, 11 September 2018, 5400–1; cf ClearView, Module 6 Case Study Submission, 8–9 [29].

of premiums or an adjustment of policy terms is appropriate.⁷⁰ ClearView also agreed to inform ASIC if it decided to recommence selling through the Direct channel.⁷¹ Mr Martin said that ClearView had no present intention of doing so.⁷² Indeed, he went so far as to say that it was difficult to understand how an insurer could sell life insurance in outbound sales calls in a way that was both financially viable and legally compliant.⁷³

Mr Martin told the Commission that ASIC had not indicated whether it would take any further action in respect of ClearView's many breaches of the anti-hawking provisions, or what may have been unconscionable conduct or misleading or deceptive conduct engaged in by its sales agents.⁷⁴

1.3 What the case study showed

Mr Martin accepted that Clearview may have engaged in misconduct in a number of respects. Those concessions were properly made.

In respect of the anti-hawking issues, Mr Martin accepted that ClearView may have breached the prohibition on the hawking of **financial products** contained in section 992A of the Corporations Act up to 303,000 times between early 2014 and mid-2017.⁷⁵ This flowed from ClearView's acknowledgments, to both ASIC and the Commission, that there were 303,000 calls in respect of which ClearView could not positively verify that there had been no breach of that provision.⁷⁶ With that said, I recognise, consistently with ClearView's submissions, that it is unlikely that each and every call involved a breach.⁷⁷

⁷⁰ Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 62 [351(c)]; see also Transcript, Gregory Martin, 11 September 2018, 5400–1; cf ClearView, Module 6 Case Study Submission, 8 [29].

⁷¹ Transcript, Gregory Martin, 11 September 2018, 5402.

⁷² Transcript, Gregory Martin, 11 September 2018, 5402.

⁷³ Transcript, Gregory Martin, 11 September 2018, 5402.

⁷⁴ Transcript, Gregory Martin, 11 September 2018, 5402–3.

⁷⁵ Transcript, Gregory Martin, 10 September 2018, 5343.

⁷⁶ ClearView, Module 6 Case Study Submission, 4 [11].

⁷⁷ ClearView, Module 6 Case Study Submission, 4 [13].

In respect of the mis-selling issues, Mr Martin accepted that in the calls in which ClearView representatives mis-sold insurance policies between 2013 and 2016, ClearView may have, on occasion, breached the prohibition on unconscionable conduct contained in sections 12CA and 12CB of the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act) by pressuring individuals to purchase policies.⁷⁸ Mr Martin also accepted that in these calls, ClearView representatives may have breached the prohibition on misleading or deceptive conduct contained in section 12DA of the ASIC Act, by misrepresenting matters such as whether customers were committing to purchase an insurance policy, and the terms of those policies.⁷⁹

Mr Martin also accepted that ClearView may have failed to discharge its general obligations as an **Australian financial services licensee** in four respects:

- First, ClearView may have contravened the obligation contained in section 912A(1)(a) of the Corporations Act to do all things necessary to ensure that the financial services covered by its **Australian financial services licence** were provided efficiently, honestly and fairly.⁸⁰ ClearView's systemic failures in its sales processes meant that policyholders were frequently being sold policies in circumstances where ClearView was not behaving honestly or fairly.
- Second, ClearView may have failed to ensure that its representatives were adequately trained to provide the financial services covered by its Australian financial services licence, in contravention of section 912A(1)(f) of the Corporations Act.⁸¹ ClearView sales agents were encouraged to sell aggressively, sign up customers immediately, and use other inappropriate methods of obtaining sales.⁸²

⁷⁸ Transcript, Gregory Martin, 11 September 2018, 5401.

⁷⁹ Transcript, Gregory Martin, 11 September 2018, 5401.

⁸⁰ Transcript, Gregory Martin, 11 September 2018, 5401.

⁸¹ Transcript, Gregory Martin, 11 September 2018, 5401.

⁸² Transcript, Gregory Martin, 11 September 2018, 5387, 5389.

- Third, ClearView may have failed to take reasonable steps to ensure that its representatives complied with financial services laws, in contravention of section 912A(1)(ca) of the Corporations Act.⁸³ ClearView had inadequate training, quality assurance and compliance processes to ensure that its representatives complied with financial services laws.
- Fourth, ClearView may have failed to have in place adequate arrangements for the management of the conflict of interest that it created between the interests of its representatives and the interests of its customers, in contravention of section 912A(1)(aa) of the Corporations Act.⁸⁴ The remuneration and incentive structures that ClearView had in place encouraged sales agents to make as many sales as possible, sometimes to the detriment of customers' best interests.⁸⁵

The matter having been drawn to ASIC's attention, it is for ASIC to determine what further action it can and should take.

ClearView did not take speedy or effective action to address substantial compliance issues when they became apparent. As I noted earlier, Mr Martin's evidence was that the compliance issues that were identified in the 42 calls provided to ASIC were 'almost endemic' within ClearView Direct's sales process for a number of years.⁸⁶

Further, ClearView did not take meaningful steps to address defects in its quality assurance processes after becoming aware that they were ineffective.⁸⁷ Despite having decided to address the deficiencies in the quality assurance processes by moving towards monitoring 100% of sales calls, ClearView did not execute that decision, because it decided

⁸³ Transcript, Gregory Martin, 11 September 2018, 5401.

⁸⁴ Transcript, Gregory Martin, 11 September 2018, 5402.

⁸⁵ Transcript, Gregory Martin, 11 September 2018, 5402.

⁸⁶ Transcript, Gregory Martin, 10 September 2018, 5358.

⁸⁷ Transcript, Gregory Martin, 11 September 2018, 5392–3.

to commence shutting down its Direct sales business.⁸⁸ As a consequence, problematic sales practices appear to have continued for almost a year.⁸⁹

I would attribute ClearView's conduct to its culture and governance practices, its risk management practices, and its remuneration practices.

There was a culture within Clearview Direct that tolerated aggressive sales tactics at the cost of compliance,⁹⁰ and the management of ClearView Direct did not treat compliance issues, such as the breaches of the anti-hawking provisions, as matters that required escalation and consideration.⁹¹

The quality assurance program within ClearView Direct was seriously inadequate.⁹² Its staff lacked qualifications, experience, supervision and resources.⁹³

Finally, the remuneration and incentive structures within ClearView Direct encouraged sales agents to make as many sales as possible. This they did, sometimes at the expense of the customers' best interests.⁹⁴

The most telling general point to emerge from the case study was Mr Martin's frank acknowledgment that he found it difficult to see how it would be possible to sell life insurance in outbound sales calls in a way that is both financially viable and legally compliant.⁹⁵ As he rightly said, it is difficult to see how a customer can come to a view in a phone call that lasts 20 minutes about 'a fairly complex sort of area of financial services'.⁹⁶

⁸⁸ Transcript, Gregory Martin, 11 September 2018, 5393.

⁸⁹ Transcript, Gregory Martin, 11 September 2018, 5392–3.

⁹⁰ Transcript, Gregory Martin, 10 September 2018, 5359.

⁹¹ Transcript, Gregory Martin, 10 September 2018, 5345.

⁹² Transcript, Gregory Martin, 10 September 2018, 5358.

⁹³ Transcript, Gregory Martin, 11 September 2018, 5396–7.

⁹⁴ Transcript, Gregory Martin, 11 September 2018, 5402.

⁹⁵ Transcript, Gregory Martin, 11 September 2018, 5402.

⁹⁶ Transcript, Gregory Martin, 11 September 2018, 5402.

2 Freedom

2.1 Background

At the time of the sixth round of hearings, Freedom Insurance Group Limited (Freedom) marketed and distributed life insurance products directly to consumers by telephone. The case study examined Freedom's sales and retention practices, both generally and in relation to an individual consumer. The Commission heard evidence from Mr Craig Orton, Freedom's Chief Operating Officer.⁹⁷ The Commission also heard evidence from Mr Bruce Stewart, whose son was sold an insurance policy by Freedom in June 2016.⁹⁸

At 3pm on 10 September 2018 – the first day of the sixth round of hearings and the day before Mr Orton was due to give evidence – Freedom notified the Commission of substantial changes to its business model.⁹⁹ Freedom told the Commission that it intended to cease selling all insurance products, except funeral insurance and loan protection cover, through outbound sales calls.¹⁰⁰ While Mr Orton accepted that this was a significant change to Freedom's business model, Freedom was not able to produce any documents that directly recorded this decision.¹⁰¹ I mention this not for the purpose of suggesting that Mr Orton's evidence should be disbelieved,¹⁰² but because I consider it remarkable that a decision of this kind would not be documented by a publicly listed company. Publicly available documents indicate that, after the Commission took evidence from Mr Orton, Freedom

⁹⁷ Exhibit 6.67, Witness statement of Craig Orton, 27 August 2018, 1 [1].

⁹⁸ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 2–3 [9]–[12]; Transcript, Craig Orton, 11 September 2018, 5408.

⁹⁹ Transcript, Craig Orton, 11 September 2018, 5423.

¹⁰⁰ Transcript, Craig Orton, 11 September 2018, 5423.

¹⁰¹ Transcript, Craig Orton, 11 September 2018, 5423, 5425; cf Freedom Insurance Group Ltd, Module 6 Case Study Submission, 2–3 [11].

¹⁰² Cf Freedom Insurance Group Ltd, Module 6 Case Study Submission, 2 [7].

determined to suspend all direct sales of life insurance through outbound telephone calls.¹⁰³

2.2 Evidence

2.2.1 Mr Stewart's son

Mr Stewart's son was born with Down syndrome.¹⁰⁴ While Mr Stewart's son has a degree of independence,¹⁰⁵ he has difficulties understanding whether a product is 'expensive or cheap', and whether he has enough money to make purchases.¹⁰⁶ As a result, Mr Stewart and his wife assist their son to manage his finances.¹⁰⁷ In 2016, when Freedom sold Mr Stewart's son an insurance policy, his only source of income was the Disability Support Pension.¹⁰⁸

Mr Stewart learnt that his son had taken out insurance after his son received a letter from Freedom.¹⁰⁹ The letter said that Mr Stewart's son had taken out a Freedom Protection Plan, which comprised three types of cover: funeral, accidental death and accidental injury.¹¹⁰ The letter said that premiums for the funeral cover would not be due for 12 months, but that premiums for the accidental death and accidental injury cover would be due 12 days later.¹¹¹

¹⁰³ See, eg, Freedom Insurance, 'ASX/Media Release: Freedom Announces Business Restructure' (Media Release, 2 October 2018) 1.

¹⁰⁴ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 1–2 [5]; Transcript, Bruce Stewart, 11 September 2018, 5406.

¹⁰⁵ Transcript, Bruce Stewart, 11 September 2018, 5407.

¹⁰⁶ Transcript, Bruce Stewart, 11 September 2018, 5407.

¹⁰⁷ Transcript, Bruce Stewart, 11 September 2018, 5407.

¹⁰⁸ Transcript, Bruce Stewart, 11 September 2018, 5407.

¹⁰⁹ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 2 [9]–[10]; Transcript, Bruce Stewart, 11 September 2018, 5408.

¹¹⁰ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-1 [FIG.0001.0001.0057 at .0059]; Transcript, Bruce Stewart, 11 September 2018, 5408.

¹¹¹ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-1 [FIG.0001.0001.0057 at .0057]; Transcript, Bruce Stewart, 11 September 2018, 5408.

Mr Stewart was ‘flummoxed’ by the letter.¹¹² He did not understand how or why his son had been signed up, so he asked his son what had happened.¹¹³ Mr Stewart’s son remembered speaking to someone on the phone, and providing that person with his debit card details, but could not explain why he had done so.¹¹⁴ Mr Stewart did not think that his son understood that he had provided those details in order to purchase an insurance policy.¹¹⁵

The following day, Mr Stewart telephoned Freedom and attempted to cancel the policy on his son’s behalf.¹¹⁶ Mr Stewart was not able to do this. Instead, a Freedom representative told Mr Stewart that they would listen to a recording of the call in which Mr Stewart’s son was sold the policy and then call Mr Stewart back.¹¹⁷ The representative also told Mr Stewart that the sales agent who sold his son the policy probably did not know that his son had a disability.¹¹⁸

Mr Stewart did not receive a call back from Freedom, and did not receive any response to an email that he sent to Freedom’s Head of Operations lodging a formal complaint.¹¹⁹ Two days later, Mr Stewart telephoned Freedom again.¹²⁰

¹¹² Transcript, Bruce Stewart, 11 September 2018, 5408.

¹¹³ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 3 [14]; Transcript, Bruce Stewart, 11 September 2018, 5408.

¹¹⁴ Transcript, Bruce Stewart, 11 September 2018, 5408–9.

¹¹⁵ Transcript, Bruce Stewart, 11 September 2018, 5408–9.

¹¹⁶ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 4 [15]; Transcript, Bruce Stewart, 11 September 2018, 5409.

¹¹⁷ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 4 [17]; Transcript, Bruce Stewart, 11 September 2018, 5409.

¹¹⁸ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-2 [FIG.0001.0001.0060]; Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-3 [FIG.0001.0001.0258 at .0259]; Transcript, Craig Orton, 12 September 2018, 5512.

¹¹⁹ Transcript, Bruce Stewart, 11 September 2018, 5410–11.

¹²⁰ Transcript, Bruce Stewart, 11 September 2018, 5411.

During this second phone call to Freedom, Mr Stewart and his son were transferred to Freedom's Retention team, a group within Freedom whose chief task was to dissuade customers from cancelling their policies.¹²¹

A Freedom retention agent that they spoke with tried to explain the potential benefits of the policy for Mr Stewart's son, and emphasised several times that the policy was free for the first 12 months.¹²² The retention agent also said that there was no reason for Freedom to have known that Mr Stewart's son had a disability.¹²³ However, the retention agent ultimately agreed to cancel the policy.¹²⁴ Mr Stewart's son was asked to confirm that he wished to 'terminate the policy'.¹²⁵ Mr Stewart's son had difficulty articulating those words.¹²⁶

After the phone call, the retention agent engaged in an instant messenger conversation with another Freedom representative, in which disparaging remarks were made about Mr Stewart and his son.¹²⁷ Mr Orton accepted that this conduct was 'totally inappropriate'.¹²⁸

During the call in which the policy was cancelled, Mr Stewart asked Freedom to provide him with copies of the recordings of the sales calls

¹²¹ Transcript, Bruce Stewart, 11 September 2018, 5412; Transcript, Craig Orton, 11 September 2018, 5435.

¹²² Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 5 [24]; Transcript, Bruce Stewart, 11 September 2018, 5412.

¹²³ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-6 [FIG.0001.0001.0261 at .0264].

¹²⁴ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 5 [22].

¹²⁵ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-6 [FIG.0001.0001.0261 at .0266].

¹²⁶ Transcript, Craig Orton, 11 September 2018, 5413.

¹²⁷ Transcript, Bruce Stewart, 11 September 2018, 5415–16; Transcript, Craig Orton, 12 September 2018, 5517.

¹²⁸ Transcript, Craig Orton, 12 September 2018, 5517.

with his son.¹²⁹ Mr Stewart did not receive these recordings until August 2018, shortly before the Commission was to take evidence about the matter.¹³⁰

Excerpts of two of these calls were played in the course of Mr Stewart's evidence. In the first call, which lasted for just over two minutes, a Freedom sales agent asked Mr Stewart's son whether his mother was at home, and discontinued the call when he determined that she was not.¹³¹ In the second call, which took place two days later and which lasted for eighteen and a half minutes, the same sales agent sold the policy to Mr Stewart's son.¹³² Mr Stewart told the Commission that, having listened to that call, he did not think that his son had any understanding of what he was signing up for.¹³³ I agree. Mr Orton accepted that the sales agent's actions were inappropriate, and that he should have known that Mr Stewart's son was not capable of understanding what was occurring during the call.¹³⁴ Mr Orton agreed that the sales agent who sold the policy to Mr Stewart's son had engaged in 'deeply troubling conduct'.¹³⁵ Again, I agree.

2.2.2 Selling to vulnerable consumers

In a submission provided to the Commission in August, Freedom acknowledged that it had engaged in misconduct and conduct that fell below community standards and expectations in respect of its treatment of at least six other vulnerable consumers.¹³⁶ These instances related to conduct both before and after the introduction of Freedom's vulnerable customer training

¹²⁹ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-6 [FIG.0001.0001.0261 at .0265].

¹³⁰ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 6–7 [30]–[35].

¹³¹ Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-15 [FIG.0001.0001.0002].

¹³² Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-17 [FIG.0001.0001.0003].

¹³³ Transcript, Bruce Stewart, 11 September 2018, 5417.

¹³⁴ Transcript, Craig Orton, 11 September 2018, 5446.

¹³⁵ Transcript, Craig Orton, 11 September 2018, 5446.

¹³⁶ Transcript, Craig Orton, 11 September 2018, 5448–50; see also Exhibit 6.72, Freedom's Response to Commission Request of 3 August 2018.

in February 2017.¹³⁷ The most recent complaint was received by Freedom in late April 2018.¹³⁸

On 7 September 2018, in the week before Mr Orton was due to give evidence, Freedom filed a breach report with ASIC that related, in part, to the complaints that Freedom had received in relation to its treatment of vulnerable consumers.¹³⁹ Freedom told ASIC that when taken together, the conduct of its sales agents in connection with these sales may have breached sections 912A(1)(a), 912A(1)(ca) or 912A(1)(f) of the Corporations Act, which require Freedom to do all things necessary to ensure that the financial services covered by its Australian financial services licence are provided efficiently, honestly and fairly, to take reasonable steps to ensure that its representatives comply with financial services laws, and to ensure that its representatives are adequately trained, and are competent, to provide financial services.¹⁴⁰

When asked about the causes of these problems, Mr Orton referred to a history of insufficient quality assurance coverage for calls made by Freedom Insurance representatives.¹⁴¹ The breach report filed by ASIC also linked Freedom's remuneration structures with its mis-selling to vulnerable consumers, a topic to which I will return.¹⁴²

2.2.3 Accidental death and accidental injury policies

Before turning to those matters, I make some observations about Freedom's sale of accidental death and accidental injury products. As I previously indicated, on the day before Mr Orton gave evidence, Freedom told the Commission that it had ceased the outbound sale of those products.¹⁴³

¹³⁷ Transcript, Craig Orton, 11 September 2018, 5449–50.

¹³⁸ Transcript, Craig Orton, 11 September 2018, 5450.

¹³⁹ Exhibit 6.74, 7 September 2018, Freedom Breach Notice.

¹⁴⁰ Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 3–4.

¹⁴¹ Transcript, Craig Orton, 11 September 2018, 5451.

¹⁴² Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 5; Transcript, Craig Orton, 11 September 2018, 5453.

¹⁴³ Transcript, Craig Orton, 11 September 2018, 5423.

However, the products will still be sold on Freedom's website, and will still be offered to customers if they request them.¹⁴⁴

In the statement that he provided to the Commission, Mr Orton suggested that 'accidental death cover, combined with an accidental injury rider, provides a relatively low cost alternative insurance benefit to full life cover'.¹⁴⁵ However, in his oral evidence, Mr Orton conceded that those types of cover were not a 'true alternative' to life cover,¹⁴⁶ because the circumstances in which a person could make a claim on those policies were much more limited than under a life insurance policy.¹⁴⁷

Despite this, Freedom engaged in 'downgrading' sales practices in relation to accidental death policies, by offering the product to customers who failed to qualify for life cover.¹⁴⁸ Mr Orton accepted this practice should not occur.¹⁴⁹ Freedom also offered an accidental death policy to policyholders who attempted to cancel their existing life insurance policy.¹⁵⁰ Mr Orton accepted that the instructions given to its retention agents in this regard were not 'appropriate', and that selling the product in this context carried with it a risk that customers would be confused about the type of policy that they were getting.¹⁵¹

Mr Orton also conceded that Freedom's sales processes for accidental death policies were deficient, because the sales scripts failed to notify customers of the narrow definition of 'accident' or the key exclusions

¹⁴⁴ Transcript, Craig Orton, 11 September 2018, 5431–2.

¹⁴⁵ Exhibit 6.67, Witness statement of Craig Orton, 27 August 2018, 20 [57].

¹⁴⁶ Transcript, Craig Orton, 11 September 2018, 5432.

¹⁴⁷ Transcript, Craig Orton, 11 September 2018, 5432.

¹⁴⁸ Transcript, Craig Orton, 11 September 2018, 5434–6.

¹⁴⁹ Transcript, Craig Orton, 11 September 2018, 5434–5.

¹⁵⁰ Transcript, Craig Orton, 11 September 2018, 5435–6.

¹⁵¹ Transcript, Craig Orton, 11 September 2018, 5436; see also Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [12].

from these policies.¹⁵² Mr Orton accepted that as a result, policyholders could be confused about what their policies covered.¹⁵³

Until it stopped outbound sales of its accidental death product, Freedom sold significant numbers of accidental death policies – around 19,000 policies in 2016 and around 21,000 in 2017.¹⁵⁴ Despite this, at the time of the hearings, Freedom had consistently received only a very small number of claims – no more than 22 in any of the last three years.¹⁵⁵

2.2.4 Remuneration and incentives

Between 2013 and 2015, Freedom used a volume-based commission structure.¹⁵⁶ In about 2015, Freedom began introducing variants to this model.¹⁵⁷ Amongst other things, Freedom introduced requirements that sales agents cover their ‘seat cost’, and the cost of their leads, before they would be eligible to earn commission.¹⁵⁸ Mr Orton conceded that this increased the possibility that sales agents would engage in aggressive sales tactics.¹⁵⁹ More broadly, Mr Orton recognised that Freedom’s commission structure over recent years had created a situation in which sales agents had been incentivised to pursue sales aggressively.¹⁶⁰

In the breach notification that it provided to ASIC on 7 September 2018, Freedom notified ASIC that between 1 January 2018 and May 2018, the variable component of its sales agent remuneration arrangements may have breached section 963E of the Corporations Act, which prohibits Australian financial services licence holders accepting conflicted remuneration.¹⁶¹

¹⁵² Transcript, Craig Orton, 11 September 2018, 5443–4.

¹⁵³ Transcript, Craig Orton, 11 September 2018, 5444.

¹⁵⁴ Transcript, Craig Orton, 11 September 2018, 5439.

¹⁵⁵ Transcript, Craig Orton, 11 September 2018, 5440.

¹⁵⁶ Transcript, Craig Orton, 11 September 2018, 5454.

¹⁵⁷ Transcript, Craig Orton, 11 September 2018, 5455.

¹⁵⁸ Transcript, Craig Orton, 11 September 2018, 5456.

¹⁵⁹ Transcript, Craig Orton, 11 September 2018, 5457.

¹⁶⁰ Transcript, Craig Orton, 11 September 2018, 5463.

¹⁶¹ Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 2–3.

Freedom informed ASIC that from 1 October 2018, no commission-based incentives would be paid to Freedom's sales teams.¹⁶² Mr Orton told the Commission that this was because of concerns that commissions may inappropriately influence the conduct of sales agents:¹⁶³ in Mr Orton's words, 'any commission payable [to] a sales agent has the potential to be conflicted'.¹⁶⁴

Mr Orton also gave evidence about various incentive programs for sales agents, including non-monetary incentive programs, which had been run by Freedom over recent years. A number of these incentive programs were based solely on sales made by a sales agent, without any qualifying quality assurance requirement.¹⁶⁵ Mr Orton accepted that these incentive programs, particularly the higher value incentive programs, encouraged conflicted conduct by sales agents, and that this risk was heightened where no quality assurance qualifications were placed upon participation.¹⁶⁶ In its September 2018 breach notification to ASIC, Freedom also told ASIC that it considered that certain incentive programs run between January and April 2018 constituted 'conflicted remuneration', in breach of section 963E of the Corporations Act.¹⁶⁷

2.2.5 Quality assurance and disciplinary processes

Mr Orton acknowledged that Freedom's quality assurance monitoring processes had been inadequate.¹⁶⁸ The evidence indicated that Freedom's guidelines for 'marking' a sales call for quality assurance purposes were insufficiently robust.¹⁶⁹ For example, at the time Mr Stewart's son was

¹⁶² Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 3.

¹⁶³ Transcript, Craig Orton, 11 September 2018, 5464–5.

¹⁶⁴ Transcript, Craig Orton, 11 September 2018, 5454.

¹⁶⁵ Transcript, Craig Orton, 11 September 2018, 5467;
cf Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6 [33].

¹⁶⁶ Transcript, Craig Orton, 11 September 2018, 5471.

¹⁶⁷ Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 2.

¹⁶⁸ Transcript, Craig Orton, 11 September 2018, 5473.

¹⁶⁹ See, eg, Transcript, Craig Orton, 11 September 2018, 5474–6;
cf Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [13].

sold his insurance, a sales call would not be marked as a ‘fail’ even if the representative demonstrated many instances of misleading, deceptive, false or incomplete information.¹⁷⁰ Many similar deficiencies persisted in the call marking guidelines until July 2018. Mr Orton conceded that the marking guidelines should have been strengthened earlier.¹⁷¹

The Commission also heard evidence about Freedom’s ineffective disciplinary practices, including the actions taken in respect of the sales agent who sold the policy to Mr Stewart’s son. The sales agent had received an initial written warning in January 2016, and a ‘final written warning’ in February 2016.¹⁷² In the following months, additional concerns were raised about the sales agent’s practices.¹⁷³ For the most part, these warnings and concerns were not referred to in the fortnightly feedback that Freedom provided to the sales agent: rather, the sales agent’s supervisor continued to encourage him to ‘aim big’ and sell more policies.¹⁷⁴ Mr Orton conceded that the disciplinary processes in place at this time did not adequately respond to misconduct by representatives,¹⁷⁵ and that there were broad problems in the feedback loop used by Freedom Insurance to monitor and address such instances of misconduct.¹⁷⁶

2.2.6 Retention strategies

In its submission to the Commission, Freedom acknowledged approximately 27 instances of conduct in relation to Freedom’s retention processes that fell below community standards and expectations.¹⁷⁷ The vast majority

¹⁷⁰ Transcript, Craig Orton, 11 September 2018, 5475.

¹⁷¹ Transcript, Craig Orton, 11 September 2018, 5479.

¹⁷² Exhibit 6.86, 28 January 2016, First Written Warning; Exhibit 6.87, 16 February 2016, Final Warning.

¹⁷³ Exhibit 6.89, 2 March 2016, Email Concerning Call Converted; Exhibit 6.91, 6 April 2016, Email from Bryan Reilly; Transcript, Craig Orton, 11 September 2018, 5489.

¹⁷⁴ Exhibit 6.88, 16 February 2016, Freedom Insurance Fortnightly 121.

¹⁷⁵ Transcript, Craig Orton, 11 September 2018, 5481.

¹⁷⁶ Transcript, Craig Orton, 11 September 2018, 5493.

¹⁷⁷ Transcript, Craig Orton, 12 September 2018, 5508.

of instances related to complaints received since the start of February 2018.¹⁷⁸ Mr Orton accepted that Freedom's retention processes had been too strong,¹⁷⁹ and that Freedom had at times made it 'too difficult to cancel [policies]'.¹⁸⁰ Information provided by Freedom to ASIC indicated that over a 12-month period, Freedom had received an average of 72 cancellation requests a day,¹⁸¹ and that policyholders had only succeeded in cancelling their policies in 28.5% of calls made to Freedom.¹⁸²

The Commission also heard about various retention marketing campaigns run by Freedom, including as recently as July 2018.¹⁸³ The retention campaigns were directed to dissuading policyholders from cancelling their policies, or getting them to reinstate cancelled policies.¹⁸⁴ Mr Orton conceded that these campaigns were designed to make it as difficult as possible for people to cancel their policies, and to win policyholders back after they had cancelled.¹⁸⁵ Mr Orton said that these campaigns should not have been initiated, and that Freedom would stop running campaigns of this nature.¹⁸⁶

2.3 What the case study showed

2.3.1 Misconduct

In its submissions to the Commission, Freedom suggested that in circumstances where ASIC was reviewing Freedom's practices, 'ASIC might be considered the more appropriate body to review and make final determinations regarding the past conduct of Freedom Insurance

¹⁷⁸ Transcript, Craig Orton, 12 September 2018, 5508.

¹⁷⁹ Transcript, Craig Orton, 12 September 2018, 5508–9.

¹⁸⁰ Transcript, Craig Orton, 12 September 2018, 5505.

¹⁸¹ Transcript, Craig Orton, 12 September 2018, 5501.

¹⁸² Transcript, Craig Orton, 12 September 2018, 5502.

¹⁸³ Exhibit 6.100, 3 July 2018, Retention Marketing Campaign; Transcript, Craig Orton, 12 September 2018, 5520–2.

¹⁸⁴ Transcript, Craig Orton, 12 September 2018, 5518–19.

¹⁸⁵ Transcript, Craig Orton, 12 September 2018, 5522–3.

¹⁸⁶ Transcript, Craig Orton, 12 September 2018, 5522–3.

[than the Commission is]’.¹⁸⁷ As I have previously explained, I am not empowered to and do not make ‘final determinations’: I am authorised only to consider whether conduct ‘*might* have amounted to misconduct’.¹⁸⁸ I do not consider that ASIC’s current investigation into aspects of Freedom’s practices relieves me of that duty.¹⁸⁹

Freedom’s actions may have amounted to misconduct in a number of respects.

In respect of Freedom’s sales to vulnerable customers, I consider that by selling insurance to Mr Stewart’s son, in circumstances where the sales agent knew, or ought to have known, that Mr Stewart’s son did not understand what he was agreeing to, Freedom may have engaged in unconscionable conduct within the meaning of sections 12CA or 12CB of the ASIC Act.¹⁹⁰ Freedom accepted that the sales agent ‘knew or ought to have known that Mr Stewart’s son did not understand what he was agreeing to’,¹⁹¹ but said that his inappropriate conduct ‘should not be characterised as conduct of Freedom Insurance itself’.¹⁹² In circumstances where the sales agent was acting as a representative of Freedom, within the sales structures put in place by Freedom, I do not accept this submission.¹⁹³ Freedom also submitted that this was an ‘isolated incident’ that ‘should not be used to characterise the general conduct of the organisation’.¹⁹⁴ Putting to one side the question of whether the incident was isolated, I do not consider that there is any justification for reading sections 12CA or 12CB as only applying to systemic issues.

For similar reasons, I consider that Freedom may have also engaged in unconscionable conduct in respect of the other three instances where

¹⁸⁷ Freedom Insurance Group Ltd, Module 6 Case Study Submission, 2 [9].

¹⁸⁸ *Letters Patent*, 14 December 2017, (a) (emphasis added).

¹⁸⁹ Cf *Letters Patent*, 14 December 2017, 3.

¹⁹⁰ Transcript, Craig Orton, 12 September 2018, 5446.

¹⁹¹ Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [16].

¹⁹² Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [17].

¹⁹³ See also Corporations Act s 917B.

¹⁹⁴ Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [18].

insurance was sold to vulnerable consumers that were the subject of Freedom's recent breach notification to ASIC.¹⁹⁵

In addition, Freedom acknowledged both in its breach notification to ASIC and in its submissions to the Commission that the conduct of its sales agents in connection with those four vulnerable customers may have constituted a breach of sections 912A(1)(a), 912A(1)(ca) or 912A(1)(f) of the Corporations Act.¹⁹⁶ I have no reason to doubt that that acknowledgment was properly made.

In respect of Freedom's quality assurance practices, Freedom failed, until July 2018, to appropriately frame its call marking guidelines to ensure that most or all types of serious misconduct, including legislative breaches, constituted a 'QA fail'.¹⁹⁷ I accept that Freedom's call marking guidelines were only one aspect of its quality assurance and risk management regime.¹⁹⁸ However, in my view, they were a significant aspect of that regime, because they set out the criteria by which the performance of Freedom's representatives would be assessed. In my view, the defects evident in the guidelines prior to July 2018 suggest that Freedom historically failed to have in place sufficient processes to deter legislative breaches in the sales process. As a result, I consider that Freedom may have failed to take reasonable steps to ensure that its representatives complied with financial services laws for the purposes of section 912A(1)(ca) of the Corporations Act, or to have in place adequate risk management systems, as required by section 912A(1)(h) of the Act.

In respect of Freedom's remuneration and incentive practices, Freedom acknowledged in its breach notification to ASIC that until May 2018, it may have breached section 963E of the Corporations Act in respect of the

¹⁹⁵ Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 3–4; cf Freedom Insurance Group Ltd, Module 6 Case Study Submission, 4 [19]–[20].

¹⁹⁶ Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 4; Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [22].

¹⁹⁷ Freedom Insurance Group Ltd, Module 6 Case Study Submission, 4 [24].

¹⁹⁸ Freedom Insurance Group Ltd, Module 6 Case Study Submission, 4–5 [25]–[27].

variable component of its sales agent remuneration structure.¹⁹⁹ Freedom reiterated that acknowledgment in its submissions to the Commission.²⁰⁰ I have no reason to doubt the appropriateness of that acknowledgment.

Similarly, Freedom also acknowledged to both ASIC and the Commission that it may have breached section 963 of the Corporations Act in respect of the non-monetary benefits that it provided to its representatives between January and April 2018.²⁰¹ In its submissions to the Commission, Freedom accepted that it may therefore have historically failed to have in place adequate arrangements for the management of conflicts of interest that arose between its representatives and its policyholders, in breach of section 912A(1)(aa) of the Corporations Act.²⁰² Again, I have no reason to doubt the appropriateness of those acknowledgments.

Finally, in respect of compliance with the anti-hawking regime, Freedom acknowledged certain breaches of the anti-hawking provisions in the Corporations Act to both the Commission and ASIC.²⁰³ I consider that the acknowledgment was properly made.

These matters having been reported to ASIC, it is for ASIC to decide what further steps it should take.

2.3.2 Conduct falling below community standards and expectations

Freedom's submissions to the Commission only addressed one of the findings identified by Senior Counsel Assisting as being open on the evidence.²⁰⁴ That matter related to three instances of conduct that fell below community standards and expectations relating to Freedom's treatment of

¹⁹⁹ Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 3.

²⁰⁰ Freedom Insurance Group Ltd, Module 6 Case Study Submission, 5 [28].

²⁰¹ Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 2;
Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6 [32].

²⁰² Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6 [32].

²⁰³ Transcript, Craig Orton, 12 September 2018, 5526; Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6 [35].

²⁰⁴ Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6–7 [36]–[37].

vulnerable consumers, which were acknowledged to the Commission, but which were not included in Freedom's breach notification to ASIC. In its submissions to the Commission, Freedom accepted that those instances were properly characterised as conduct that fell below community standards and expectations.²⁰⁵

Freedom did not address the other four matters identified by Senior Counsel Assisting as being open on the evidence. In my view, each of those matters is capable of being characterised as conduct that fell below community standards and expectations:

- The first related to the 27 instances of retention- and cancellation-related conduct that Freedom previously identified to the Commission as falling below community standards and expectations.²⁰⁶
- The second related to the heavy-handed retention strategies employed by Freedom, which may result in policyholders finding it difficult to cancel policies that they no longer want or need.²⁰⁷ In my view, the community would not expect that an insurance company would make it so difficult to cancel a policy that was no longer deemed necessary or desirable.
- The third related to Freedom's disciplinary procedures, which were inadequate to address problematic conduct by its sales agents. One stark example is Freedom's conduct towards the sales agent who sold the policy to Mr Stewart's son: he was encouraged to sell aggressively, even in circumstances where Freedom held serious concerns about his sales practices.²⁰⁸
- The fourth related to Freedom's failure to appropriately recognise and respond to the harm suffered by Mr Stewart's son. This was demonstrated in a number of respects, including by Freedom's failure to call back Mr Stewart when it had promised to do so,²⁰⁹ Freedom's

²⁰⁵ Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6 [36].

²⁰⁶ Transcript, Craig Orton, 12 September 2018, 5508.

²⁰⁷ Transcript, Craig Orton, 12 September 2018, 5522–3.

²⁰⁸ Transcript, Craig Orton, 11 September 2018, 5481–9, see specifically at 5485.

²⁰⁹ Transcript, Bruce Stewart, 11 September 2018, 5409.

failure to ensure that Mr Stewart received the call recordings in a timely manner,²¹⁰ and the belittling tone of Freedom's internal communications about Mr Stewart and his son.²¹¹ Taken together, these matters indicated a lack of regard for the harm suffered by Mr Stewart's son, and a lack of interest in providing effective or timely redress.

2.3.3 Causes of the conduct

In my view, the conduct of Freedom is to be attributed to its culture and governance practices and its remuneration practices. As Mr Orton accepted, Freedom's remuneration and incentives structure encouraged highly aggressive and inappropriate sales practices.²¹² Freedom's quality assurance and disciplinary processes were insufficient to deter and detect these inappropriate practices. These difficulties were compounded by Freedom's failure to provide training to its staff about dealing with vulnerable consumers until February 2017.²¹³ Overall, these matters contributed to a culture in which sales agents were encouraged to sell aggressively, without regard for the needs of consumers (including vulnerable consumers), and with few, if any, constraints on their conduct.

3 Commlnsure

3.1 Background

At the relevant time, CBA conducted its insurance business under the name Commlnsure. The Commission examined Commlnsure's handling of claims made under life insurance policies that provided trauma cover. The case study examined the way that Commlnsure handled two particular claims – one by an insured person who had a heart attack, and the other by an insured person who had breast cancer – as well as a number of issues relating to the definition of 'heart attack' in Commlnsure's policies.

²¹⁰ Transcript, Craig Orton, 11 September 2018, 5412–14.

²¹¹ Transcript, Craig Orton, 12 September 2018, 5517.

²¹² Transcript, Craig Orton, 11 September 2018, 5466; see also Exhibit 6.74, 7 September 2018, Freedom Breach Notice.

²¹³ Transcript, Craig Orton, 11 September 2018, 5449.

The Commission heard evidence from Ms Helen Troup, the Executive General Manager of CommInsure.

3.2 Evidence

3.2.1 First insured – heart attack

In the first case examined, the insured took out a life insurance policy in 2000.²¹⁴ The policy included cover for ‘heart attacks’, as defined in the policy.²¹⁵ The insured suffered a heart attack in January 2014, and made a claim under the policy later that month.²¹⁶

The medical definitions in the insured’s policy were updated from time to time.²¹⁷ At the time the insured suffered his heart attack, however, CommInsure had not made any substantive changes to the definition of ‘heart attack’ since July 2005 but, in 2013, had changed the title of the relevant definition from ‘Heart attack’ to ‘Heart attack of specified severity’.²¹⁸

In accordance with the medical opinion of one of CommInsure’s medical officers, Dr Carless, CommInsure denied the insured’s claim for a full trauma benefit on the basis of his heart attack, because he did not meet the relevant policy definition.²¹⁹ Among other things, the definition required elevation in levels of troponin I above 2.0 mcg/L, but the insured’s levels of troponin I did not rise to that level.²²⁰

²¹⁴ Transcript, Helen Troup, 12 September 2018, 5548.

²¹⁵ Transcript, Helen Troup, 12 September 2018, 5550.

²¹⁶ Transcript, Helen Troup, 12 September 2018, 5552.

²¹⁷ Transcript, Helen Troup, 12 September 2018, 5550.

²¹⁸ Transcript, Helen Troup, 12 September 2018, 5551.

²¹⁹ Transcript, Helen Troup, 12 September 2018, 5555.

²²⁰ Transcript, Helen Troup, 12 September 2018, 5554, 5560–1.

The insured made a complaint to CommInsure in June 2014,²²¹ but CommInsure did not change its decision.²²²

In March 2016, the ABC's *Four Corners* program and Fairfax Media reported on concerns about CommInsure's life insurance business.²²³ Among other things, the reporting raised concerns that the definition of 'heart attack' in CommInsure's trauma policies was out of date, and did not reflect developments in medical science.²²⁴

As a result of these reports, CommInsure decided to bring forward a planned update to its 'heart attack' definition to March 2016.²²⁵ It decided to backdate the application of the new definition to 11 May 2014.²²⁶

Shortly after the March 2016 media reports, the insured made a complaint to the Financial Ombudsman Service (FOS) about his claim with CommInsure.²²⁷ At that time, a representative of CBA told the insured that the updated 'heart attack' definition did not apply to his claim, which was made in January 2014, because the updated definition only applied from 11 May 2014.²²⁸ Despite this, the representative asked the insured for information to allow his claim to be assessed against the updated definition.²²⁹ Ms Troup acknowledged that this communication was likely to confuse the insured,²³⁰ and raise his hopes about the potential outcome of his claim.²³¹

²²¹ Transcript, Helen Troup, 12 September 2018, 5555.

²²² Transcript, Helen Troup, 12 September 2018, 5555.

²²³ Transcript, Helen Troup, 12 September 2018, 5556.

²²⁴ Transcript, Helen Troup, 12 September 2018, 5556.

²²⁵ Transcript, Helen Troup, 12 September 2018, 5557.

²²⁶ Transcript, Helen Troup, 12 September 2018, 5557.

²²⁷ Transcript, Helen Troup, 12 September 2018, 5557.

²²⁸ Transcript, Helen Troup, 12 September 2018, 5559.

²²⁹ Transcript, Helen Troup, 12 September 2018, 5558–9.

²³⁰ Transcript, Helen Troup, 12 September 2018, 5559.

²³¹ Transcript, Helen Troup, 12 September 2018, 5559.

At about this time, CBA asked Dr Carless to provide a further medical opinion about the claim, assessing the claim against both the previous (2013) definition and the new (2016) definition of ‘heart attack’.²³²

Dr Carless again concluded that the insured did not meet the 2013 definition, but said that he did satisfy the 2016 definition.²³³

On the basis of this opinion, CBA told FOS that it was still CommInsure’s position that the insured did not meet the 2013 definition of ‘heart attack’, and that it was the 2013 definition that applied to the insured’s claim.²³⁴

CBA also challenged FOS’s jurisdiction to deal with the dispute, on the basis that the dispute related to a matter of commercial judgment for CommInsure.²³⁵ FOS rejected CommInsure’s challenge to its jurisdiction, an action Ms Troup later said was ‘appropriate’.²³⁶

Despite FOS having considered and rejected the jurisdictional argument, CBA continued to maintain that the dispute was outside FOS’s jurisdiction,²³⁷ and twice challenged that jurisdiction again.²³⁸ Ms Troup acknowledged that this should not have happened, and that CBA should have accepted FOS’s determination as to its jurisdiction.²³⁹ Ms Troup attributed this conduct to a failure to log the decision about FOS’s jurisdiction in CBA’s case management system.²⁴⁰

Having rejected CBA’s challenge to its jurisdiction, FOS asked CBA to provide the medical opinion on which it relied to say that the insured did not meet the 2013 definition, and asked CBA to obtain and provide a medical opinion about whether the insured met the 2016 definition. In response to

²³² Transcript, Helen Troup, 12 September 2018, 5559–60.

²³³ Transcript, Helen Troup, 12 September 2018, 5559–60.

²³⁴ Transcript, Helen Troup, 12 September 2018, 5561; Exhibit 6.138, Witness statement of Helen Troup, 28 August 2018, Exhibit HT-27 [CBA.0001.0508.0118 at .0118]

²³⁵ Transcript, Helen Troup, 12 September 2018, 5561.

²³⁶ Transcript, Helen Troup, 12 September 2018, 5561.

²³⁷ Transcript, Helen Troup, 12 September 2018, 5565, 5567.

²³⁸ Transcript, Helen Troup, 12 September 2018, 5561, 5565, 5567.

²³⁹ Transcript, Helen Troup, 12 September 2018, 5565.

²⁴⁰ Transcript, Helen Troup, 12 September 2018, 5565.

this request, CBA provided the opinion of Dr Carless referred to earlier, but redacted the section of the opinion dealing with the 2016 definition.²⁴¹ In its covering email, CBA said that it ‘decline[d] [FOS’s] request to obtain or provide a medical report to assess whether the Applicant would satisfy the upgraded definition of Heart Attack’.²⁴² Ms Troup accepted that it was ‘misleading’ for CBA to convey to FOS that CommInsure did not already have a medical opinion about whether the insured met the 2016 definition.²⁴³ Ms Troup acknowledged that CBA acted inconsistently with FOS’s Terms of Reference and ASIC Regulatory Guide 139 in refusing to provide this information to FOS.²⁴⁴ She said that this conduct was misguided, and was not a decision that she would have made.²⁴⁵

In July 2016, FOS wrote to CBA requesting further information, including information about the decision to backdate the 2016 definition to May 2014.²⁴⁶ CBA did not provide information about this decision to FOS, because it did not consider it relevant to the dispute.²⁴⁷ Ms Troup acknowledged that the failure to respond to FOS’s request was a breach of FOS’s Terms of Reference; she accepted that it was not ‘open or transparent’.²⁴⁸

In August 2016, more than three months after FOS’s first request, CBA provided Dr Carless’s opinion to FOS in unredacted form.²⁴⁹ In October 2016, FOS made a recommendation in favour of the insured.²⁵⁰ CBA rejected that recommendation,²⁵¹ but settled the matter with the insured

²⁴¹ Transcript, Helen Troup, 12 September 2018, 5563–4.

²⁴² Transcript, Helen Troup, 12 September 2018, 5563.

²⁴³ Transcript, Helen Troup, 12 September 2018, 5564.

²⁴⁴ Transcript, Helen Troup, 12 September 2018, 5570.

²⁴⁵ Transcript, Helen Troup, 12 September 2018, 5571.

²⁴⁶ Transcript, Helen Troup, 12 September 2018, 5566.

²⁴⁷ Transcript, Helen Troup, 12 September 2018, 5568, 5570.

²⁴⁸ Transcript, Helen Troup, 12 September 2018, 5570.

²⁴⁹ Transcript, Helen Troup, 12 September 2018, 5568.

²⁵⁰ Transcript, Helen Troup, 12 September 2018, 5571.

²⁵¹ Transcript, Helen Troup, 12 September 2018, 5571.

on an ex gratia basis.²⁵² Ms Troup acknowledged that CommInsure's handling of the dispute contributed to the delay in resolving the dispute with the insured and affected CBA's relationship with FOS.²⁵³

3.2.2 Second insured – breast cancer

In the second case examined, the Commission heard that the insured took out a life insurance policy in 1996.²⁵⁴ In March 2016, the insured was diagnosed with breast cancer, and underwent two surgeries to have the cancer removed.²⁵⁵ Following this, in August 2016, she made a claim under her policy.²⁵⁶

At the time the insured made her claim, the definition of 'cancer' that applied to her policy had not been updated since November 1998.²⁵⁷ One of the exclusions from that definition was 'carcinoma in situ unless leading to radical breast surgery'.²⁵⁸

In August 2016, CommInsure denied the insured's claim²⁵⁹ on the basis that she had a carcinoma in situ and her treatment did not involve 'radical breast surgery'.²⁶⁰ CommInsure formed the view that the treatment did not constitute 'radical breast surgery' because the insured had not undergone a mastectomy.²⁶¹ CommInsure did not explain this in the letter it sent to the insured,²⁶² and Ms Troup acknowledged that the letter did not provide the insured with an adequate explanation of why her claim had been declined.²⁶³

²⁵² Transcript, Helen Troup, 12 September 2018, 5572.

²⁵³ Transcript, Helen Troup, 12 September 2018, 5575.

²⁵⁴ Transcript, Helen Troup, 13 September 2018, 5638.

²⁵⁵ Transcript, Helen Troup, 13 September 2018, 5640.

²⁵⁶ Transcript, Helen Troup, 13 September 2018, 5640.

²⁵⁷ Transcript, Helen Troup, 13 September 2018, 5639.

²⁵⁸ Transcript, Helen Troup, 13 September 2018, 5640.

²⁵⁹ Transcript, Helen Troup, 13 September 2018, 5641.

²⁶⁰ Transcript, Helen Troup, 13 September 2018, 5641.

²⁶¹ Transcript, Helen Troup, 13 September 2018, 5642.

²⁶² Transcript, Helen Troup, 13 September 2018, 5642.

²⁶³ Transcript, Helen Troup, 13 September 2018, 5642.

The term ‘radical breast surgery’ was not defined in the policy.²⁶⁴ Similarly, the policy did not specify that a mastectomy was required to meet the definition of ‘radical breast surgery’.²⁶⁵ Ms Troup accepted that the lack of definition of ‘radical breast surgery’ in the policy resulted in confusion for the insured.²⁶⁶

The insured and her husband told CommInsure they were not happy with its decision to decline the claim, and in February 2017 they provided CommInsure with further information from the insured’s GP and surgeon. Both medical practitioners said that the treatment the insured had for her breast cancer constituted ‘radical breast surgery’.²⁶⁷ Despite the views of these two medical practitioners, CommInsure maintained its decision to decline the claim, again on the basis that the insured had not had a mastectomy.²⁶⁸

Ms Troup accepted that CommInsure’s decision to decline the claim was unacceptable in circumstances where CommInsure:²⁶⁹

- was relying on a definition of cancer that, at the time, was about 18 years old;
- imposed limitations on that definition that were not expressed in the policy documents; and
- did not account for the way in which the insured had been treated by her doctors and the opinion expressed by those doctors.

²⁶⁴ Transcript, Helen Troup, 13 September 2018, 5642.

²⁶⁵ Transcript, Helen Troup, 13 September 2018, 5642–3.

²⁶⁶ Transcript, Helen Troup, 13 September 2018, 5642.

²⁶⁷ Transcript, Helen Troup, 13 September 2018, 5644.

²⁶⁸ Transcript, Helen Troup, 13 September 2018, 5645.

²⁶⁹ Transcript, Helen Troup, 13 September 2018, 5645–6.

Ms Troup also acknowledged that CommInsure had breached its duty to act towards the insured with the utmost good faith, by denying her claim in these circumstances.²⁷⁰

The insured made a complaint to FOS in April 2017.²⁷¹ Ms Troup accepted that CBA's engagement with FOS in relation to the complaint fell below what the community would expect of it.²⁷² Specifically, CBA chose not to respond to FOS's request for information or to seek an extension of time to respond to that request.²⁷³

Ultimately, FOS made a recommendation in favour of the insured.²⁷⁴ The insured and CommInsure accepted the recommendation, and CommInsure paid the insured \$169,305 plus interest of just under \$5,000.²⁷⁵ Ms Troup acknowledged that FOS made the right decision²⁷⁶ and that CommInsure's handling of the claim caused distress to the insured.²⁷⁷

3.2.3 The decision not to update the 'heart attack' definition

Ms Troup also gave evidence about the decisions that CommInsure made in relation to the 'heart attack' definition, including decisions about whether to update the definition, and about the date from which the updated definition would be applied.

Ms Troup told the Commission that, between July 2005 and March 2016, CommInsure had considered updating its 'heart attack' definition,

²⁷⁰ Transcript, Helen Troup, 13 September 2018, 5646.

²⁷¹ Transcript, Helen Troup, 13 September 2018, 5646.

²⁷² Transcript, Helen Troup, 13 September 2018, 5649.

²⁷³ Transcript, Helen Troup, 13 September 2018, 5649.

²⁷⁴ Transcript, Helen Troup, 13 September 2018, 5650.

²⁷⁵ Transcript, Helen Troup, 13 September 2018, 5650.

²⁷⁶ Transcript, Helen Troup, 13 September 2018, 5650.

²⁷⁷ Transcript, Helen Troup, 13 September 2018, 5650.

but decided not to.²⁷⁸ Ms Troup accepted that, from at least early 2012, CommInsure knew that its definition of ‘heart attack’:

- first, did not reflect the definition of ‘heart attack’ adopted by an international taskforce of medical practitioners as a generally accepted and universally applicable definition. Among other things that description required reference to whether the insured person’s cardiac biomarkers were elevated above the 99th percentile of a normal reference population, rather than above some absolute level;²⁷⁹
- second, depending on the laboratory equipment used, might have required troponin I levels 20 times higher than those required under the universal definition of ‘heart attack’;²⁸⁰ and
- third, could discriminate against CommInsure’s female customers, as it was less common for women to reach the troponin I level specified in the definition.²⁸¹

Ms Troup also told the Commission that in 2012, CommInsure’s Chief Medical Officer had expressed the view that he would ‘personally move to the universal definition’ of ‘heart attack’.²⁸²

Ms Troup accepted that CommInsure should have updated its definition of ‘heart attack’ in 2012 to reflect the universal definition.²⁸³ Ms Troup acknowledged that the decision by CommInsure not to update the definition of ‘heart attack’ in 2012 fell below community standards and expectations.²⁸⁴

In 2013, CommInsure amended the title of its ‘heart attack’ definition to read ‘Heart attack of a specified severity’.²⁸⁵ Ms Troup accepted that, prior to that

²⁷⁸ Transcript, Helen Troup, 12 September 2018, 5595.

²⁷⁹ Transcript, Helen Troup, 12 September 2018, 5596.

²⁸⁰ Transcript, Helen Troup, 12 September 2018, 5602.

²⁸¹ Transcript, Helen Troup, 12 September 2018, 5602.

²⁸² Transcript, Helen Troup, 12 September 2018, 5602.

²⁸³ Transcript, Helen Troup, 12 September 2018, 5603.

²⁸⁴ Transcript, Helen Troup, 12 September 2018, 5593.

²⁸⁵ Transcript, Helen Troup, 12 September 2018, 5604.

change, people reading the policy would have assumed that the policy was intended to apply to all heart attacks.²⁸⁶

By May 2014, a number of other insurers had updated their 'heart attack' definitions to reflect the universal definition.²⁸⁷ Ms Troup acknowledged that CommInsure's failure to update its definition in May 2014 was a commercial misjudgment that had adverse consequences for its policyholders.²⁸⁸ Ms Troup accepted that this misjudgment was at least in part the result of CommInsure focusing on commercial considerations at the expense of the interests of its customers, or the potential reputational risks to CommInsure.²⁸⁹ Ms Troup also accepted that the decision not to update the definition in 2014 fell below community standards and expectations.²⁹⁰

3.2.4 The decision not to backdate the updated 'heart attack' definition to 2012

As mentioned above, when CommInsure decided to update its 'heart attack' definition in March 2016, it decided to backdate the application of that definition to 11 May 2014.²⁹¹

Ms Troup told the Commission that this decision was based upon the date of the last relevant PDS.²⁹² Ms Troup acknowledged that another reason for choosing this date was that it was in the middle of the period in which CommInsure's competitors had updated their definitions.²⁹³

After receiving a letter from ASIC in March 2017, CommInsure decided to backdate the updated definition of 'heart attack' even further, to October 2012.²⁹⁴ In October 2012, the international taskforce of medical practitioners

²⁸⁶ Transcript, Helen Troup, 12 September 2018, 5609.

²⁸⁷ Transcript, Helen Troup, 12 September 2018, 5605.

²⁸⁸ Transcript, Helen Troup, 12 September 2018, 5605.

²⁸⁹ Transcript, Helen Troup, 12 September 2018, 5605, 5609.

²⁹⁰ Transcript, Helen Troup, 12 September 2018, 5594.

²⁹¹ Transcript, Helen Troup, 12 September 2018, 5583.

²⁹² Transcript, Helen Troup, 12 September 2018, 5583.

²⁹³ Transcript, Helen Troup, 12 September 2018, 5584.

²⁹⁴ Transcript, Helen Troup, 12 September 2018, 5587.

referred to above had published a paper endorsing a universally accepted medical definition of ‘heart attack’ that was different to the definition used by CommInsure.²⁹⁵ Ms Troup acknowledged that October 2012 was a more appropriate date to which to backdate the definition, and that CommInsure should have settled on this date at the point that it decided that backdating was necessary.²⁹⁶

3.2.5 ASIC’s investigation and misleading advertising

Ms Troup was asked about the way that CommInsure advertised its trauma policies between December 2012 and March 2016.

In connection with its investigation into CommInsure in 2016, ASIC raised concerns with CommInsure about its advertising of its trauma policies.²⁹⁷ In particular, ASIC raised concerns that certain web pages and brochures made available by CBA were misleading or deceptive.²⁹⁸ In essence, ASIC’s concern was that the material was not sufficiently qualified or limited to convey the specific criteria that consumers would need to meet to satisfy the ‘heart attack’ definition.²⁹⁹

Ms Troup was asked about two web pages and two brochures made available by CommInsure concerning its trauma policies.³⁰⁰ She accepted, rightly in my view, that a person reading the documents would have been likely to believe that CommInsure’s trauma policy covered *all* heart attacks and, of course, as has been seen, that was not the case.³⁰¹ Ms Troup accepted that the documents were misleading.³⁰² CommInsure had not made this acknowledgment prior to the Commission’s hearings.³⁰³

²⁹⁵ Transcript, Helen Troup, 12 September 2018, 5596.

²⁹⁶ Transcript, Helen Troup, 12 September 2018, 5589, 5593.

²⁹⁷ Transcript, Helen Troup, 13 September 2018, 5618.

²⁹⁸ Transcript, Helen Troup, 13 September 2018, 5618.

²⁹⁹ Transcript, Helen Troup, 13 September 2018, 5618.

³⁰⁰ Transcript, Helen Troup, 13 September 2018, 5619–24.

³⁰¹ Transcript, Helen Troup, 13 September 2018, 5620–4.

³⁰² Transcript, Helen Troup, 13 September 2018, 5621–4.

³⁰³ Transcript, Helen Troup, 13 September 2018, 5631.

ASIC did not take any enforcement action against CommInsure for these misleading advertisements. Rather, ASIC and CommInsure reached an agreement under which, among other things, CommInsure would make a voluntary community benefit payment of \$300,000, and would commission a compliance review of its advertising sign-off processes and procedures.³⁰⁴

3.3 What the case study showed

3.3.1 ‘Heart attack’ definition and advertising

Both CBA and Ms Troup rightly acknowledged that, by failing to update its ‘heart attack’ definition in 2012 and in 2014 to accord with the medical definition that was accepted at that time, CommInsure engaged in conduct that fell below community standards and expectations.³⁰⁵

The evidence demonstrated that this conduct was attributable, at least in part, to CommInsure not adequately taking into account the interests of customers in making those decisions, and instead being motivated by commercial considerations. Ms Troup acknowledged this to be the case.³⁰⁶

As noted above, Ms Troup accepted that the two web pages and two brochures made available by CommInsure concerning its trauma policies were misleading.³⁰⁷ In its submissions, CBA rightly accepted that, by publishing these documents without any prominent qualification that only heart attacks of specified severity were covered by CommInsure’s trauma policies, CommInsure contravened section 12DA of the ASIC Act, and therefore engaged in misconduct.³⁰⁸ CBA also rightly accepted that, by publishing the web pages and brochures, it may have contravened section 12DB of the ASIC Act.³⁰⁹

³⁰⁴ Transcript, Helen Troup, 13 September 2018, 5630.

³⁰⁵ CBA, Module 6 Case Study Submission, 10 [36]; Transcript, Helen Troup, 12 September 2018, 5593–4.

³⁰⁶ Transcript, Helen Troup, 12 September 2018, 5605, 5609.

³⁰⁷ Transcript, Helen Troup, 13 September 2018, 5621–4.

³⁰⁸ CBA, Module 6 Case Study Submission, 6 [20].

³⁰⁹ CBA, Module 6 Case Study Submission, 7 [23].

The matter having already been investigated by ASIC, it is not necessary for me to make any referral.

3.3.2 Individual cases

In relation to the insured who suffered a heart attack, both Ms Troup and CBA rightly accepted that CBA's conduct in withholding part of Dr Carless's medical opinion from FOS, and saying that it declined to obtain or provide such an opinion, misled FOS.³¹⁰ CBA acknowledged that this constituted misconduct.³¹¹ Ms Troup conceded that, by engaging in this conduct, CBA had failed to be open and transparent in its dealings with FOS and had acted inconsistently both with ASIC Regulatory Guide 139 and with FOS's terms of reference.³¹²

Both Ms Troup and CBA also rightly accepted that CBA contravened clause 7.2 of FOS's Terms of Reference by declining to provide information to FOS about CBA's decision to backdate the updated 'heart attack' definition to May 2014.³¹³ CBA acknowledged that this constituted misconduct.³¹⁴

These matters having already been investigated by FOS and ASIC, it is not necessary for me to make any referral.

In relation to the insured who suffered from breast cancer, CBA accepted that, in failing to give adequate consideration to the differences in medical opinions concerning the nature of the insured's surgery, and failing to escalate her claim for review, CBA's conduct fell below community standards and expectations.³¹⁵

³¹⁰ CBA, Module 6 Case Study Submission, 5 [13]; Transcript, Helen Troup, 12 September 2018, 5564–5.

³¹¹ CBA, Module 6 Case Study Submission, 5 [13].

³¹² Transcript, Helen Troup, 12 September 2018, 5570.

³¹³ CBA, Module 6 Case Study Submission, 5 [16]; Transcript, Helen Troup, 12 September 2018, 5575.

³¹⁴ CBA, Module 6 Case Study Submission, 5 [16].

³¹⁵ CBA, Module 6 Case Study Submission, 9 [31].

In her evidence, Ms Troup went further, and – as noted above – acknowledged that CommInsure had breached its duty to act towards the insured with the utmost good faith, by denying her claim in circumstances where CommInsure:³¹⁶

- relied on a definition of cancer that was, at the relevant time, about 18 years old;
- imposed limitations on that definition that were not expressed in the policy documents; and
- did not account for the way in which the insured had been treated by her doctors and the opinion expressed by those doctors.

Despite Ms Troup's acknowledgment, CBA did not accept in its submissions that CommInsure had breached its duty of utmost good faith in handling the insured's claim.³¹⁷ CBA contended that, to establish a breach of that duty, it was necessary to demonstrate that CommInsure had engaged in conduct that was capricious or unreasonable.³¹⁸ It went on to say that there was no evidence that CommInsure acted capriciously, unreasonably, or less than honestly towards the insured.³¹⁹

It has been said that the touchstone of the duty of utmost good faith is to act, consistently with commercial standards of fairness and decency, with due regard to the interests of the insured.³²⁰ By declining the insured's claim in the circumstances referred to above, it is arguable that CommInsure failed to act with due regard to the interests of the insured. It is also arguable that CommInsure failed to act reasonably. Accordingly, I consider that CommInsure may have breached its obligation under section 13 of the

³¹⁶ Transcript, Helen Troup, 13 September 2018, 5645–6.

³¹⁷ CBA, Module 6 Case Study Submission, 9 [32]–[33].

³¹⁸ CBA, Module 6 Case Study Submission, 9 [32]. See *TAL Life Ltd v Shuetrim* (2016) 91 NSWLR 439, 452 [49] (Leeming JA).

³¹⁹ CBA, Module 6 Case Study Submission, 9 [33].

³²⁰ See *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1, 12 [15] (Gleeson CJ and Crennan J).

Insurance Contracts Act 1984 (Cth) (the Insurance Contracts Act) to act towards the insured with the utmost good faith.

I refer CommInsure's conduct to ASIC, pursuant to paragraph (a) of the Commission's Terms of Reference, for ASIC to consider what action it can and should take.

In relation to this insured, CBA also rightly accepted that its failure to respond to FOS within the required time or request an extension of time in connection with the dispute was conduct that fell below community standards and expectations.³²¹

3.3.3 Effectiveness of mechanisms for redress

In both of the specific cases considered in this case study, there were aspects of CBA's dealings with FOS that were concerning.

In the case of the first insured, who suffered from a heart attack, Ms Troup accepted that CBA misled FOS, made inappropriate challenges to its jurisdiction, and failed to provide information requested by FOS in breach of FOS's Terms of Reference. In the case of the second insured, who suffered from breast cancer, CBA failed to respond to FOS within the required time, without providing an explanation or requesting an extension of time.

External dispute resolution (EDR) schemes like FOS are an important mechanism for redress for consumers in their dealings with insurance companies. When insurance companies fail to be open, transparent and responsive in their dealings with FOS, it undermines the effectiveness of EDR mechanisms as a mechanism for redress.

4 TAL

4.1 Background

The Commission examined how TAL Life Limited (TAL) handled claims made by three people under income protection policies. The Commission

³²¹ CBA, Module 6 Case Study Submission, 11 [43].

heard evidence from Ms Loraine van Eeden, the General Manager of Claims. Ms van Eeden made three statements to the Commission. Only two of those statements were tendered; the person to whom the third statement related did not wish to have their circumstances examined by the Commission.³²²

4.2 Evidence

4.2.1 The first insured

The first insured applied for an income protection policy from TAL in February 2009.³²³ In the online application form that she completed, she was asked a number of questions about her personal history. One of those questions asked whether she had, or had ever had, 'depression, anxiety, panic attacks, stress, psychosis, schizophrenia, bipolar disorder, attempted suicide, chronic fatigue, postnatal depression or any other mental or nervous disorder'.³²⁴ She answered 'no'.³²⁵ TAL offered the insured income protection cover, which she accepted.³²⁶

In May 2010, the insured made a claim under her policy for stress-induced depression and anxiety, which was tied to circumstances at her workplace.³²⁷ Along with her claim form, the insured provided TAL with a letter from her GP, which explained that she had a generalised anxiety disorder that prevented her from working, and indicated that her condition was a 'new onset illness'.³²⁸

Pursuant to an authority provided by the insured, TAL began bringing in her medical records, and records about a related workers' compensation claim.³²⁹ Ms van Eeden accepted that until 2013, it was TAL's practice to

³²² Transcript, Loraine van Eeden, 13 September 2018, 5661.

³²³ Transcript, Loraine van Eeden, 13 September 2018, 5672.

³²⁴ Transcript, Loraine van Eeden, 13 September 2018, 5673.

³²⁵ Transcript, Loraine van Eeden, 13 September 2018, 5673.

³²⁶ Transcript, Loraine van Eeden, 13 September 2018, 5675.

³²⁷ Transcript, Loraine van Eeden, 13 September 2018, 5675.

³²⁸ Transcript, Loraine van Eeden, 13 September 2018, 5677.

³²⁹ Transcript, Loraine van Eeden, 13 September 2018, 5677.

bring in extensive medical information about a claimant for the purpose of determining whether the policy could be avoided on the basis of non-disclosure.³³⁰ She agreed that this practice was not acceptable.³³¹ In September 2016, TAL had introduced a formal guideline relating to investigations. Under this guideline, TAL authorised case managers to undertake a ‘general review’ even where there were ‘no inconsistencies identified’ between the underwriting disclosures and the claim information, ‘to ensure there [was] no adverse non-disclosure’.³³² Ms van Eeden conceded that these reviews amounted to ‘fishing expeditions’ by case managers,³³³ and that TAL had engaged in a ‘fishing expedition’ in relation to this insured’s claim.³³⁴

Based on the information obtained by the case manager, the case manager formed the view that the insured may have failed to disclose a pre-existing history of ‘work-related stress’ when applying for her policy, and answered the ‘mental health’ question inaccurately.³³⁵ Ms van Eeden did not agree with this assessment.³³⁶ Despite the insured’s attempts to address TAL’s concerns,³³⁷ TAL relied on section 29(3) of the Insurance Contracts Act to avoid the policy, on the basis that the insured had breached her duty of disclosure and had made a misrepresentation.³³⁸

The insured applied to TAL for internal review of the decision.³³⁹ In November 2010, TAL’s internal dispute resolution (IDR) team confirmed the initial decision.³⁴⁰ Upon reviewing the letter that TAL’s IDR team sent to the

³³⁰ Transcript, Loraine van Eeden, 13 September 2018, 5667.

³³¹ Transcript, Loraine van Eeden, 13 September 2018, 5668.

³³² Transcript, Loraine van Eeden, 13 September 2018, 5680.

³³³ Transcript, Loraine van Eeden, 13 September 2018, 5681; cf TAL, Module 6 Case Study Submission, 5–7 [14]–[20].

³³⁴ Transcript, Loraine van Eeden, 13 September 2018, 5682.

³³⁵ Transcript, Loraine van Eeden, 13 September 2018, 5682, 5688.

³³⁶ Transcript, Loraine van Eeden, 13 September 2018, 5688.

³³⁷ Transcript, Loraine van Eeden, 13 September 2018, 5685–6.

³³⁸ Transcript, Loraine van Eeden, 13 September 2018, 5689.

³³⁹ Transcript, Loraine van Eeden, 13 September 2018, 5690.

³⁴⁰ Transcript, Loraine van Eeden, 13 September 2018, 5690.

insured, Ms van Eeden agreed that the IDR team had not seriously engaged with the insured's request for internal review, and that the letter merely reiterated the claims team's decision.³⁴¹

In February 2011, the insured lodged a complaint with FOS about the avoidance of her policy.³⁴² As part of this process, the insured provided extensive medical material to TAL.³⁴³ Ms van Eeden accepted that this material provided a comprehensive response to the allegations being put by TAL against the insured.³⁴⁴ Despite this, TAL continued to defend the FOS dispute.³⁴⁵

On 5 October 2012, more than two years after the insured had made her claim to TAL, FOS delivered a recommendation in favour of the insured, finding that TAL was not entitled to avoid her policy.³⁴⁶ TAL rejected the Recommendation.³⁴⁷ Ms van Eeden conceded that this decision was inappropriate.³⁴⁸ FOS later delivered a determination in favour of the insured,³⁴⁹ directing TAL to reinstate her policy and to pay her benefits, with interest.³⁵⁰

Following this, TAL did a number of things that were inconsistent with the determination, including:

- requesting that the insured repay premiums that TAL had previously refunded in order for her claim to be assessed;³⁵¹

³⁴¹ Transcript, Loraine van Eeden, 13 September 2018, 5690.

³⁴² Transcript, Loraine van Eeden, 13 September 2018, 5691.

³⁴³ Transcript, Loraine van Eeden, 13 September 2018, 5692–3.

³⁴⁴ Transcript, Loraine van Eeden, 13 September 2018, 5693.

³⁴⁵ Transcript, Loraine van Eeden, 13 September 2018, 5693.

³⁴⁶ Transcript, Loraine van Eeden, 13 September 2018, 5695–6.

³⁴⁷ Transcript, Loraine van Eeden, 13 September 2018, 5697.

³⁴⁸ Transcript, Loraine van Eeden, 13 September 2018, 5698.

³⁴⁹ Transcript, Loraine van Eeden, 13 September 2018, 5698.

³⁵⁰ Transcript, Loraine van Eeden, 13 September 2018, 5698.

³⁵¹ Transcript, Loraine van Eeden, 13 September 2018, 5699.

- failing to promptly assess all aspects of her claim;³⁵² and
- failing to pay interest in the correct sum and for the full period.³⁵³

Ms van Eeden agreed that TAL should have moved more quickly to put the insured in the position that she would have been in had TAL assessed her claim correctly three years earlier.³⁵⁴

In November 2013, about eight months after the FOS determination, TAL began to conduct surveillance of the insured. The surveillance lasted for at least four months,³⁵⁵ and included both ‘desktop’ and physical surveillance.³⁵⁶ Ms van Eeden accepted that the surveillance authorised by TAL in this case was ‘deeply inappropriate’,³⁵⁷ and that the material reported to TAL was ‘very personal and highly intrusive’ on the insured’s privacy.³⁵⁸

In December 2013, while the surveillance was continuing, TAL asked the insured to complete a daily activity diary, commencing from 4 November 2013.³⁵⁹ Ms van Eeden accepted that this was another attempt by TAL to disprove the insured’s entitlement to benefits.³⁶⁰ Despite the insured having provided TAL with medical evidence that the daily diary was exacerbating her state of anxiety and was probably having a negative impact on her health,³⁶¹ TAL continued to insist on completion of the diary.³⁶²

³⁵² Transcript, Loraine van Eeden, 13 September 2018, 5701.

³⁵³ Transcript, Loraine van Eeden, 13 September 2018, 5702.

³⁵⁴ Transcript, Loraine van Eeden, 13 September 2018, 5703.

³⁵⁵ Transcript, Loraine van Eeden, 13 September 2018, 5707.

³⁵⁶ Transcript, Loraine van Eeden, 13 September 2018, 5708–11.

³⁵⁷ Transcript, Loraine van Eeden, 13 September 2018, 5711.

³⁵⁸ Transcript, Loraine van Eeden, 13 September 2018, 5710.

³⁵⁹ Transcript, Loraine van Eeden, 13 September 2018, 5711.

³⁶⁰ Transcript, Loraine van Eeden, 13 September 2018, 5714.

³⁶¹ Transcript, Loraine van Eeden, 13 September 2018, 5714.

³⁶² Transcript, Loraine van Eeden, 13 September 2018, 5717.

Ms van Eeden accepted that this resulted in harm to the insured,³⁶³ and accepted that some of the case manager's communications with the insured about the diary amounted to bullying.³⁶⁴ Ms van Eeden also accepted that the case manager misrepresented to the insured that completion of the diary was a term of her policy.³⁶⁵

The insured made a further complaint to FOS about TAL's insistence that she complete a daily diary.³⁶⁶ TAL told FOS that it was standard practice in the industry to require the completion of a diary.³⁶⁷ Ms van Eeden accepted that it was not, and was unable to say why TAL had misrepresented the position to FOS.³⁶⁸

In March 2014, while the second FOS dispute was continuing, TAL informed the insured that she no longer met the definition of 'total disablement', that it would cease paying benefits to her, and that she would be required to repay \$69,000 in benefits that she had been paid to date.³⁶⁹ In support of its decision, TAL relied upon section 56(1) of the Insurance Contracts Act, which applies to fraudulent claims.³⁷⁰

Ms van Eeden accepted that the insured's claim had not been made fraudulently,³⁷¹ and that the communication of these matters would have caused 'considerable distress' to the insured.³⁷² Ms van Eeden also agreed that by this time, the case manager managing the insured's case had no regard for the wellbeing of the insured, and was on a mission to stop her from receiving benefits under the policy.³⁷³

³⁶³ Transcript, Loraine van Eeden, 13 September 2018, 5719.

³⁶⁴ Transcript, Loraine van Eeden, 13 September 2018, 5717.

³⁶⁵ Transcript, Loraine van Eeden, 13 September 2018, 5718.

³⁶⁶ Transcript, Loraine van Eeden, 13 September 2018, 5717.

³⁶⁷ Transcript, Loraine van Eeden, 13 September 2018, 5721.

³⁶⁸ Transcript, Loraine van Eeden, 13 September 2018, 5721.

³⁶⁹ Transcript, Loraine van Eeden, 14 September 2018, 5732.

³⁷⁰ Transcript, Loraine van Eeden, 13 September 2018, 5724.

³⁷¹ Transcript, Loraine van Eeden, 13 September 2018, 5724.

³⁷² Transcript, Loraine van Eeden, 13 September 2018, 5726.

³⁷³ Transcript, Loraine van Eeden, 14 September 2018, 5734–5.

In April 2014, TAL declined an invitation from FOS to participate in a conciliation conference with a view to resolving the insured's claim.³⁷⁴ In November 2014, FOS delivered its Recommendation in the second dispute. FOS found that the insured had not made a fraudulent claim, that it was not fair and reasonable to require her to complete the diary, and that she remained entitled to benefits.³⁷⁵ TAL challenged the Recommendation insofar as it related to the diary.³⁷⁶ The matter proceeded to a determination, where FOS again found in favour of the insured.³⁷⁷ After the determination, TAL again failed to calculate the payment of interest correctly.³⁷⁸

Since the determination, TAL has continued to engage in heavy-handed tactics in relation to the insured's claim,³⁷⁹ and has continued to make several mis-steps in relation to the insured that it attributes to systems or administrative issues.³⁸⁰ These have included failing to provide the insured with monthly statements, failing to pay the insured her benefits in a timely manner, and informing the insured that she was required to pay her premiums, despite being on claim.³⁸¹ Perhaps most worryingly, shortly after Ms van Eeden gave evidence, TAL wrote to the insured, advising her that she had failed to pay her quarterly premium by the due date, and saying that if she did not remedy this by 23 November 2018, she would 'no longer be covered' under her policy, and '[a]ny claims made after this date *cannot* be paid'.³⁸²

³⁷⁴ Transcript, Loraine van Eeden, 14 September 2018, 5741.

³⁷⁵ Transcript, Loraine van Eeden, 14 September 2018, 5742.

³⁷⁶ Transcript, Loraine van Eeden, 14 September 2018, 5745.

³⁷⁷ Transcript, Loraine van Eeden, 14 September 2018, 5747.

³⁷⁸ Transcript, Loraine van Eeden, 14 September 2018, 5749.

³⁷⁹ Cf Transcript, Loraine van Eeden, 14 September 2018, 5751.

³⁸⁰ Transcript, Loraine van Eeden, 14 September 2018, 5757.

³⁸¹ Transcript, Loraine van Eeden, 14 September 2018, 5757.

³⁸² Exhibit 6.483, 23 October 2018, Letter TAL Missed Premium Payments 19092018.pdf.

Overall, Ms van Eeden accepted that TAL's conduct was a 'deeply troubling response to a legitimate mental health claim', and that it involved 'a series of wrong decisions' and 'very troubling breaches of the insured's privacy'.³⁸³ Ms van Eeden accepted that the poor conduct extended 'over a significant number of years' and involved 'numerous TAL employees'.³⁸⁴ She also accepted that TAL did not impose disciplinary consequences on the case manager who had authorised and overseen the surveillance of the insured, misrepresented terms of the insured's policy, insisted upon use of the daily diary and used bullying tactics against the insured,³⁸⁵ nor on a subsequent case manager who had managed the file and other files in a way that was of concern to her superiors.³⁸⁶

4.2.2 The second insured

The second insured took out a TAL income protection policy in October 2013.³⁸⁷ At the time that she obtained the policy, she was asked whether she had 'ever had or received medical advice or treatment' for a significant number of health conditions, including 'depression, anxiety, panic attacks ... or any other mental or nervous condition'.³⁸⁸ She answered 'no'.³⁸⁹

In mid-December 2013, the insured was diagnosed with cervical cancer.³⁹⁰ She made a claim on her policy in January 2014.³⁹¹ From January to May 2014, TAL paid the claim.³⁹² Throughout this period, TAL brought in and

³⁸³ Transcript, Loraine van Eeden, 14 September 2018, 5758.

³⁸⁴ Transcript, Loraine van Eeden, 14 September 2018, 5758.

³⁸⁵ Transcript, Loraine van Eeden, 14 September 2018, 5746, 5754; see also Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 27–8 [189(a)], 30 [193].

³⁸⁶ Transcript, Loraine van Eeden, 14 September 2018, 5752–4.

³⁸⁷ Transcript, Loraine van Eeden, 14 September 2018, 5763.

³⁸⁸ Transcript, Loraine van Eeden, 14 September 2018, 5764.

³⁸⁹ Transcript, Loraine van Eeden, 14 September 2018, 5764.

³⁹⁰ Transcript, Loraine van Eeden, 14 September 2018, 5763.

³⁹¹ Transcript, Loraine van Eeden, 14 September 2018, 5763.

³⁹² Transcript, Loraine van Eeden, 14 September 2018, 5763.

reviewed information about the insured's medical history.³⁹³ TAL ostensibly did this because the insured's claim was made in close proximity to the risk commencement date.³⁹⁴ However, Ms van Eeden accepted that this was another general review, or 'fishing expedition', conducted by the case manager.³⁹⁵ That this is the proper characterisation of what was done was reinforced by the fact that the medical information brought in was not confined to information relevant to the claimed condition.³⁹⁶ TAL did not tell the insured that it was conducting these investigations.³⁹⁷

At the end of June 2014, without giving the insured notice, TAL avoided her contract of insurance on the basis that she had failed to disclose a prior history of depression.³⁹⁸ Ms van Eeden accepted that at this time, TAL generally did not give policyholders an opportunity to provide information prior to their policy being avoided for non-disclosure, and that this was a systemic deficiency within TAL.³⁹⁹

TAL first communicated this decision to the insured by phone.⁴⁰⁰ After listening to a recording of the call, Ms van Eeden acknowledged that:

- TAL had not informed the insured of its decision in an appropriate way;⁴⁰¹
- there had been a lack of empathy and lack of sensitivity towards the insured's situation;⁴⁰²

³⁹³ Transcript, Loraine van Eeden, 14 September 2018, 5766.

³⁹⁴ Transcript, Loraine van Eeden, 14 September 2018, 5766.

³⁹⁵ Transcript, Loraine van Eeden, 14 September 2018, 5766.

³⁹⁶ Transcript, Loraine van Eeden, 14 September 2018, 5766.

³⁹⁷ Transcript, Loraine van Eeden, 14 September 2018, 5766.

³⁹⁸ Transcript, Loraine van Eeden, 14 September 2018, 5763.

³⁹⁹ Transcript, Loraine van Eeden, 14 September 2018, 5770.

⁴⁰⁰ Transcript, Loraine van Eeden, 14 September 2018, 5769.

⁴⁰¹ Transcript, Loraine van Eeden, 14 September 2018, 5769.

⁴⁰² Transcript, Loraine van Eeden, 14 September 2018, 5770.

- the situation was compounded by the insured's case manager having left her with the impression that she might need to pay back the benefits that she had received from TAL under the policy;⁴⁰³ and
- overall, the way in which the phone call was handled fell below community standards and expectations.⁴⁰⁴

TAL subsequently sent a letter to the insured confirming that her policy would be avoided.⁴⁰⁵ In that letter, TAL asserted that the insured had breached her duty of good faith under section 13 of the Insurance Contracts Act.⁴⁰⁶

Ms van Eeden acknowledged that this assertion was itself a breach by TAL of its duty of utmost good faith.⁴⁰⁷ Ms van Eeden also acknowledged that until recently, if TAL declined a claim for non-disclosure, its communications to the policyholder would generally allege that they had breached their duty of good faith.⁴⁰⁸ Ms van Eeden conceded that there would have been many cases of innocent non-disclosure in which this allegation was made, and which would have been very unfair to the policyholder.⁴⁰⁹

The letter to the insured emphasised that TAL reserved its right to recover the payments it had made to her.⁴¹⁰ Until about 2017, it had been TAL's practice to reserve its right to repayment of benefits where it avoided a policy for non-disclosure.⁴¹¹

The insured challenged TAL's decision to avoid the policy in FOS.⁴¹² While the FOS dispute was continuing, TAL undertook further investigations into

⁴⁰³ Transcript, Loraine van Eeden, 14 September 2018, 5770.

⁴⁰⁴ Transcript, Loraine van Eeden, 14 September 2018, 5770.

⁴⁰⁵ Transcript, Loraine van Eeden, 14 September 2018, 5771.

⁴⁰⁶ Transcript, Loraine van Eeden, 14 September 2018, 5771.

⁴⁰⁷ Transcript, Loraine van Eeden, 14 September 2018, 5772.

⁴⁰⁸ Transcript, Loraine van Eeden, 14 September 2018, 5772.

⁴⁰⁹ Transcript, Loraine van Eeden, 14 September 2018, 5772.

⁴¹⁰ Transcript, Loraine van Eeden, 14 September 2018, 5772.

⁴¹¹ Transcript, Loraine van Eeden, 14 September 2018, 5773.

⁴¹² Transcript, Loraine van Eeden, 14 September 2018, 5763.

the insured's disclosures.⁴¹³ Ms van Eeden accepted that TAL did so to try to find a basis for avoidance that was directly related to the claimed condition.⁴¹⁴

In particular, TAL sought a further retrospective underwriting opinion in relation to some symptoms experienced by the insured prior to entering into the policy, which TAL considered may have been indicative of cervical cancer.⁴¹⁵ The underwriter advised that if those symptoms had been disclosed, the insured's application for a policy would have been refused on that basis,⁴¹⁶ potentially providing TAL with an alternative basis for avoiding the contract of insurance.⁴¹⁷ Upon receiving the opinion, TAL's General Manager of Claims expressed some concern about TAL 'trying to make retrospective decisions when the facts at the time were different'.⁴¹⁸

In April 2015, TAL and the insured attended a FOS conciliation conference.⁴¹⁹ Despite having known of the proposed additional basis for avoidance for at least two weeks, TAL only told the insured of it on the day before the conference.⁴²⁰ Ms van Eeden did not know whether this was a strategic decision by TAL, but accepted that it was part of a broader pattern of delay in TAL's dealings with FOS in this matter.⁴²¹ Following the conciliation conference, TAL and the insured settled the dispute by TAL waiving its right to recover the \$25,000 paid to the insured, and paying her a further \$25,000.⁴²²

⁴¹³ Transcript, Loraine van Eeden, 14 September 2018, 5776.

⁴¹⁴ Transcript, Loraine van Eeden, 14 September 2018, 5776.

⁴¹⁵ Transcript, Loraine van Eeden, 14 September 2018, 5777.

⁴¹⁶ Transcript, Loraine van Eeden, 14 September 2018, 5777.

⁴¹⁷ Transcript, Loraine van Eeden, 14 September 2018, 5777.

⁴¹⁸ Transcript, Loraine van Eeden, 14 September 2018, 5777.

⁴¹⁹ Exhibit 6.179, Witness statement of Loraine van Eeden, 31 August 2018, 26 [96].

⁴²⁰ Transcript, Loraine van Eeden, 14 September 2018, 5778.

⁴²¹ Transcript, Loraine van Eeden, 14 September 2018, 5778.

⁴²² Transcript, Loraine van Eeden, 14 September 2018, 5778.

4.2.3 The third insured

As I have already mentioned, no statement was tendered in respect of the third insured's case. Accordingly, the cross-examination in this part of the case study focused upon a number of acknowledgments made by TAL in a signed, but untendered, statement.

First, TAL's Claims Decision Committee had determined to avoid the insured's policy, but before that decision was communicated to the insured, the case manager added some additional grounds for avoidance, namely an alleged non-disclosure of a mental health condition.⁴²³ This additional information was derived from the contents of an underwriting opinion obtained by the case manager, which was inconsistent with the Committee's decision.⁴²⁴ The case manager then communicated that revised position to the insured.⁴²⁵

Ms van Eeden accepted that the case manager should not have communicated the content of the underwriting decision, rather than the decision of the Committee, to the insured, and that this fell below what the community would expect.⁴²⁶ Ms van Eeden attributed this to a lack of oversight of, and rigour in, the case manager's decision-making process.⁴²⁷

Second, following TAL's decision to avoid the insured's policy, the insured applied for internal review of that decision.⁴²⁸ Following that internal review, the file was returned to the original case manager.⁴²⁹ That case manager undertook a review of the file that extended beyond the recommendation made by TAL's IDR team.⁴³⁰ Ms van Eeden accepted that the case manager's failure to conduct a review in accordance with the IDR team's

⁴²³ Transcript, Loraine van Eeden, 14 September 2018, 5780.

⁴²⁴ Transcript, Loraine van Eeden, 14 September 2018, 5780.

⁴²⁵ Transcript, Loraine van Eeden, 14 September 2018, 5781.

⁴²⁶ Transcript, Loraine van Eeden, 14 September 2018, 5780–1.

⁴²⁷ Transcript, Loraine van Eeden, 14 September 2018, 5780.

⁴²⁸ Transcript, Loraine van Eeden, 14 September 2018, 5781.

⁴²⁹ Transcript, Loraine van Eeden, 14 September 2018, 5781.

⁴³⁰ Transcript, Loraine van Eeden, 14 September 2018, 5781.

recommendation fell below what the community would expect.⁴³¹ She said that TAL was revising its processes to ensure that claims are no longer remitted from its IDR team back to the original case manager, to improve independence in the decision-making process.⁴³²

Third, Ms van Eeden acknowledged that, in light of both of these matters, TAL's decision to defend the insured's matter in FOS fell below community standards and expectations.⁴³³

Fourth, similarly to the case of the first insured, Ms van Eeden accepted that TAL knew about, but did nothing to stop, the inappropriate approach that had been adopted by TAL in response to the insured's claim.⁴³⁴

Fifth, similarly to the case of the second insured, Ms van Eeden accepted that TAL should have handled the insured's claim with greater sensitivity and empathy.⁴³⁵

4.2.4 The audit of declined mental health claims

As a result of the issues raised in these case studies, Ms van Eeden said that she will review all mental health claims that TAL declined for non-disclosure between 2013 and 2016 to ensure that appropriate processes were followed.⁴³⁶

4.3 What the case study showed

This case study showed how TAL had dealt with separate claims under three income protection policies. The claimants had different medical conditions. The case study raised several broader questions about TAL's policies and procedures.

⁴³¹ Transcript, Loraine van Eeden, 14 September 2018, 5781.

⁴³² Transcript, Loraine van Eeden, 14 September 2018, 5781–2.

⁴³³ Transcript, Loraine van Eeden, 14 September 2018, 5783.

⁴³⁴ Transcript, Loraine van Eeden, 14 September 2018, 5783.

⁴³⁵ Transcript, Loraine van Eeden, 14 September 2018, 5784.

⁴³⁶ Transcript, Loraine van Eeden, 14 September 2018, 5783.

Much of TAL's conduct was rightly acknowledged as problematic by TAL in the statements that it provided to the Commission, in the course of cross-examination, or in TAL's subsequent submissions to the Commission.

4.3.1 Misconduct

In relation to the first insured, TAL acknowledged on numerous occasions that it had breached its duty of utmost good faith towards the insured, breached professional standards, and engaged in conduct that was misleading.⁴³⁷ These breaches all stemmed from TAL's 'approach of seeking to avoid the claim, rather than to support the insured'.⁴³⁸ TAL accepted that this was evidenced by numerous types of inappropriate conduct, including:⁴³⁹

- the engagement of, and inappropriate use of, and instructions to, external investigators;
- the excessive use of surveillance;
- bullying tactics and offensive communications;⁴⁴⁰
- misrepresentation of policy terms; and
- misuse of the daily activities diary.

All these acknowledgments were properly made.

In relation to the second insured, TAL accepted that it may have breached its duty of utmost good faith by telling the second insured, when it avoided her contract of insurance, that she had breached her duty of utmost good

⁴³⁷ Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 27–8 [188]–[189(a)]; Transcript, Loraine van Eeden, 14 September 2018, 5747–8; TAL, Module 6 Case Study Submission, 1–3 [4]–[5].

⁴³⁸ TAL, Module 6 Case Study Submission, 1 [4].

⁴³⁹ TAL, Module 6 Case Study Submission, 1–2 [4]; Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 27–8 [188]–[189(a)].

⁴⁴⁰ See also Transcript, Loraine van Eeden, 13 September 2018, 5718, Transcript, Loraine van Eeden, 14 September 2018, 5748.

faith.⁴⁴¹ At most, the second insured had innocently failed to disclose certain information about her medical history.⁴⁴² TAL accepted that this constituted a breach of its obligation of utmost good faith.⁴⁴³ Again, the concession was properly made.

I also consider TAL's broader concession about such communications to have been appropriately made. Until early 2017, TAL's standard practice was to tell policyholders whose contracts were being avoided under section 29 of the Insurance Contracts Act that they had breached their duty of good faith.⁴⁴⁴ TAL accepted that when it made this allegation against a policyholder in respect of an innocent non-disclosure, TAL breached its duty of utmost good faith to that policyholder.⁴⁴⁵ In its written submissions, TAL said that there were 'something less than 497 [cases] over a four year period' in which such allegations were made.⁴⁴⁶

In the course of Senior Counsel Assisting's closing address, I raised for consideration whether TAL's misleading and incorrect statement to FOS in relation to the first insured – namely, that the use of a daily activities diary was standard practice in the industry – was capable of constituting a breach of the contract between FOS and TAL, and therefore, misconduct.⁴⁴⁷ As TAL has conceded, 'there is no doubt an implied term of the contract between TAL and FOS that TAL would not knowingly make misrepresentations calculated to lead FOS into error'.⁴⁴⁸ Despite this, TAL submitted that it did not breach that term because the misleading statement was accompanied

⁴⁴¹ Transcript, Loraine van Eeden, 14 September 2018, 5772.

⁴⁴² Transcript, Loraine van Eeden, 14 September 2018, 5771–2.

⁴⁴³ Transcript, Loraine van Eeden, 14 September 2018, 5772; TAL, Module 6 Case Study Submission, 3 [6].

⁴⁴⁴ Transcript, Loraine van Eeden, 14 September 2018, 5772; TAL, Module 6 Case Study Submission, 3 [7].

⁴⁴⁵ Transcript, Loraine van Eeden, 14 September 2018, 5772; TAL, Module 6 Case Study Submission, 3 [7].

⁴⁴⁶ TAL, Module 6 Case Study Submission, 4 [8]; see also Exhibit 6.179, Witness statement of Loraine van Eeden, 31 August 2018, 2–3 [11].

⁴⁴⁷ Transcript, Commissioner, 21 September 2018, 6483; see also Transcript, Loraine van Eeden, 13 September 2018, 5721.

⁴⁴⁸ TAL, Module 6 Case Study Submission, 12 [40(a)].

by a concession that TAL would no longer require the first insured to complete the diary.⁴⁴⁹ I am not persuaded by this argument. The fact that TAL told FOS that it had decided not to press the first insured to complete the diary (a decision it later reversed),⁴⁵⁰ does not alter the misleading character of its statement about standard practice in the industry. In any event, irrespective of the contractual position, the statement about industry practice may well have been ‘misleading’ or ‘deceptive’ in the sense described in the Commission’s Terms of Reference, and if that was so, it would have been misconduct on this basis alone.

I refer TAL’s conduct to ASIC, pursuant to paragraph (a) of the Commission’s Terms of Reference, for ASIC to consider what action it can and should take.

I also raised for consideration whether TAL’s actions may have worsened the medical condition of the first insured, and whether this may constitute misconduct or conduct that fell below community standards and expectations.⁴⁵¹ TAL submitted that no such finding was open, because the most recent psychiatric report in evidence did not attribute to TAL any ‘responsibility for the observed decline in the First Insured’s mental health’.⁴⁵² This is unsurprising: the focus of the report was not on identifying causes of the first insured’s condition.⁴⁵³ However, the report did make clear that there was a marked deterioration in the first insured’s condition over the period of her engagement with TAL, and that the first insured had expressed ‘fearfulness and anger which was directed towards the insurance process’.⁴⁵⁴

⁴⁴⁹ TAL, Module 6 Case Study Submission, 12–13 [40(a)].

⁴⁵⁰ TAL, Module 6 Case Study Submission, 11 [35].

⁴⁵¹ Transcript, Commissioner Hayne, 21 September 2018, 6484.

⁴⁵² TAL, Module 6 Case Study Submission, 7 [22].

⁴⁵³ Exhibit 6.202, 13 July 2017, Report of Dr Anthony Dinnen.

⁴⁵⁴ Transcript, Loraine van Eeden, 14 September 2018, 5755–6; Exhibit 6.202, 13 July 2017, Report of Dr Anthony Dinnen.

Ms van Eeden accepted that TAL's actions towards the first insured were capable of causing her considerable distress,⁴⁵⁵ and that TAL failed to properly acknowledge her distress in some significant respects.⁴⁵⁶ I doubt that all of TAL's conduct towards the insured is properly characterised – as TAL would have it –⁴⁵⁷ as no more than TAL exercising rights it had under the insurance contract. Even if the conduct can be connected to TAL's contractual rights, the manner in which TAL exercised those rights may have exacerbated the first insured's condition. I consider that TAL's conduct fell below community standards and expectations.

4.3.2 Conduct falling below community standards and expectations

TAL's conduct fell below community standards and expectations in a number of other respects.

First, until 2017, TAL did not have adequate systems to train its case managers, or to oversee the actions of its case managers. In its statements and its submissions to the Commission, TAL accepted that this finding was open.⁴⁵⁸ In the case of the first and third insureds, this resulted in a number of inappropriate actions being taken, and a failure by TAL to correct those decisions in a timely manner.⁴⁵⁹

Second, at least until 2016, TAL did not have robust systems to avoid potential conflicts of interest. This is demonstrated by reference to two specific examples.

In the case of the first insured, TAL permitted a case manager to sit on the Claims Decision Committee when the Committee was reviewing that

⁴⁵⁵ Transcript, Loraine van Eeden, 13 September 2018, 5687, 5726; Transcript, Loraine van Eeden, 14 September 2018, 5756.

⁴⁵⁶ Transcript, Loraine van Eeden, 14 September 2018, 5761.

⁴⁵⁷ TAL, Module 6 Case Study Submission, 8 [23].

⁴⁵⁸ Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 30 [193]–[194]; TAL, Module 6 Case Study Submission, 8 [25].

⁴⁵⁹ Transcript, Loraine van Eeden, 14 September 2018, 5785; TAL, Module 6 Case Study Submission, 8–9 [25].

manager's recommendation. In its written submissions to the Commission, TAL accepted that this fell below community standards and expectations, because the Committee's 'decision-making should have been independent from the case manager'.⁴⁶⁰ I agree.

In the case of the third insured, TAL remitted claims to case managers after TAL's IDR team had essentially indicated that the case manager had taken the wrong approach.⁴⁶¹ In the course of cross-examination, Ms van Eeden accepted that it was inappropriate to 'remit[] a decision of the internal dispute resolution body to the person who has been found by them to have engaged in poor conduct'.⁴⁶² Despite this acceptance, TAL submitted that the practice did not fall below community standards and expectations, because it would not have been readily foreseeable during the period that the practice was employed that it was 'prejudicing the independence of the process'.⁴⁶³ To my mind, Ms van Eeden's concession was appropriate, and TAL's submission does not convince me to the contrary.

The third way in which TAL's conduct fell below community standards and expectations was its failure to have adequate systems in place to ensure that its IDR team conducted a robust analysis of declined claims, in a way that was independent of the claims team.⁴⁶⁴ In its written submissions, TAL accepted that its IDR team did not undertake a robust review of the decision to avoid the first insured's policy, but said that the evidence did not 'support a finding that there existed a systemic failure by the IDR team to conduct robust review of declined claims'.⁴⁶⁵ However, in Ms van Eeden's statements to the Commission, and under cross-examination, Ms van Eeden recognised that the IDR team had been 'embedded within the operational functions of TAL', that the team was 'not located in a way that enhanced any independence', and that the team was 'not sufficiently independent of

⁴⁶⁰ TAL, Module 6 Case Study Submission, 9 [27].

⁴⁶¹ Transcript, Loraine van Eeden, 14 September 2018, 5782.

⁴⁶² Transcript, Loraine van Eeden, 14 September 2018, 5782.

⁴⁶³ TAL, Module 6 Case Study Submission, 10 [29].

⁴⁶⁴ Transcript, Loraine van Eeden, 13 September 2018, 5690–1;
Transcript, Loraine van Eeden, 14 September 2018, 5760.

⁴⁶⁵ TAL, Module 6 Case Study Submission, 11 [33].

the business' at the time that the first insured made her claim.⁴⁶⁶ In my view, these acknowledgments show that TAL's IDR team was not set up in a way that promoted robust analysis of declined claims, independent of the claims team.⁴⁶⁷ And the fact is that TAL's IDR team did not make a robust analysis of the first insured's declined claim.

The fourth way in which TAL's conduct fell below community standards and expectations concerned its engagement with FOS. In its submissions, TAL accepted that it failed to engage with FOS in a frank and cooperative way in a number of respects, and that this was conduct that fell below community standards and expectations.⁴⁶⁸ As noted above, TAL made a misleading and incorrect statement to FOS in relation to the first insured, namely that the use of a daily activities diary was standard practice in the industry;⁴⁶⁹ TAL delayed in communicating to FOS the additional basis on which it was relying to avoid the second insured's policy;⁴⁷⁰ TAL refused to participate in a conciliation conference with the first insured;⁴⁷¹ and TAL in some respects failed to comply with FOS's decisions in respect of the first insured in a timely manner, or in some instances, until pushed by FOS to do so.⁴⁷² In my view, TAL was right to accept that each of these instances involved conduct that fell below community standards and expectations.

⁴⁶⁶ Transcript, Loraine van Eeden, 14 September 2018, 5760; see also Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 29 [190(a)], 30 [195].

⁴⁶⁷ Transcript, Loraine van Eeden, 13 September 2018, 5690–1; Transcript, Loraine van Eeden, 14 September 2018, 5760.

⁴⁶⁸ TAL, Module 6 Case Study Submission, 11 [34].

⁴⁶⁹ TAL, Module 6 Case Study Submission, 11 [35]; see also Transcript, Loraine van Eeden, 14 September 2018, 5758.

⁴⁷⁰ TAL, Module 6 Case Study Submission, 11 [36]; see also Transcript, Loraine van Eeden, 14 September 2018, 5778.

⁴⁷¹ TAL, Module 6 Case Study Submission, 11 [37]; see also Transcript, Loraine van Eeden, 14 September 2018, 5741.

⁴⁷² TAL, Module 6 Case Study Submission, 11 [38]; Transcript, Loraine van Eeden, 13 September 2018, 5697–8, 5700, 5702; Transcript, Loraine van Eeden, 14 September 2018, 5745, 5761.

Fifth, historically, TAL failed to afford policyholders an opportunity to address TAL before it avoided their policies.⁴⁷³ Until mid-2017, TAL generally failed to afford policyholders – including the second and third insureds – an opportunity to address TAL, and the material that TAL was relying upon, prior to TAL deciding to avoid their policy.⁴⁷⁴ Both in Ms van Eeden’s statement and in TAL’s submission to the Commission, it was accepted that this conduct fell below community standards and expectations.⁴⁷⁵

The sixth way in which TAL’s conduct fell below community standards and expectations concerned TAL’s communications with its policyholders. As acknowledged by TAL, several aspects of TAL’s communications with the first, second and third insureds fell below community standards and expectations. In relation to the first insured, TAL accepted that it communicated in a way that was inappropriate, bullying, threatening and misleading.⁴⁷⁶ In respect of the second and third insureds, TAL accepted that it failed to communicate in a sensitive and empathetic way that recognised the difficult circumstances that they were facing⁴⁷⁷ (for example by telling the second insured that she may have to repay the benefits that she had obtained under the policy).⁴⁷⁸

The seventh way in which TAL’s conduct fell below community standards and expectations concerned TAL’s systems and processes. TAL made

⁴⁷³ Transcript, Loraine van Eeden, 14 September 2018, 5770–1, 5784.

⁴⁷⁴ TAL, Module 6 Case Study Submission, 13 [41].

⁴⁷⁵ Exhibit 6.179, Witness statement of Loraine van Eeden, 31 August 2018, 27–8 [106], 29 [113(c)]; TAL, Module 6 Case Study Submission, 13 [41].

⁴⁷⁶ Transcript, Loraine van Eeden, 13 September 2018, 5717–18; Transcript, Loraine van Eeden, 14 September 2018, 5748; Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 27–9 [188]–[189]; see also TAL, Module 6 Case Study Submission, 14 [42].

⁴⁷⁷ Exhibit 6.179, Witness statement of Loraine van Eeden, 31 August 2018, 27 [103]; Transcript, Loraine van Eeden, 14 September 2018, 5784.

⁴⁷⁸ Transcript, Loraine van Eeden, 14 September 2018, 5770; see also TAL, Module 6 Case Study Submission, 14 [43(b)]. TAL made a similar statement to the first insured: see Transcript, Loraine van Eeden, 13 September 2018, 5726 and Transcript, Loraine van Eeden, 14 September 2018, 5732–4.

a number of administrative errors in respect of the first insured's case, including erroneously notifying her that her policy would be cancelled for non-payment of premiums.⁴⁷⁹ As is apparent from what I have said, these errors continued after Ms van Eeden gave evidence.⁴⁸⁰ Ms van Eeden acknowledged that these types of errors could have been a significant stressor for someone in the first insured's position, and could have impacted on her health.⁴⁸¹ TAL accepted, and I agree, that these errors constituted conduct that fell below community standards and expectations.⁴⁸²

4.3.3 Causes of the conduct

TAL accepted that a cause of much of the conduct referred to above was inadequate training and oversight of TAL case managers.⁴⁸³ Ms van Eeden accepted that at the time when the three claims were made – 2010, 2014 and 2015 – there was minimal oversight within TAL of its senior case managers.⁴⁸⁴ In addition, there were no structured ongoing training programs, nor any mandatory induction, at least in relation to TAL's claims philosophy.⁴⁸⁵ Ms van Eeden acknowledged that this was a serious flaw in TAL's systems.⁴⁸⁶

Another likely cause was the culture of TAL at the time that the claims were made. Ms van Eeden said that she was unable to speak to TAL's general culture during that period, as she was not employed by TAL at the time.⁴⁸⁷ However, Ms van Eeden accepted that there were multiple employees of TAL 'involved in extremely poor conduct across [the] three files over

⁴⁷⁹ Transcript, Loraine van Eeden, 14 September 2018, 5757.

⁴⁸⁰ Exhibit 6.483, 23 October 2018, Letter TAL Missed Premium Payments 19092018.pdf.

⁴⁸¹ Transcript, Loraine van Eeden, 14 September 2018, 5761.

⁴⁸² TAL, Module 6 Case Study Submission, 14–15 [44].

⁴⁸³ TAL, Module 6 Case Study Submission, 15 [46].

⁴⁸⁴ Transcript, Loraine van Eeden, 14 September 2018, 5759; see also TAL, Module 6 Case Study Submission, 15 [46(c)].

⁴⁸⁵ Transcript, Loraine van Eeden, 14 September 2018, 5759; Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 30 [194]; TAL, Module 6 Case Study Submission, 15 [46(a)–(b)].

⁴⁸⁶ Transcript, Loraine van Eeden, 14 September 2018, 5760.

⁴⁸⁷ Transcript, Loraine van Eeden, 14 September 2018, 5736.

different periods of time'.⁴⁸⁸ These included people at a number of levels of the business, from the claims team, the IDR team and the EDR team.⁴⁸⁹ Ms van Eeden accepted that the fact that there were 'so many problems with so many people involved over such a lengthy period of time [was] quite telling [in terms of] TAL's culture'.⁴⁹⁰ To my mind, the matters raised by TAL in its written submissions do not detract from this.⁴⁹¹

A further cause of the conduct was a lack of independence in some parts of TAL's decision-making processes.⁴⁹² This was illustrated by TAL permitting a case manager to sit on the Claims Decision Committee when the Committee was reviewing that case manager's recommendation,⁴⁹³ TAL's willingness to remit claims to case managers after its IDR team had essentially indicated that the case manager had taken the wrong approach,⁴⁹⁴ and TAL historically having structured its IDR team and EDR team in a way that did not enhance their independence from TAL's business.⁴⁹⁵

Finally, TAL's conduct towards FOS indicates a culture within at least some parts of TAL that, at least at that time, had inadequate respect for FOS.⁴⁹⁶

⁴⁸⁸ Transcript, Loraine van Eeden, 14 September 2018, 5737.

⁴⁸⁹ Transcript, Loraine van Eeden, 14 September 2018, 5737, 5758, 5773–4, 5785–6.

⁴⁹⁰ Transcript, Loraine van Eeden, 14 September 2018, 5785.

⁴⁹¹ TAL, Module 6 Case Study Submission, 16–18 [47]–[54].

⁴⁹² TAL, Module 6 Case Study Submission, 18–19 [56]–[58].

⁴⁹³ TAL, Module 6 Case Study Submission, 9 [27].

⁴⁹⁴ Transcript, Loraine van Eeden, 14 September 2018, 5782.

⁴⁹⁵ Transcript, Loraine van Eeden, 14 September 2018, 5760.

⁴⁹⁶ Cf TAL, Module 6 Case Study Submission, 18 [55].

5 REST

5.1 Background

This case study concerned the conduct of the Retail Employees Superannuation Pty Limited, a registerable superannuation entity licensee and the trustee of Retail Employees Superannuation Trust (REST). The focus of the case study was the provision of life insurance, total and permanent disability (TPD), and income protection policies to REST members.

Lachlan Ross, Project Specialist in the REST Operations Team, gave evidence on REST's behalf.⁴⁹⁷ Additional statements of Natalie Binns, Paul Howard and Joseph de Bruyn were also tendered.⁴⁹⁸

REST is a large fund, with about two million members.⁴⁹⁹ Between 1.4 and 1.5 million of those members have group life insurance with REST.⁵⁰⁰ REST offers its members default life, TPD and income protection cover, through the fund.⁵⁰¹

Since 2004, AIA has been REST's group life insurer.⁵⁰² Mr Ross estimated that REST will pay AIA annual premiums of between \$750 million and \$800 million in the current policy year.⁵⁰³

The REST case study focused on particular clauses in the group life policies held by REST and the application of those clauses in particular cases.

⁴⁹⁷ Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, 1 [1].

⁴⁹⁸ Exhibit 6.229, Witness statement of Natalie Binns, 31 August 2018;
Exhibit 6.230, Witness statement of Paul Howard, 7 September 2018;
Exhibit 6.231, Witness statement of Joseph de Bruyn, 12 September 2018.

⁴⁹⁹ Transcript, Lachlan Ross, 14 September 2018, 5805.

⁵⁰⁰ Transcript, Lachlan Ross, 14 September 2018, 5805.

⁵⁰¹ Exhibit 6.229, Witness statement of Natalie Binns, 31 August 2018, 2–4 [7].

⁵⁰² Transcript, Lachlan Ross, 14 September 2018, 5806.

⁵⁰³ Transcript, Lachlan Ross, 14 September 2018, 5806.

5.2 Evidence

5.2.1 REST's minimum balance and prescribed employment status clauses

The first type of clause considered was described as a 'prescribed minimum balance clause', being a clause that requires the REST member to maintain a specified balance in their superannuation account in order to obtain or maintain insurance coverage. The second type of clause considered was described as a 'prescribed employment status clause'. That type of clause required a member to have a specified type of employment, or to work a minimum number of hours, in order to obtain or maintain coverage.

Until December 2017, the default policies offered to REST's members contained a prescribed minimum balance clause that operated in conjunction with a prescribed employment status clause.⁵⁰⁴ The operation of these clauses combined meant that if a member's balance fell below a certain amount – \$3,000 for TPD and \$1,200 for life – and a member was not working, or did not receive contributions from their employer, the member would lose default life and TPD cover after 71 days.⁵⁰⁵

Between 2013 and 2018, the operation of the prescribed minimum balance clause led to REST denying the death claims of 11 members and the TPD claims of 36 members.⁵⁰⁶

Once REST became aware that a member had ceased working, and had a balance below the minimum threshold, it ceased charging premiums to that member.⁵⁰⁷ However, if REST was not notified that a member had ceased working, it continued to deduct premiums from the member's account regardless of whether they had a balance below the minimum threshold.⁵⁰⁸

⁵⁰⁴ Transcript, Lachlan Ross, 14 September 2018, 5808, 5816.

⁵⁰⁵ Transcript, Lachlan Ross, 14 September 2018, 5808, 5815–6.

⁵⁰⁶ Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, 3 [7].

⁵⁰⁷ Transcript, Lachlan Ross, 14 September 2018, 5819.

⁵⁰⁸ Transcript, Lachlan Ross, 14 September 2018, 5820–2.

The operation of the prescribed minimum balance and prescribed employment status clauses was considered by reference to two examples.

The totally and permanently disabled member

In the first case, a REST member became totally and permanently disabled five days after his cover ceased.⁵⁰⁹ Until a claim was made, REST had not been aware that the member had ceased work.⁵¹⁰ REST had continued to deduct premiums up until the time of the member's claim.⁵¹¹ The claim was denied because of the operation of the prescribed minimum balance and prescribed employment status clauses.⁵¹² All premiums paid by the member after his coverage had ceased were refunded to him.⁵¹³

The paraplegic member

In the second case, the member had joined REST in 2005.⁵¹⁴ She became a paraplegic in May 2012 after falling from the fifth floor of a building.⁵¹⁵

After the member was injured, she received her 2012 REST annual statement.⁵¹⁶ The statement informed her that she had TPD coverage of \$108,000.⁵¹⁷ The statement did not mention the \$3,000 minimum

⁵⁰⁹ Transcript, Lachlan Ross, 14 September 2018, 5820–1.

⁵¹⁰ Transcript, Lachlan Ross, 14 September 2018, 5820–1; Exhibit 6.227, 10 November 2017, AIA Procedural Fairness Letter about Declining TPD, 2.

⁵¹¹ Transcript, Lachlan Ross, 14 September 2018, 5822.

⁵¹² Transcript, Lachlan Ross, 14 September 2018, 5822.

⁵¹³ Exhibit 6.227, 10 November 2017, AIA Procedural Fairness Letter about Declining TPD, 3.

⁵¹⁴ Transcript, Lachlan Ross, 14 September 2018, 5828.

⁵¹⁵ Transcript, Lachlan Ross, 14 September 2018, 5831.

⁵¹⁶ Exhibit 6.225, Witness statement of Lachlan Ross, 7 September 2018, Exhibit LGR-21 [RST.0013.0001.0047]; Transcript, Lachlan Ross, 14 September 2018, 5831.

⁵¹⁷ Exhibit 6.225, Witness statement of Lachlan Ross, 7 September 2018, Exhibit LGR-21 [RST.0013.0001.0047 at .0052]; Transcript, Lachlan Ross, 14 September 2018, 5832.

balance requirement.⁵¹⁸ Mr Ross gave evidence that this information ‘possibly’ should have been included in REST annual statements.⁵¹⁹

In January 2014, with the assistance of her lawyers, the member submitted a TPD claim to REST.⁵²⁰ It took REST six months to provide the claim to AIA.⁵²¹ Mr Ross gave evidence that this was ‘too long’⁵²² and that a delay of this length would now be unusual.⁵²³ After being notified of the claim, AIA had to follow up REST for further information on a number of occasions.⁵²⁴

In November 2014, AIA accepted the member’s claim, and transferred \$108,000 to REST.⁵²⁵ REST did not immediately notify the member.⁵²⁶

In December 2014, REST emailed AIA requesting that it review its decision.⁵²⁷ REST also refunded the \$108,000 to AIA.⁵²⁸ Mr Ross said that this communication was made because REST had realised that it had made an administrative mistake in relation to the member’s last employment date, and had failed to enter that date into its systems.⁵²⁹ Mr Ross said that he considered it appropriate for REST’s administrator to have acted as it did.⁵³⁰ He did not consider that conduct to be inconsistent with REST’s obligation to

⁵¹⁸ Transcript, Lachlan Ross, 14 September 2018, 5832–3.

⁵¹⁹ Transcript, Lachlan Ross, 14 September 2018, 5832–3.

⁵²⁰ Transcript, Lachlan Ross, 14 September 2018, 5834.

⁵²¹ Transcript, Lachlan Ross, 14 September 2018, 5834.

⁵²² Transcript, Lachlan Ross, 14 September 2018, 5834.

⁵²³ Transcript, Lachlan Ross, 14 September 2018, 5834.

⁵²⁴ Transcript, Lachlan Ross, 14 September 2018, 5834.

⁵²⁵ Exhibit 6.225, Witness statement of Lachlan Ross, 7 September 2018, Exhibit LGR-38 [RST.0010.0003.0099].

⁵²⁶ Transcript, Lachlan Ross, 14 September 2018, 5837.

⁵²⁷ Exhibit 6.225, Witness statement of Lachlan Ross, 7 September 2018, Exhibit LGR-41 [RST.0010.0003.0105].

⁵²⁸ Exhibit 6.225, Witness statement of Lachlan Ross, 7 September 2018, Exhibit LGR-41 [RST.0010.0003.0105].

⁵²⁹ Transcript, Lachlan Ross, 14 September 2018, 5836–7.

⁵³⁰ Transcript, Lachlan Ross, 14 September 2018, 5837.

do everything that is reasonable to pursue an insurance claim for the benefit of a beneficiary if the claim has a reasonable prospect of success.⁵³¹

AIA reviewed its decision and determined that the claim should be denied.⁵³²

The member later commenced litigation in the Supreme Court of New South Wales.⁵³³ After some time, and various amendments to the member's pleading, AIA settled the claim and paid the member the full amount insured.⁵³⁴

Mr Ross did not believe that REST failed to act in the best interests of the member, but said that with hindsight, he wished REST could have done more to get the benefit paid to the member sooner.⁵³⁵

A question arose during this case study as to whether REST did everything that is reasonable to pursue the member's claim, as is required by section 52(7)(d) of the *Superannuation Industry (Supervision) Act 1993* (Cth) (the SIS Act). Whether it did would turn on a number of factors, including on whether the claim had a reasonable prospect of success at any particular point. However where, as here, the intent of this part of the case was to explore the operation of particular types of clause and to consider at a more general level the role of the trustee in the handling of group life claims, it is unnecessary for me to form a concluded view on that issue. It is enough to say that the claim was factually difficult and that REST's records were incomplete and inaccurate (at least in some part due to incorrect data entry by REST or its administrator).⁵³⁶

⁵³¹ Transcript, Lachlan Ross, 14 September 2018, 5837.

⁵³² Transcript, Lachlan Ross, 14 September 2018, 5840.

⁵³³ Transcript, Lachlan Ross, 14 September 2018, 5843,
Transcript, Lachlan Ross, 17 September 2018, 5850.

⁵³⁴ Transcript, Lachlan Ross, 17 September 2018, 5850; Exhibit 6.225,
Witness statement of Lachlan Ross, 7 September 2018, 13 [53].

⁵³⁵ Transcript, Lachlan Ross, 17 September 2018, 5850.

⁵³⁶ Transcript, Lachlan Ross, 14 September 2018, 5836.

5.2.2 REST's definition of TPD

Another clause considered in the course of the case study was the clause defining 'totally and permanently disabled'. Mr Ross said that TPD insurance is the most complex type of group life insurance offered because the test is complicated.⁵³⁷

REST's definition of 'totally and permanently disabled' has three disjunctive limbs. The first limb has two elements. A person must be absent from work for a period of three consecutive months, and be so disabled that they are unlikely to engage in any occupation for which they are reasonably suited though education, training or experience.⁵³⁸ The second element of the first limb requires that the member be so disabled that it is unlikely that the member will ever engage in any reasonably suitable occupation. That limb is not unlike the definition of 'permanent incapacity' in the SIS Regulations.⁵³⁹ The second limb of REST's definition will be met if a member has suffered specific injuries, for example the loss of use of two hands or two feet.⁵⁴⁰ The third limb of the definition requires that the member be unable to perform at least two 'activities of daily living' –dressing, bathing, toileting, mobility or feeding – without assistance.⁵⁴¹

Mr Ross accepted that it was possible for a member to satisfy the first limb of REST's definition, but not the second or the third limbs.⁵⁴² However, REST will only assess a member's eligibility against the first limb if the

⁵³⁷ Transcript, Lachlan Ross, 17 September 2018, 5851.

⁵³⁸ Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0681].

⁵³⁹ *Superannuation Industry (Supervision) Regulations 1994* (Cth) reg 1.03C, which provides that a member is taken to be suffering permanent incapacity if the member's ill-health (whether physical or mental) makes it unlikely that the member will engage in gainful employment for which the member is reasonably qualified by education, training or experience.

⁵⁴⁰ Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0681].

⁵⁴¹ Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0682].

⁵⁴² Transcript, Lachlan Ross, 17 September 2018, 5852.

member satisfies REST that they have been in ‘Gainful Employment’ in the 13 months before the incident.⁵⁴³ REST defines ‘Gainful Employment’ as:⁵⁴⁴

Being employed for gain or reward in any business, trade, profession or employment for at least ten (10) hours per week. If a member does *not* meet the ‘Gainful Employment’ requirement, REST will assess their eligibility for TPD benefits under the second and third limb of REST’s definition, but not the first limb.⁵⁴⁵

In the last five years, REST has denied the death or TPD claims of 224 of its members based on the operation of its prescribed employment status clause, including the ‘Gainful Employment’ requirement.⁵⁴⁶

5.2.3 Income protection

REST provides default income protection cover to its members.⁵⁴⁷

Mr Ross considered that this form of insurance cover was particularly valuable to REST’s membership.⁵⁴⁸

A member may not claim the income protection benefit if that member is unemployed.⁵⁴⁹ Despite this, absent explicit notification that a member had ceased working, Mr Ross was not aware of any systems that REST had in place to detect and stop the deduction of income protection premiums for unemployed members.⁵⁵⁰ Mr Ross accepted that this meant that those members would be paying a premium for a policy on which they could not claim, but did not accept that income protection insurance would be ‘junk

⁵⁴³ Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0681].

⁵⁴⁴ Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0679].

⁵⁴⁵ Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0681].

⁵⁴⁶ Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, 11 [32].

⁵⁴⁷ Exhibit 6.229, Witness statement of Natalie Binns, 31 August 2018, 2–4 [7].

⁵⁴⁸ Transcript, Lachlan Ross, 17 September 2018, 5854.

⁵⁴⁹ Transcript, Lachlan Ross, 17 September 2018, 5854–5.

⁵⁵⁰ Transcript, Lachlan Ross, 17 September 2018, 5854–5.

insurance' in those circumstances.⁵⁵¹ In its submissions, REST resisted any finding that it should have systems in place to determine if a member might be unemployed and noted that it included warnings in member statements and on its website.⁵⁵²

In the last five years, REST declined 37 income protection claims due to the requirement for the claimant to be employed.⁵⁵³

5.2.4 Reasons for decisions – Death benefits

One of the topics addressed in the statement of Paul Howard was REST's process for giving reasons for decisions in response to complaints about the proposed payment of death benefits.⁵⁵⁴ After the case study concluded, REST provided a further statement of Mr Howard, which supplemented his earlier statement.⁵⁵⁵

The additional information provided in the supplementary statement included that, on 20 September 2018, REST filed a breach report with ASIC and the Australian Prudential Regulation Authority (APRA) in which REST said that it considered that it had inadvertently breached section 101(1)(c) of the SIS Act – which requires trustees to provide reasons for a decision in response to a complaint about the proposed payment of a death benefit.⁵⁵⁶ The statement says that REST considered that it may have breached that section 184 times since 15 March 2017.⁵⁵⁷

In the light of that evidence, I find that REST may have engaged in misconduct by breaching section 101(1)(c) of the SIS Act. Section 29E(1)(a)

⁵⁵¹ Transcript, Lachlan Ross, 17 September 2018, 5855.

⁵⁵² REST, Module 6 Case Study Submission, 12–13 [55]–[59].

⁵⁵³ Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, 15 [51].

⁵⁵⁴ Exhibit 6.230, Witness statement of Paul Howard, 7 September 2018, 3 [6].

⁵⁵⁵ Exhibit 6.422, Witness statement of Paul Howard, 20 September 2018, 4–6 [9]–[13], 5–6 [15].

⁵⁵⁶ Exhibit 6.422, Witness statement of Paul Howard, 20 September 2018, Exhibit PBH-63 [RST.0016.0003.0004].

⁵⁵⁷ Exhibit 6.422, Witness statement of Paul Howard, 20 September 2018, Exhibit PBH-63 [RST.0016.0003.0004 at .0004].

of that Act imposes a condition on the licences of all responsible superannuation entities to comply with various laws, including the SIS Act. It follows that REST may also have breached a condition imposed on its licence. In its submissions, REST accepted that such findings were open.⁵⁵⁸

REST's failure to comply with section 101(1)(c) and the licence condition imposed by section 29E(1)(a) was the direct result of its systems, in particular, the use of a template letter that was inadequately drafted.⁵⁵⁹

5.3 What the case study showed

The case study demonstrated the complexities faced by the administration of a group life insurance scheme within a large superannuation fund. It also demonstrated the profound effects for individual members from policy wording negotiated by superannuation trustees and group life insurers.

A point that emerged strongly from the evidence is that there are benefits to be gained from simplicity in key definitions, terms and exclusions. The simpler the term, the more readily it can be conveyed to members and the greater the prospect of members having an understanding of the extent of the cover.

Because group life insurance is, by definition, provided without advice and because it is attached to a passive and very long-term investment, the need for simplicity in the product and the effective communication of terms is heightened. Multi-limbed definitions that operate in combination with other definitions will always be more difficult for a trustee to explain, and for a member to comprehend, than a unitary definition.

Conversely, a definition of clear application – such as a prescribed minimum balance clause that operates without the engagement of other definitions – will be more readily capable of comprehension, provided the substance of the clause is clearly conveyed to a member in an appropriate way and with appropriate regularity.

It is important to recognise that group life insurance through superannuation – perhaps even more so in the case of large scale funds with a broad range

⁵⁵⁸ REST, Module 6 Case Study Submission, 15–16 [71]–[72].

⁵⁵⁹ Exhibit 6.422, Witness statement of Paul Howard, 20 September 2018, 1 [3(a)].

of members – is radically removed from a policy of insurance bought directly by a consumer and even more so than a policy taken out on advice.

None of that is to ignore that product pricing looms large in any negotiation or that changes to policy wording will sometimes have pricing effects. But it should also be remembered that the difficulties borne of complexity are not only a risk to the member. Complexities in policy terms generate complexity in policy administration.

Some of those complexities were demonstrated in the course of the case study. One was the difficulty in communicating accurately with members. Not infrequently REST has communicated with members in a way that did not accurately reflect the terms of the Group Life Policy.⁵⁶⁰ REST disclosed 52 separate miscommunication incidents affecting more than 48,500 members.⁵⁶¹

Mr Ross accepted that the operation of the minimum balance and prescribed employment status clauses made it complicated to communicate with members about their level of cover, and that this was one of the reasons that REST removed the prescribed minimum balance clause in December 2017.⁵⁶²

REST's submissions acknowledged both the importance of, and the difficulty in, communicating with members about aspects of group life insurance. REST said that 'there are many provisions of an insurance policy which will potentially be of critical importance to members, and there is no obvious means of communicating all of these provisions in another, easier to understand manner. This is a problem which is easy to identify but a perfect solution is elusive'.⁵⁶³

⁵⁶⁰ Exhibit 6.229, Witness statement of Natalie Binns, 31 August 2018, 36 [47], Exhibit NSB-37 [RST.0009.0004.3502].

⁵⁶¹ Exhibit 6.229, Witness statement of Natalie Binns, 31 August 2018, Exhibit NSB-37 [RST.0009.0004.3502].

⁵⁶² Transcript, Lachlan Ross, 14 September 2018, 5816.

⁵⁶³ REST, Module 6 Case Study Submission, 12–13 [56].

REST also noted that it could not ‘compel members to take an interest in their insurance arrangements’.⁵⁶⁴ So much may be accepted. But the circumstances in which group life cover is offered, including the statutory requirements for the provision of some types of cover to MySuper members,⁵⁶⁵ mean that it would be wrong for trustees to ‘assume that members will appreciate the value of the insurance cover provided to them ... and take an active interest in its management’, as REST does.⁵⁶⁶

Moreover, because premiums are deducted from member accounts, and because the purpose of those accounts is ultimately to provide an income in retirement, superannuation trustees should be vigilant in ascertaining that the premiums deducted are in fact payable by the member *before* the deduction is made. The standard is not one of perfection, but it is not adequate for trustees to assume that the data provided to them is correct, especially in the face of contrary evidence (for example, the absence of contributions for a period of time).

Continuing to deduct insurance premiums when a person is no longer covered by insurance may constitute a failure to perform the trustee’s duties and exercise the trustee’s powers in the best interests of the beneficiaries as required under section 52(2)(c) of the SIS Act. It may also constitute conduct falling below community standards and expectations.⁵⁶⁷ I make no finding that REST has engaged in misconduct or conduct falling below community standards and expectations of that type here. A more wide-ranging investigation would have been necessary in order for me to be satisfied of the relevant facts. The approach taken in the case study was to interrogate practices by reference to specific cases. That provided a useful lens through which to view the operation of the various clauses and practices, but does not cover sufficient factual ground to permit findings concerning section 52(2)(c).

⁵⁶⁴ REST, Module 6 Case Study Submission, 13 [57].

⁵⁶⁵ SIS Act s 68AA.

⁵⁶⁶ REST, Module 6 Case Study Submission, 13 [57].

⁵⁶⁷ Such conduct will constitute a breach of cls 4.24, 4.25 and 4.27 of the Insurance in Superannuation Voluntary Code of Practice once it comes into force.

Failing to communicate with members about key exclusions in a way that is likely to be comprehensible by most members, and with reasonable frequency, may also amount to conduct falling below community standards and expectations.⁵⁶⁸ Again, I need not make any specific findings about REST's communications here.

6 AMP

6.1 Background

This case study concerned group life insurance offered to members of the superannuation funds of AMP Superannuation Limited (AMP Super) and NM Superannuation Proprietary Limited (NM Super), the AMP Group's superannuation trustees. AMP Life Limited (AMP Life) is the group life insurer for all AMP Super funds and for some of NM Super's funds.⁵⁶⁹

AMP Life, a wholly owned subsidiary of AMP Limited, is the group life insurer for most members of the trustees' funds.⁵⁷⁰ It is also the administrator of all of AMP Super's funds, and some of NM Super's funds;⁵⁷¹ an arrangement Mr Paul Sainsbury, Group Executive, Wealth Solutions and Customer, for the AMP Group said had existed for 'a very long time'.⁵⁷²

⁵⁶⁸ This conduct would constitute a breach of cl 5.17 of the Insurance in Superannuation Voluntary Code of Practice once it comes into force.

⁵⁶⁹ Transcript, Paul Sainsbury, 17 September 2018, 5861.

⁵⁷⁰ Transcript, Paul Sainsbury, 17 September 2018, 5861.

⁵⁷¹ Transcript, Paul Sainsbury, 17 September 2018, 5861.

⁵⁷² Transcript, Paul Sainsbury, 17 September 2018, 5863–4.

As was seen in previous rounds of hearings, AMP Life is also the trustee's investment manager⁵⁷³ and members' funds are invested through policies issued through AMP Life.⁵⁷⁴

Mr Sainsbury said that one of AMP Life's responsibilities as administrator of the trustees' funds was to undertake 'assessments of potential insurers', recommend replacement insurance arrangements and assist the trustees to 'negotiate the terms and appointment with the preferred insurer' and to ensure compliance with Prudential Standard SPS 250, Insurance in Superannuation.⁵⁷⁵ That Prudential Standard requires, amongst other things, that a trustee be able to satisfy itself, and demonstrate to APRA, that the engagement of the insurer is conducted at arm's length and is in the best interests of beneficiaries.⁵⁷⁶

Mr Sainsbury was asked about the suitability of AMP Life to undertake tasks connected with the selection of the group life insurer and the assessment of the appropriateness of those arrangements as required by Prudential Standard SPS 250. Mr Sainsbury did not accept that a conflict arose by AMP Life undertaking the task of assessing and recommending its potential competitors.⁵⁷⁷ He said that there was sufficient separation of roles within AMP Life to satisfy the requirements of Prudential Standard SPS 250.⁵⁷⁸

⁵⁷³ To the extent it has not outsourced that role to another related party within the AMP Group.

⁵⁷⁴ Exhibit 6.486, 3 October 2017, [SIGNED] ART Financial Report 30 June 2017 Final 20170927.pdf, 15; Exhibit 5.434, 3 October 2017, [SIGNED] SST Financial Report 30 June 2017 Final 20170927.pdf, 21; Exhibit 6.487, 3 October 2017, [SIGNED] NMRF Financial Report 30 June 2017 Final 20170927.pdf, 15; Exhibit 6.488, 3 October 2017, [SIGNED] ProSuper Financial Report 30 June 2017 Final 20170927.PDF, 7; Exhibit 5.435, 3 October 2017, [SIGNED] SDF Financial Report 30 June 2017 Final 20170927.pdf, 16.

⁵⁷⁵ Exhibit 6.233, Witness statement of Paul Sainsbury, 10 September 2018, 17 [67].

⁵⁷⁶ Transcript, Paul Sainsbury, 17 September 2018, 5862; Exhibit 6.235, 15 November 2012, APRA, Prudential Standard SPS 250, 15 November 2012, 6 [23].

⁵⁷⁷ Transcript, Paul Sainsbury, 17 September 2018, 5863.

⁵⁷⁸ Transcript, Paul Sainsbury, 17 September 2018, 5863.

This issue was not directed at actual or potential misconduct by AMP Super or AMP Life, but rather to the adequacy of the current regulatory regime. It was not immediately clear how the AMP trustees could satisfy APRA that the arrangement with AMP Life was at arm's length. Indeed, Mr Sainsbury said that tenders for the provision of group life insurance to the members of the trustees' funds do not occur.⁵⁷⁹

Counsel Assisting posed a number of policy questions connected with the engagement of associated entities as group life insurers after the hearing. I have considered those questions in the chapter of Volume 1 of this Report that deals with the superannuation sector.

6.2 The case studies

The Commission heard evidence from Mr Sainsbury.⁵⁸⁰

Three issues were examined in the course of Mr Sainsbury's evidence. They were: the charging of higher premiums for delinked members where AMP is not aware of the member's smoker status, AMP's processes for ceasing to charge premiums once notified of a member's death, and the provision of default insurance to MySuper members.

6.2.1 Delinked members and smoker rates

A delinked employee is a fund member who was previously part of an employer superannuation plan, but was transferred to another plan after ceasing employment with the employer.⁵⁸¹

AMP defaulted delinked employees to a standard insurance rate.⁵⁸² Delinked employees were defaulted to this rate, Mr Sainsbury said, because AMP did not have a full understanding of the health of those members.⁵⁸³

⁵⁷⁹ Transcript, Paul Sainsbury, 17 September 2018, 5864.

⁵⁸⁰ Transcript, Paul Sainsbury, 17 September 2018, 5861.

⁵⁸¹ Transcript, Paul Sainsbury, 17 September 2018, 5864.

⁵⁸² Transcript, Paul Sainsbury, 17 September 2018, 5865.

⁵⁸³ Transcript, Paul Sainsbury, 17 September 2018, 5865.

Mr Sainsbury described the standard rate as being different to an ‘actual smoker rate’, although he accepted that for group life policies there were only two rates: the standard rate and the non-smoker rate.⁵⁸⁴ He also accepted that the only criterion applied in order to move a member from the standard rate to the non-smoker rate was the submission by the member of a non-smoker declaration.⁵⁸⁵ Mr Sainsbury agreed that what he called ‘the nuanced differences’ between the rates would be difficult for a member to understand.⁵⁸⁶

The issues in connection with default insurance rates for delinked members were examined, in part, by reference to a particular case. A delinked employee, who was a non-smoker, was informed by his financial adviser that he had been classified as a smoker.⁵⁸⁷ Until that point, the member was unaware that he was classified as a smoker.⁵⁸⁸ It was not stated on his annual statement.⁵⁸⁹ At the time of the discovery, the member was being charged \$2,600 in premiums per month.⁵⁹⁰ The premium reduced to \$1,600 per month on the member’s reclassification as a non-smoker.⁵⁹¹

Until then, the member had been charged almost \$77,000 in additional premiums.⁵⁹² AMP declined to refund this amount to the member on the basis that its records showed that the member was issued with the non-smoker declaration at the time of his delinking, and that it had ‘clearly’

⁵⁸⁴ Transcript, Paul Sainsbury, 17 September 2018, 5868–70, 5875.

⁵⁸⁵ Transcript, Paul Sainsbury, 17 September 2018, 5875.

⁵⁸⁶ Transcript, Paul Sainsbury, 17 September 2018, 5871.

⁵⁸⁷ Transcript, Paul Sainsbury, 17 September 2018, 5864;
Exhibit 6.236, 27 February 2013, Email Financial Planner to Planner Liaison.

⁵⁸⁸ Transcript, Paul Sainsbury, 17 September 2018, 5864.

⁵⁸⁹ Transcript, Paul Sainsbury, 17 September 2018, 5864.

⁵⁹⁰ Transcript, Paul Sainsbury, 17 September 2018, 5864.

⁵⁹¹ Transcript, Paul Sainsbury, 17 September 2018, 5864.

⁵⁹² Transcript, Paul Sainsbury, 17 September 2018, 5866, 5877;
Exhibit 6.242, 6 June 2014, AMP Premium Comparison Calculation.

explained what would happen to his insurance once he left his employer.⁵⁹³ This was the only occasion where the matter was drawn squarely to the member's attention.

Internal AMP documents of 2013 described AMP's failure to include the 'smoker status' in its annual statements as 'unethical'.⁵⁹⁴ Mr Sainsbury did not agree that it was unethical to fail to include the smoker status in annual member statements⁵⁹⁵ because members received a welcome letter on delinking, and were given an opportunity at that stage to elect non-smoking rates.⁵⁹⁶

The member subsequently lodged a complaint with the Superannuation Complaints Tribunal.⁵⁹⁷ AMP's position remained that it had acted appropriately and should not be required to refund the additional premiums.⁵⁹⁸ The Tribunal held that AMP had not acted fairly and reasonably in refusing to refund the customer.⁵⁹⁹

Mr Sainsbury accepted that it would have been better if annual statements disclosed the smoker status – particularly in circumstances where there was a very significant difference in the premium.⁶⁰⁰ In 2013 member statements were 'enhanced' to show the member whether or not they had been classified as a smoker for the purposes of their insurance policy.⁶⁰¹

⁵⁹³ Transcript, Paul Sainsbury, 17 September 2018, 5870–3; Exhibit 6.238, 15 March 2013, Letter AMP to Member Concerning 'Your Inquiry'; Exhibit 6.239, 14 October 2013, Internal AMP Emails Concerning SCT Complaint, September 2013.

⁵⁹⁴ Transcript, Paul Sainsbury, 17 September 2018, 5866; Exhibit 6.237, undated, Request for Reversal of Premium.

⁵⁹⁵ Transcript, Paul Sainsbury, 17 September 2018, 5866–7.

⁵⁹⁶ Transcript, Paul Sainsbury, 17 September 2018, 5866.

⁵⁹⁷ Exhibit 6.244, 6 May 2015, SCT Determination of Complaint; Exhibit 6.239, September 2013, Internal AMP Emails Concerning SCT Complaint.

⁵⁹⁸ Exhibit 6.244, 6 May 2015, SCT Determination of Complaint, 8 [46]; Exhibit 6.239, September 2013, Internal AMP Emails Concerning SCT Complaint.

⁵⁹⁹ Exhibit 6.244, 6 May 2015, SCT Determination of Complaint, 8–9.

⁶⁰⁰ Transcript, Paul Sainsbury, 17 September 2018, 5867.

⁶⁰¹ Transcript, Paul Sainsbury, 17 September 2018, 5878.

Mr Sainsbury was familiar with ASIC *Report 529*, entitled *Member Experience of Superannuation*, in which ASIC expressed the view that only 14.5% of adults were daily smokers, and that, in these circumstances, it was statistically appropriate to assume a person is not a smoker in the absence of other information about that member or group of members.⁶⁰² Mr Sainsbury was not aware of the trustees taking any step to implement that recommendation.⁶⁰³

In its written submissions, AMP resisted any finding that premiums were charged to members on a statistically inappropriate basis.⁶⁰⁴ In large part it did so by relying on facts and information not in evidence.⁶⁰⁵ It did that despite questions being put to AMP regarding smoker default settings on two occasions in the weeks before the sixth round of hearings commenced.⁶⁰⁶

AMP could not have been in doubt that issues connected with default settings and life premiums were of interest to the Commission. The questions put to AMP in Rubric 6-69 directly raised the issue of smoker status and default settings. AMP chose to respond with short answers.⁶⁰⁷ Mr Sainsbury's statement explained that hybrid rates usually apply where no non-smoking declaration is made.⁶⁰⁸ He explained the hybrid category as reflecting a group of customers where a portion are smokers and a portion are non-smokers.⁶⁰⁹ He also explained that premiums for the hybrid category fall between the smoker and non-smoker premium rates.⁶¹⁰

⁶⁰² Transcript, Paul Sainsbury, 17 September 2018, 5881–2.

⁶⁰³ Transcript, Paul Sainsbury, 17 September 2018, 5882–3.

⁶⁰⁴ AMP, Module 6 Case Study Submission, 7–8 [34]–[38].

⁶⁰⁵ AMP, Module 6 Case Study Submission, 7–8 [34]–[38].

⁶⁰⁶ The questions were first put to AMP on 16 August 2018 in the form of questions 11 to 15 of Rubric 6-69. See Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, 1 [1]. Additional questions 12A to 12C were then included by email dated 5 September 2018, and are answered in Mr Sainsbury's statement (Exhibit 6.234).

⁶⁰⁷ Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, 9–13 [35(b)], [42], [47], [48], [52], [53].

⁶⁰⁸ Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, 9 [35(c)].

⁶⁰⁹ Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, 9 [35(b)].

⁶¹⁰ Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, 9 [35(b)].

No further explanation was given of the method of calculation, for example, by demonstrating how the hybrid rate accounted for smoking rates and why that was statistically appropriate.

Having followed the course it did, I cannot form any concluded view about the force of the additional material AMP supplied so late in the day. Regardless of whether there was some arguable basis for charging the rates it did to persons who had not declared themselves not to be smokers, AMP's conduct in not disclosing the bases on which the particular premium was charged to this member merit the criticisms levelled against AMP.

What this part of the case study showed

In the case that proceeded to the Superannuation Complaints Tribunal, AMP did not communicate with the member in an effective way that he was being charged a higher premium because a non-smoking declaration had not been completed. Given the very significant differential in the premiums, it was incumbent on AMP to communicate that fact in a comprehensible way at reasonably regular intervals. It failed to do so. AMP's conduct fell below community standards and expectations.

The state of the evidence does not permit me to make findings that AMP may have engaged in misconduct or conduct falling below community standards and expectations beyond the case of the specific member. What can be said at a more general level is if a trustee did not ensure that the rates charged to members were based on appropriate statistical assumptions, the trustee's conduct would likely amount to a breach of one or more of the grounds set out in sections 52(2)(b) and (c) of the SIS Act. It would also be conduct falling below community standards and expectations.

The case study emphasised the importance of fee-related decisions, and the basis for those decisions, being communicated in an effective way both to staff and to customers. The evidence demonstrated that some staff within AMP thought the rate charged to members who had not completed a non-smoking declaration was a smoker rate.⁶¹¹ That is unsurprising given that the only step that needed to be taken to be paid a lesser rate was

⁶¹¹ See, eg, Transcript, Paul Sainsbury, 17 September 2018, 5877.

to complete the declaration. And some of AMP's own communications appeared to confuse the issue.⁶¹²

6.2.2 The charging and refunding of premiums to deceased members' accounts

The second issue examined in Mr Sainsbury's evidence concerned group life premiums charged to deceased members.

In April 2018, AMP identified that life insurance premiums were continuing to be deducted from deceased members' accounts, and that after payment of a death benefit, refunds were not being processed to deceased members' accounts.⁶¹³ AMP had investigated this issue after evidence given by CBA at the Commission's second round of hearings, concerning fees being charged to deceased customers.⁶¹⁴

On 26 June 2018, AMP notified ASIC and APRA that it had breached section 912A(1)(c) of the Corporations Act and sections 29VC and 52(2)(b) of the SIS Act because insurance premiums charged after the member's death were either not refunded, or the refunded amount was incorrect.⁶¹⁵ That breach notification identified 3,124 members with a total of \$922,902 in premium refunds owing.⁶¹⁶ AMP said that it determined the matter was reportable under section 912D of the Corporations Act (and section 29JA of the SIS Act) on 12 June 2018.⁶¹⁷

⁶¹² See, eg, Exhibit 6.239, September 2013, Internal AMP Emails Concerning SCT Complaint; Transcript, Paul Sainsbury, 17 September 2018, 5873–4.

⁶¹³ Transcript, Paul Sainsbury, 17 September 2018, 5883.

⁶¹⁴ Transcript, Paul Sainsbury, 17 September 2018, 5891.

⁶¹⁵ Transcript, Paul Sainsbury, 17 September 2018, 5884; Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046 at .0046].

⁶¹⁶ Transcript, Paul Sainsbury, 17 September 2018, 5884; Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046 at .0046].

⁶¹⁷ Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046 at .0047].

As at 5 September 2018, AMP had identified that 4,645 customers were affected by this issue, with \$1.3 million in premium refunds owing.⁶¹⁸

The potential breaches identified by AMP Super were described as failures to *refund* premiums.⁶¹⁹ The potential breaches were not said to relate to the *charging* of premiums to deceased members.⁶²⁰ In the course of Mr Sainsbury's evidence, the anterior question of AMP Super's right to deduct premiums from a deceased member's account where AMP had been notified of the death was explored.

As the potential breaches have been reported to ASIC and APRA, it is not necessary for me to make any referral.

In its submissions, AMP accepted that before July 2018, its process for some corporate superannuation products – the submissions do not identify which products or the total number of members across those products – was to stop deducting premiums 'only on finalisation of the claim'.⁶²¹ Premiums charged between the date of death and the date of finalisation of the claim were later refunded to the member's account (save for those cases identified in the breach reports).⁶²²

The issue of continuing to deduct life insurance premiums from deceased members' accounts had been raised within AMP in 2016.

A reversal of premiums was requested in respect of a particular deceased member in an internal email dated 8 June 2016.⁶²³ AMP had been notified of the member's death in February 2015, but was still deducting premiums from the member's account at the date of the email.⁶²⁴ The reversal request

⁶¹⁸ Transcript, Paul Sainsbury, 17 September 2018, 5892.

⁶¹⁹ Transcript, Paul Sainsbury, 17 September 2018, 5884; Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046].

⁶²⁰ Transcript, Paul Sainsbury, 17 September 2018, 5889–91.

⁶²¹ AMP, Module 6 Case Study Submission, 13 [59].

⁶²² AMP, Module 6 Case Study Submission, 13 [60].

⁶²³ Exhibit 6.246, 2016–2018, AMP Emails, April and July 16, 2–4.

⁶²⁴ Exhibit 6.246, 2016–2018, AMP Emails, April and July 16, 2–4.

prompted another AMP staff member to query why the premiums were still being deducted.⁶²⁵ That query was met with the response that ‘the current process is to charge until the claim is processed, which triggers a refund’.⁶²⁶

Mr Sainsbury was asked if he understood AMP to have a continuing entitlement to charge premiums once a member passed away.⁶²⁷ He answered: ‘No. That’s not our practice. It’s not our policy’.⁶²⁸ But until recently it was both AMP’s practice and policy to continue to deduct premiums until the life insurance claim was finalised.

In July 2018, AMP changed that process.⁶²⁹ Its current process was explained as follows: ‘AMP reverses any premiums, which were paid after the date of death and prior to AMP being notified of the death, to the superannuation account before any amount is made available to the beneficiary’.⁶³⁰ This process was said to result in the member’s account being restored to the position it would have been in had no post-death deductions occurred and to account ‘for the time value of money (ie – any investment gains or losses or interest, as applicable)’.⁶³¹

How the time value of money is accounted for, and whether it was accounted for in the previous process, is not entirely clear. There was no evidence directed to that issue and the above explanation raises a number of questions. It is enough to say that any process that failed to restore the member’s account to the position that it would have been in but for the post-death deductions would be unarguably unfair to the beneficiary of the funds.

⁶²⁵ Exhibit 6.246, 2016–2018, AMP Emails, April and July 16, 2.

⁶²⁶ Exhibit 6.246, 2016–2018, AMP Emails, April and July 16, 2; see also Transcript, Paul Sainsbury, 17 September 2018, 5886–7.

⁶²⁷ Transcript, Paul Sainsbury, 17 September 2018, 5891.

⁶²⁸ Transcript, Paul Sainsbury, 17 September 2018, 5891.

⁶²⁹ AMP, Module 6 Case Study Submission, 13 [59].

⁶³⁰ AMP, Module 6 Case Study Submission, 12 [57(c)].

⁶³¹ AMP, Module 6 Case Study Submission, 12 [57(c)].

What this part of the case study showed

In its submissions AMP appeared to acknowledge that it had no entitlement to premium payments from a member's account after the member had died, stating that its 'policy at all times had been that the liability to pay premiums on a life insurance policy ceases on the date of death'.⁶³² It then submitted that both its current process *and* its previous process are compliant with the Corporations Act and the SIS Act 'and reflect the proper conduct of a prudent trustee'.⁶³³

That submission is at odds with AMP's earlier statement – reflected in the evidence of Mr Sainsbury – that liability to pay premiums ceases on death. Indeed it appears to assume a continuing right in AMP to deduct premiums after death and how an insurer could be entitled to charge life insurance premiums after the life insured has died was not, and could not be, explained.

Unsurprisingly AMP did not point to any contractual right to continue deducting premiums once it has been notified of a member's death, and AMP accepts that the liability of members to pay premiums on a life insurance policy ceases on the date of death. It follows that the wrongful deduction of funds from member accounts was inherent in AMP's previous process of continuing to deduct premiums for some corporate superannuation plans until the claim was finalised. That the funds were subsequently refunded lessens the harm. But it does not cure the breach.

At a minimum, the previous process meant that one or more of AMP Super and AMP Life may have engaged in misconduct by failing to provide financial services to members efficiently, honestly and fairly as required by section 912A(1)(a) of the Corporations Act.⁶³⁴ AMP Super may also have engaged in misconduct by breaching the duty imposed by the caveat set out in section 52(2)(b) of the SIS Act to act with the skill and diligence of a prudent trustee.

⁶³² AMP, Module 6 Case Study Submission, 12 [56].

⁶³³ AMP, Module 6 Case Study Submission, 12 [61].

⁶³⁴ See Corporations Act ss 766A(1)(b), 766C(1)(a) and (b) and 763A(1)(a) and (b).

That leaves the breaches reported to APRA and ASIC concerning the failure to refund premiums charged after the death of a member. In its submissions, AMP explained that the breach notification related to specific conduct and did not raise any issue in respect of AMP's policy or its previous process 'as a whole'.⁶³⁵ The errors were said to have been caused 'as a consequence of process and human error'.⁶³⁶

In the breach report to ASIC, AMP identified that AMP Super had breached sections 29VC and 52(2)(b) of the SIS Act and sections 912A(1)(a) and (c) of the Corporations Act.⁶³⁷ The breach report also advised that AMP Life had breached section 912A(1)(a) of the Corporations Act.⁶³⁸ I find that AMP Super and AMP Life may have engaged in misconduct by breaching each of those sections.

6.2.3 Breach of trustee obligation to provide insurance

The third issue explored in this case study concerned the obligation imposed on trustees by section 68AA of the SIS Act to ensure that the fund provides, relevantly, permanent incapacity benefit to each MySuper member of the fund on an opt-out basis.

One of the topics addressed in Mr Sainsbury's second statement was the case of an AMP Super MySuper member, who was not provided with insurance.⁶³⁹ The member was a delinked employee and lost his

⁶³⁵ AMP, Module 6 Case Study Submission, 13 [60].

⁶³⁶ AMP, Module 6 Case Study Submission, 13 [60].

⁶³⁷ Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046].

⁶³⁸ Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046].

⁶³⁹ Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018; Transcript, Paul Sainsbury, 17 September 2018, 5893; Exhibit 6.247, 6 December 2017, Letter to Craig Meller.

insurance coverage when he ceased employment with his employer.⁶⁴⁰
At the time of the delinking, the MySuper regime was not in place.⁶⁴¹

The issue came to the member's attention after he was diagnosed with a very serious illness and sought to claim on the group life policy.⁶⁴²
After being informed that there was no life insurance attached to the superannuation account, the member's wife wrote to Craig Meller, the then CEO of AMP.⁶⁴³ Mr Meller referred the matter to AMP's Customer Advocate.⁶⁴⁴

Mr Sainsbury accepted that at the relevant time, the member was a MySuper member.⁶⁴⁵ AMP Super had determined that it was not appropriate to provide insurance to the member because, when he was delinked, a welcome call had been made to him that 'talked about him not having insurance cover in place', and on that basis he was deemed to have opted out.⁶⁴⁶ The member was then in a category of members who were not offered insurance as part of the transition to MySuper.⁶⁴⁷

That position was repeated in AMP's submissions, which noted that section 68AA of the SIS Act permits the trustee to determine reasonable conditions to which the provision of permanent incapacity or death benefits will be subject.⁶⁴⁸ The submissions also relied upon legal advice – said to have been provided to APRA, but not in evidence – that concluded that the conduct was not in contravention of section 68AA.⁶⁴⁹

⁶⁴⁰ Exhibit 6.247, 6 December 2017, Letter to Mr Meller, CEO.

⁶⁴¹ Transcript, Paul Sainsbury, 17 September 2018, 5894.

⁶⁴² Transcript, Paul Sainsbury, 17 September 2018, 5892–3.

⁶⁴³ Exhibit 6.247, 6 December 2017, Letter to Mr Meller, CEO.

⁶⁴⁴ Transcript, Paul Sainsbury, 17 September 2018, 5893.

⁶⁴⁵ Transcript, Paul Sainsbury, 17 September 2018, 5894.

⁶⁴⁶ Transcript, Paul Sainsbury, 17 September 2018, 5895.

⁶⁴⁷ Transcript, Paul Sainsbury, 17 September 2018, 5894–5.

⁶⁴⁸ AMP, Module 6 Case Study Submission, 17 [81].

⁶⁴⁹ AMP, Module 6 Case Study Submission, 17 [83]–[84].

The AMP Customer Advocate did not agree. The Customer Advocate concluded that the member should have been provided with insurance.⁶⁵⁰ The trustee does not agree with the Customer Advocate's conclusion and does not consider that the trustee breached any obligation owed to the member.⁶⁵¹ Notwithstanding that, Mr Sainsbury said that the trustee considered the Customer Advocate's decision to be 'appropriate'.⁶⁵²

An ex gratia payment was made to the member on the recommendation of the Customer Advocate.⁶⁵³ In its submissions, AMP sought to add some additional facts – which it had not led from Mr Sainsbury or otherwise sought to tender into evidence – about the payments made to the member and the timing of those payments.⁶⁵⁴ It is not necessary to take that additional information into account in order to form the view that the Customer Advocate's role was central to the member obtaining the result that he did.

AMP subsequently commenced an investigation into whether other MySuper members had not been provided with insurance.⁶⁵⁵ AMP Super issued a 'possible' breach notification to APRA and ASIC about the issue on 4 June 2018.⁶⁵⁶ APRA rejected that letter and invited a formal breach notification from AMP Super.⁶⁵⁷ That notification was provided on 10 August 2018.⁶⁵⁸ The notification said that AMP was in the process of satisfying itself that the non-provision of insurance to 1,600 MySuper members was appropriate.⁶⁵⁹ Mr Sainsbury said that it would take another month or two until AMP Super would reach a view on this issue.⁶⁶⁰

⁶⁵⁰ Transcript, Paul Sainsbury, 17 September 2018, 5895.

⁶⁵¹ Transcript, Paul Sainsbury, 17 September 2018, 5895.

⁶⁵² Transcript, Paul Sainsbury, 17 September 2018, 5895.

⁶⁵³ Transcript, Paul Jon Sainsbury, 17 September 2018, 5895–6.

⁶⁵⁴ AMP, Module 6 Case Study Submission, 18 [93], 18–19 [95].

⁶⁵⁵ Transcript, Paul Sainsbury, 17 September 2018, 5896.

⁶⁵⁶ Transcript, Paul Sainsbury, 17 September 2018, 5896.

⁶⁵⁷ Transcript, Paul Sainsbury, 17 September 2018, 5896.

⁶⁵⁸ Exhibit 6.249, 10 August 2018, Letter AMP to APRA.

⁶⁵⁹ Transcript, Paul Sainsbury, 17 September 2018, 5896; Exhibit 6.249, 10 August 2018, Letter AMP to APRA.

⁶⁶⁰ Transcript, Paul Sainsbury, 17 September 2018, 5897.

As the potential breaches have been reported to ASIC and APRA, it is not necessary for me to make any referral.

What this part of the case study showed

This aspect of the case study drew out two points. The first is the need for trustees to pay close attention to the insurance position of MySuper members, particularly those who transitioned to a MySuper product from a corporate plan or from a plan that did not have insurance attached to it. The second was the benefits of having an internal office dedicated to advocating in the interest of the customer.

Given that the investigation remained ongoing at the time of the hearings, and the complexities inherent in the particular member's case, I need not make any specific findings of misconduct or conduct falling below community standards and expectations in respect of this issue.

6.3 What the case study showed

I have already made findings of misconduct and conduct falling below community standards and expectations above. In summary, I have found that:

- In respect of the member charged a higher premium after delinking, AMP's conduct fell below community standards and expectations by failing to communicate with the member in an effective way that he was being charged a higher premium because a non-smoking declaration had not been completed.
- In respect of the deduction of premiums from the accounts of deceased members after being notified of the death:
 - AMP Super and AMP Life may have engaged in misconduct by breaching section 912A(1)(a) of the Corporations Act.
 - AMP Super may have engaged in misconduct by breaching the duty imposed by section 52(2)(b) of the SIS Act to act with the skill and diligence of a prudent trustee.
- In respect of the failure to refund premiums deducted after the date of death:

- AMP Super may have engaged in misconduct by breaching sections 29VC and 52(2)(b) of the SIS Act and sections 912A(1)(a) and (c) of the Corporations Act.⁶⁶¹
- AMP Life may have engaged in misconduct by breaching section 912A(1)(a) of the Corporations Act.

All of the misconduct and conduct falling below community standards and expectations was caused, at least in part, by AMP's systems. Some of those systems failed to promote the best interests of members in various ways. The most striking example was provided by the second issue – the continued charging of life insurance premiums to member's accounts after death. AMP's previous process for stopping premiums eschewed the 'obvious' solution of turning the premium deductions off upon notification of death.⁶⁶² No reason was given for that choice. Mr Sainsbury accepted that it was 'not the best way' to deal with the issue.⁶⁶³ That is clear from the complaints received by AMP about the continued deduction of premiums after death. Those complaints were raised, at the latest, by 2016, but no action was taken to adopt the 'obvious' solution until 2018.

7 Allianz

7.1 Background

Allianz Australia Insurance Ltd (Allianz) issues general insurance products, including travel insurance products.⁶⁶⁴ The Commission heard evidence about misleading and deceptive content that appeared on the travel insurance pages of Allianz's website between 2012 and 2018, as well as issues relating to Allianz's compliance processes, governance and culture more generally. The Commission heard evidence from Mr Michael Winter,

⁶⁶¹ Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046].

⁶⁶² Transcript, Paul Sainsbury, 17 September 2018, 5887.

⁶⁶³ Transcript, Paul Sainsbury, 17 September 2018, 5887.

⁶⁶⁴ Transcript, Michael Winter, 17 September 2018, 5910.

the Chief General Manager of Retail Distribution, and Ms Lori Callahan, the Chief Risk Officer.

7.2 Evidence

7.2.1 Mr Winter's evidence

Allianz distributes travel insurance through a number of channels, including its own website,⁶⁶⁵ and through an underwriting agency, AWP Australia Pty Ltd (AWP).⁶⁶⁶ AWP also distributes travel insurance products issued by Allianz through a number of channels, including through its website, and through the websites of third parties, such as airlines or travel businesses, which Allianz refers to as 'partners'.⁶⁶⁷

Allianz is responsible for determining the travel insurance content on its own website, and for checking that the travel insurance content of its own website, and the websites of AWP and AWP's partners, comply with the law.⁶⁶⁸ Allianz is also responsible for checking that the content of the 'purchase paths' used by customers who buy Allianz travel insurance products from those websites comply with the law.⁶⁶⁹

In 2015, Allianz decided to update the 'look and feel' of its website.⁶⁷⁰ At that time, Allianz had a process for approving new website content called the Document Compliance Sign-Off (DCSO) process.⁶⁷¹ That process was used to review the new content that was added to the website, but was not used to review the updated website as a whole

⁶⁶⁵ Transcript, Michael Winter, 17 September 2018, 5912.

⁶⁶⁶ Transcript, Michael Winter, 17 September 2018, 5913.

⁶⁶⁷ Transcript, Michael Winter, 17 September 2018, 5915.

⁶⁶⁸ Transcript, Michael Winter, 17 September 2018, 5916.

⁶⁶⁹ Transcript, Michael Winter, 17 September 2018, 5916.

⁶⁷⁰ Transcript, Michael Winter, 17 September 2018, 5917.

⁶⁷¹ Transcript, Michael Winter, 17 September 2018, 5917.

before it was made accessible to the public on 10 December 2015.⁶⁷² Mr Winter described this as a ‘failure in the approach’.⁶⁷³

Shortly before the updated website was made accessible to the public, an Allianz corporate solicitor identified issues with the updated website, including an absence of certain legally required disclaimers.⁶⁷⁴ Despite this, the website was launched. Over the coming weeks, the solicitor identified further issues with the content on the website, including misleading and deceptive statements.⁶⁷⁵ Despite these issues, Allianz did not take down any part of the website.⁶⁷⁶

In January 2016, Allianz decided to undertake a review of the website content.⁶⁷⁷ The corporate solicitor put together a proposal for an external law firm to review the website content by mid-February 2016, at a cost of \$25,000 to \$30,000.⁶⁷⁸ Mr Winter declined to approve this expense.⁶⁷⁹ As a result, the corporate solicitor spent two days a week working on the matter until the review was done.⁶⁸⁰ Mr Winter conceded that his decision not to approve this expense was not the right decision, and conceded that this was reflective of a lack of prioritisation within Allianz of fixing the issue.⁶⁸¹

⁶⁷² Transcript, Michael Winter, 17 September 2018, 5917.

⁶⁷³ Transcript, Michael Winter, 17 September 2018, 5917.

⁶⁷⁴ Transcript, Michael Winter, 17 September 2018, 5918–9.

⁶⁷⁵ Transcript, Michael Winter, 17 September 2018, 5922–5.

⁶⁷⁶ Transcript, Michael Winter, 17 September 2018, 5926.

⁶⁷⁷ Transcript, Michael Winter, 17 September 2018, 5926.

⁶⁷⁸ Transcript, Michael Winter, 17 September 2018, 5941–2; Exhibit 6.270, 5 February 2016, Emails of 5 February 2016 Concerning Allianz Website Review Scope of Review and Cost Estimates, 3–4.

⁶⁷⁹ Transcript, Michael Winter, 17 September 2018, 5943.

⁶⁸⁰ Transcript, Michael Winter, 17 September 2018, 5943.

⁶⁸¹ Transcript, Michael Winter, 17 September 2018, 5943–4.

The review ultimately took about 10 months to complete.⁶⁸² Because of the limited resources available, the corporate solicitor prioritised the review of the home, motor, life and business insurance content.⁶⁸³

By April 2016, the review had identified a number of misleading and deceptive statements in relation to the home, motor, life and boat insurance pages of the website. These included 14 such statements in relation to home insurance, four in relation to car insurance, three in relation to life insurance, and one in relation to boat insurance.⁶⁸⁴ Mr Winter accepted that these statements may have misled consumers, and were contrary to financial services laws.⁶⁸⁵

In May 2016, Allianz decided not to report the incorrect and misleading content to ASIC.⁶⁸⁶ Mr Winter was present at the meeting of the committee that made that decision, but could not recall whether the committee considered the number or frequency of similar previous breaches, as required by section 912D of the Corporations Act.⁶⁸⁷ He conceded that the decision not to report the matter to ASIC was the wrong decision.⁶⁸⁸ He also conceded that there were 'clear problems known to the committee at the time of this meeting with the way the DCSO process was operating and being applied within Allianz'.⁶⁸⁹

It took until November 2016 for Allianz to complete the review of the travel insurance content and prepare an issues list and proposed rectification plan.⁶⁹⁰ Mr Winter told the Commission that the review took so long because Allianz had failed to allocate the appropriate resources and priority to the

⁶⁸² Transcript, Michael Winter, 17 September 2018, 5944.

⁶⁸³ Transcript, Michael Winter, 17 September 2018, 5943.

⁶⁸⁴ Transcript, Michael Winter, 17 September 2018, 5926–7.

⁶⁸⁵ Transcript, Michael Winter, 17 September 2018, 5928.

⁶⁸⁶ Transcript, Michael Winter, 17 September 2018, 5929.

⁶⁸⁷ Transcript, Michael Winter, 17 September 2018, 5939.

⁶⁸⁸ Transcript, Michael Winter, 17 September 2018, 5940.

⁶⁸⁹ Transcript, Michael Winter, 17 September 2018, 5935.

⁶⁹⁰ Transcript, Michael Winter, 17 September 2018, 5946, 5948–9.

issue.⁶⁹¹ The issues list identified numerous misleading and deceptive statements about travel insurance products on Allianz's website.⁶⁹² Having compiled the issues list, Allianz provided it to AWP for review.⁶⁹³ Mr Winter conceded that this was an unnecessary step, and told the Commission that Allianz could have just fixed the issues itself.⁶⁹⁴

AWP did not return the issues list to Allianz with its comments until May 2018, about 18 months after Allianz had provided it to AWP.⁶⁹⁵ Mr Winter said that the issues list had been the topic of discussion at 14 meetings between Allianz and AWP between July 2017 and May 2018 and conceded that Allianz had been aware of the failure to rectify these issues.⁶⁹⁶ He accepted that Allianz had not treated the matter as urgent.⁶⁹⁷

Between December 2015 and May 2018, the misleading and deceptive statements identified in the issues list remained on the website.⁶⁹⁸ During that period, Allianz did not report the matter to ASIC, or even consider taking down the relevant parts of the website.⁶⁹⁹ Mr Winter conceded that neither Allianz nor AWP acted with any sense of urgency to fix the issue, or appreciated the seriousness of the issue, and that, every day the website was accessible to the public, Allianz was contravening financial services laws.⁷⁰⁰ Mr Winter accepted that, in this instance, it was more important to Allianz to protect the bottom line than to stop misleading its customers.⁷⁰¹

The Commission heard that, in May 2018, given the amount of time that had passed, Allianz decided to engage an external law firm to conduct another review of the web pages and purchase paths. That review identified

⁶⁹¹ Transcript, Michael Winter, 17 September 2018, 5926.

⁶⁹² Transcript, Michael Winter, 17 September 2018, 5948.

⁶⁹³ Transcript, Michael Winter, 17 September 2018, 5946.

⁶⁹⁴ Transcript, Michael Winter, 17 September 2018, 5950.

⁶⁹⁵ Transcript, Michael Winter, 17 September 2018, 5951.

⁶⁹⁶ Transcript, Michael Winter, 17 September 2018, 5953.

⁶⁹⁷ Transcript, Michael Winter, 17 September 2018, 5954.

⁶⁹⁸ Transcript, Michael Winter, 17 September 2018, 5954.

⁶⁹⁹ Transcript, Michael Winter, 17 September 2018, 5954.

⁷⁰⁰ Transcript, Michael Winter, 17 September 2018, 5954–5.

⁷⁰¹ Transcript, Michael Winter, 17 September 2018, 5955.

39 incorrect or misleading statements on the travel insurance pages of the website, and found that many of these statements had been on the website since 2012.⁷⁰²

In June 2018, Allianz reported the matter to ASIC.⁷⁰³ On 12 June 2018, Allianz told ASIC that the misleading and deceptive content had been on the website since December 2015.⁷⁰⁴ Although Allianz found out on 21 June 2018 that some of the misleading and deceptive statements had been on the website since July 2012,⁷⁰⁵ it did not tell ASIC this until 7 September 2018, and that was in response to a compulsory notice issued by ASIC.⁷⁰⁶

Allianz took down the travel insurance pages of its website on 6 June 2018, and disabled the direct purchase path on 12 June 2018.⁷⁰⁷ Although Allianz was aware by 14 June 2018 that there was also misleading and deceptive content in the purchase path for its partner websites, Mr Winter decided not to take down the purchase paths for those websites.⁷⁰⁸

During the period from December 2015 to June 2018, Allianz issued more than two million travel insurance policies.⁷⁰⁹ Mr Winter was not able to say how many Allianz customers were affected by the misleading and deceptive content on Allianz's website.⁷¹⁰

7.2.2 Ms Callahan's evidence

Ms Callahan gave evidence about issues relating to Allianz's compliance processes, governance and culture – both in connection with the misleading

⁷⁰² Exhibit 6.263, Witness statement of Michael Winter, 24 August 2018, 12–18 [86]; Transcript, Michael Winter, 17 September 2018, 5955–6.

⁷⁰³ Exhibit 6.263, Witness statement of Michael Winter, 24 August 2018, Exhibit MW-02 (Tab 17) [ALZ.0001.0067.0010]; Transcript, Michael Winter, 17 September 2018, 5960.

⁷⁰⁴ Exhibit 6.263, Witness statement of Michael Winter, 24 August 2018, Exhibit MW-02 (Tab 18) [ALZ.0001.0067.0059]; Transcript, Michael Winter, 17 September 2018, 5960.

⁷⁰⁵ Transcript, Michael Winter, 17 September 2018, 5975.

⁷⁰⁶ Transcript, Michael Winter, 17 September 2018, 5975.

⁷⁰⁷ Transcript, Michael Winter, 17 September 2018, 5957.

⁷⁰⁸ Transcript, Michael Winter, 17 September 2018, 5967–8.

⁷⁰⁹ Transcript, Michael Winter, 17 September 2018, 5976.

⁷¹⁰ Transcript, Michael Winter, 17 September 2018, 5976–7.

and deceptive content on the website, and more generally. Ms Callahan's evidence is dealt with in more detail below.

7.3 What the case study showed

This case study raised issues not only about the misleading and deceptive content on Allianz's website, but also about Allianz's compliance processes, governance and culture more generally.

It is convenient to begin with the issues relating to the misleading and deceptive content on Allianz's website.

7.3.1 Misleading and deceptive content on the website

In its submissions, Allianz rightly accepted that it may have engaged in conduct that was misleading or deceptive – and therefore amounted to misconduct – in respect of:⁷¹¹

- each of the 39 representations in relation to travel insurance described in the table in paragraph 86 of the statement of Michael Winter dated 24 August 2018;
- each of the 14 representations in relation to home insurance described in the table in the Annexure to that statement;
- each of the four representations in relation to motor vehicle insurance described in that Annexure;
- each of the three representations in relation to life insurance described in that Annexure; and
- the representation in relation to boat insurance described in that Annexure.

Allianz noted that the misleading representations in relation to home insurance, motor vehicle insurance, life insurance and boat insurance were remedied in 2016.⁷¹² However, as described above, the misleading

⁷¹¹ Allianz, Module 6 Case Study Submission, 1–2 [3]–[4].

⁷¹² Allianz, Module 6 Case Study Submission, 2 [4].

representations in relation to travel insurance were not remedied. They remained on the website until 2018.

The matter having been drawn to ASIC's attention, it is for it to determine what action it should take.

Allianz accepted that, by not taking steps to remove the relevant pages of its website from public view while it investigated the extent of the misleading representations and determined how to fix them, it engaged in conduct that fell below community standards and expectations.⁷¹³

In its submissions, Allianz acknowledged that the number of misrepresentations on the website, and the time it took to remedy them, gave rise to a significant breach that should have been reported to ASIC in accordance with section 912D of the Corporations Act. Allianz rightly conceded that it failed to report this breach within 10 business days, as required by section 912D.⁷¹⁴ As noted above, Mr Winter acknowledged that the decision not to report this matter to ASIC in May 2016 was the wrong decision.⁷¹⁵

I refer Allianz's conduct to ASIC, pursuant to paragraph (a) of the Commission's Terms of Reference, for ASIC to consider what action it should take.

In giving evidence about the decision not to report the website issue to ASIC in May 2016, Mr Winter said that he could not recall whether the committee had considered the number or frequency of similar previous breaches, as required by section 912D(1)(b) of the Corporations Act.⁷¹⁶ Mr Winter exhibited notes 'relating to' that meeting to his witness statement,⁷¹⁷ but those notes did not refer to the number or frequency of previous similar

⁷¹³ Allianz, Module 6 Case Study Submission, 5 [27].

⁷¹⁴ Allianz, Module 6 Case Study Submission, 2 [6].

⁷¹⁵ Transcript, Michael Winter, 17 September 2018, 5940.

⁷¹⁶ Transcript, Michael Winter, 17 September 2018, 5939.

⁷¹⁷ Exhibit 6.253, Witness statement of Michael Winter, 24 August 2018, 19 [92].

breaches.⁷¹⁸ In these circumstances, I would infer that Allianz did not take these matters into account in determining whether to report the website issue to ASIC in May 2016.

As noted above, Allianz ultimately reported the website issue to ASIC in June 2018.⁷¹⁹ It is concerning that, although Allianz found out on 21 June 2018 that some of the misleading and deceptive statements had been on the website since July 2012,⁷²⁰ it did not inform ASIC of this fact until 7 September 2018, and then in response to a compulsory notice.⁷²¹ In circumstances where Allianz had previously told ASIC that the misleading and deceptive content had only been on the website since December 2015,⁷²² I consider that the community would expect Allianz to correct its previous representation to the regulator in a more timely manner.

7.3.2 Breach reporting processes

Allianz's failure to report the website issue to ASIC in May 2016, and the inadequacy of the records of its consideration of whether to report that issue to ASIC, give rise to broader concerns about the adequacy of Allianz's breach reporting systems at that time.

In her witness statement, Ms Callahan described the key features of Allianz's breach reporting procedure since January 2013.⁷²³ She also exhibited copies of the various versions of Allianz's Compliance Incidents

⁷¹⁸ Exhibit 6.253, Witness statement of Michael Winter, 24 August 2018, Exhibit MW-02 (Tab 11) [ALZ.0001.0067.2757].

⁷¹⁹ Exhibit 6.263, Witness statement of Michael Winter, 24 August 2018, Exhibit MW-02 (Tab 17) [ALZ.0001.0067.0010]; Transcript, Michael Winter, 17 September 2018, 5960.

⁷²⁰ Transcript, Michael Winter, 17 September 2018, 5975.

⁷²¹ Transcript, Michael Winter, 17 September 2018, 5975. See Allianz, Module 6 Case Study Submission, 7 [41].

⁷²² Exhibit 6.263, Witness statement of Michael Winter, 24 August 2018, Exhibit MW-02 (Tab 18) [ALZ.0001.0067.0059]; Transcript, Michael Winter, 17 September 2018, 5960.

⁷²³ Exhibit 6.284, Witness statement of Lori Callahan, 24 August 2018, 2–6 [15]–[20].

and Breaches Handling Procedure that were in force over that time.⁷²⁴ While there were changes to that procedure over that time, the procedure for reporting breaches to ASIC remained substantially the same between January 2013 and May 2018. Among other things, that procedure required compliance officers to engage relevant senior individual stakeholders separately when determining whether to report a breach to ASIC.⁷²⁵

In May 2018, Allianz introduced a new Breach Review Committee.⁷²⁶ Allianz also began reviewing all open compliance incidents and reassessing them to determine whether they were reportable to ASIC.⁷²⁷ As a result of that process, in 2018, Allianz had reported seven significant breaches to ASIC by the time of the hearings.⁷²⁸

This was more reports than had been made in previous years. Ms Callahan said that there had been one year where Allianz reported four significant breaches but that in other years Allianz had reported either no breaches or only one breach to ASIC.⁷²⁹ Ms Callahan said that Allianz has now recognised that it needs to look at all historical breaches to determine whether Allianz had an obligation to report them to ASIC.⁷³⁰ This is because the corporate compliance department at Allianz could not assure itself that the section 912D reportability requirements had been applied to all prior breaches.⁷³¹ Ms Callahan said that this task was underway, but she was unable to say how many historical breaches would be assessed.⁷³²

⁷²⁴ Exhibit 6.284, Witness statement of Lori Callahan, 24 August 2018, Exhibits LMC-02 (Tab 1) [ALZ.0001.0017.3153], LMC-02 (Tab 2) [ALZ.0001.0078.0222], LMC-02 (Tab 3) [ALZ.1000.0002.2921], LMC-02 (Tab 4) [ALZ.0001.0078.0247], LMC-02 (Tab 5) [ALZ.1000.0004.3996], LMC-02 (Tab 6) [ALZ.0001.0017.3135], LMC-02 (Tab 7) [ALZ.0001.0077.0555].

⁷²⁵ Exhibit 6.284, Witness statement of Lori Callahan, 24 August 2018, 13 [73].

⁷²⁶ Exhibit 6.284, Witness statement of Lori Callahan, 24 August 2018, 13 [73].

⁷²⁷ Transcript, Lori Callahan, 18 September 2018, 6002.

⁷²⁸ Transcript, Lori Callahan, 18 September 2018, 6003.

⁷²⁹ Transcript, Lori Callahan, 18 September 2018, 6002–3.

⁷³⁰ Transcript, Lori Callahan, 18 September 2018, 6002.

⁷³¹ Transcript, Lori Callahan, 18 September 2018, 6002.

⁷³² Transcript, Lori Callahan, 18 September 2018, 6004.

Ms Callahan did not accept that Allianz's breach reporting procedure prior to May 2018 was inadequate to ensure that Allianz complied with its obligations under section 912D,⁷³³ but she did accept that Allianz had failed to comply with section 912D in the past.⁷³⁴ She attributed this to a failure to adhere to the documented processes.⁷³⁵ Ms Callahan also accepted that the breach reporting procedure prior to May 2018 'was not sufficient ... with regard to the consideration of the four reporting criteria'.⁷³⁶ She said that the breach reporting procedure should not have involved individual discussions with the relevant stakeholders.⁷³⁷

Given the matters accepted by Ms Callahan, her refusal to accept that the reporting procedure before 2018 was inadequate should be treated with caution. But it is not necessary for me to reach a concluded view about whether Allianz's documented breach reporting procedure was adequate to ensure that Allianz complied with its obligations under section 912D of the Corporations Act. I note that concerns about that process were expressed in an internal audit report prepared in September 2015,⁷³⁸ not long before the misleading and deceptive content on Allianz's website was discovered. But even if I assume that the documented process was adequate, Ms Callahan's evidence was that:

- the process was not always followed; and
- the failure to follow that process caused Allianz to fail to comply with its obligation under section 912D of the Corporations Act.

The adequacy of a system is not to be judged only by the way it is documented. Whether a system is adequate to fulfil a particular purpose will also depend on the way the system is understood and applied in practice. Here, Allianz's breach reporting process was not always followed,

⁷³³ Transcript, Lori Callahan, 18 September 2018, 6072. See Allianz, Module 6 Case Study Submission, 4 [21].

⁷³⁴ Transcript, Lori Callahan, 18 September 2018, 6072.

⁷³⁵ Transcript, Lori Callahan, 18 September 2018, 6072.

⁷³⁶ Transcript, Lori Callahan, 18 September 2018, 6071.

⁷³⁷ Transcript, Lori Callahan, 18 September 2018, 6071.

⁷³⁸ See Exhibit 6.284, Witness statement of Lori Callahan, 24 August 2018, Exhibit LMC-02 (Tab 12) [ALZ.0001.0078.0177 at .0206–.0207].

and Allianz's corporate compliance department could not assure itself that the section 912D reportability requirements had been applied to all prior breaches. After Allianz introduced a new process, the number of significant breaches identified increased from zero or one per year to seven in the first half of 2018. In these circumstances I would infer that, prior to May 2018, Allianz's breach reporting processes were not adequate to ensure that Allianz complied with its obligations under section 912D of the Corporations Act.

I refer Allianz's conduct to ASIC, pursuant to paragraph (a) of the Commission's Terms of Reference, for ASIC to consider what action it should take.

7.3.3 Compliance processes

The issues with Allianz's systems and processes that were explored in this case study extended beyond its breach reporting processes.

Ms Callahan accepted that, based on the evidence she and Mr Winter had given, Allianz had failed to comply with the requirement, set out in Prudential Standard CPS 220, that it have a designated compliance function that assists senior management in effectively managing compliance risks, and is adequately staffed by appropriately trained and competent persons who have sufficient authority to perform their role effectively.⁷³⁹

This concession was rightly made. The evidence of Mr Winter and Ms Callahan demonstrated that, prior to the recent commencement of the Compliance Transformation Program, Allianz's compliance systems were not adequate to meet the requirements of Prudential Standard CPS 220.

I refer Allianz's conduct to APRA, pursuant to paragraph (a) of the Commission's Terms of Reference, for APRA to consider what action it should take.

The inadequacy of Allianz's compliance systems can be illustrated by reference to four matters that each contributed to Allianz's conduct in relation to the misleading and deceptive content on the travel insurance pages on its website.

⁷³⁹ Transcript, Lori Callahan, 18 September 2018, 6076.

Processes for monitoring website content

First, I consider that Allianz's conduct in relation to the travel insurance pages on its website was attributable, in part, to the fact that, for many years, Allianz had inadequate processes for monitoring the content of its own website, and the websites of other companies that distributed its products.

Ms Callahan accepted that, for many years, Allianz had inadequate processes in this respect.⁷⁴⁰ Both Ms Callahan and Mr Winter accepted that these issues contributed to the misleading and deceptive content remaining on the travel insurance pages of the website. In its submissions, Allianz accepted that these issues were one major cause of the misleading content appearing on the relevant websites, and staying there for so long.⁷⁴¹

Both Mr Winter and Ms Callahan accepted that issues with Allianz's DCSO process were identified in 2015.⁷⁴² Despite this, in 2018, Allianz continued to have problems with its DCSO process.⁷⁴³ This was evidenced by another compliance breach, identified in May 2018, which related to hyperlinks on a number of financial institution partner websites that were linked to the incorrect PDS.⁷⁴⁴

An internal audit report prepared in August 2018 found that the execution of the DCSO process was ineffective in ensuring adherence with legislative and internal requirements.⁷⁴⁵ Ms Callahan agreed with the findings of the report.⁷⁴⁶ In its submissions, Allianz noted that it had begun to take steps to

⁷⁴⁰ Transcript, Lori Callahan, 18 September 2018, 5995.

⁷⁴¹ Allianz, Module 6 Case Study Submission, 11 [64].

⁷⁴² Transcript, Michael Winter, 17 September 2018, 5917;
Transcript, Lori Callahan, 18 September 2018, 6005.

⁷⁴³ Transcript, Lori Callahan, 18 September 2018, 6007.

⁷⁴⁴ Transcript, Lori Callahan, 18 September 2018, 6007.

⁷⁴⁵ Transcript, Lori Callahan, 18 September 2018, 6009.

⁷⁴⁶ Transcript, Lori Callahan, 18 September 2018, 6009.

address the failings identified in the report, but conceded that it was at the start of that process.⁷⁴⁷

Process for monitoring and closing compliance incidents

Second, I consider that Allianz's conduct in relation to the travel insurance pages on its website was also attributable to the fact that, for many years, Allianz has had inadequate processes for monitoring and closing compliance incidents once they had been identified.

In its submissions, Allianz accepted that this was another of the major causes of the misleading content appearing on the relevant websites, and staying there for so long.⁷⁴⁸

Ms Callahan accepted that one of the causes of the misleading and deceptive content remaining on the travel insurance pages of the website was that there was insufficient oversight of the incident by corporate compliance.⁷⁴⁹ A report to Allianz's risk committee in September 2016 recorded that remediation of the incident was substantially complete, and that all material errors on the website had been corrected – even though, at that time, the review of the travel insurance content on the website was still ongoing.⁷⁵⁰

Ms Callahan accepted that, for many years, Allianz's processes for identifying and monitoring compliance incidents were 'not sufficient ... to deliver the compliance results that one would want'.⁷⁵¹

An internal audit report from September 2015 found, among other things, that significant improvement was required in 'measuring, monitoring and reporting' within Allianz, and that there was no standard process to monitor and confirm that remedial actions had been implemented prior to closing

⁷⁴⁷ Allianz, Module 6 Case Study Submission, 11 [65].

⁷⁴⁸ Allianz, Module 6 Case Study Submission, 11 [67].

⁷⁴⁹ Transcript, Lori Callahan, 18 September 2018, 5993–4.

⁷⁵⁰ Transcript, Lori Callahan, 18 September 2018, 6017–8.

⁷⁵¹ Transcript, Lori Callahan, 18 September 2018, 5995.

reported incidents.⁷⁵² Despite the critical findings made in the report, the issue was listed as a low priority.⁷⁵³ Ms Callahan accepted that the audit report indicated that, at the time, Allianz was not taking its compliance obligations seriously, particularly in relation to remedial action necessary after a compliance incident had been identified.⁷⁵⁴

At the time the Commission heard evidence about his matter, monitoring and supervision remained an issue at Allianz. An internal audit report prepared in August 2018 found that '[t]he compliance plans for laws, legislation and regulation(s) impacting product and related processes are out of date and *compliance monitoring is not taking place*'.⁷⁵⁵ Ms Callahan agreed with this finding.⁷⁵⁶ She said that Allianz was only 'at the start' of addressing it.⁷⁵⁷

Oversight of AWP

Third, I consider that Allianz's conduct in relation to the travel insurance pages on its website was also attributable to inadequate oversight of AWP by Allianz, prior to July 2018.

In its submissions, Allianz accepted that this was a contributing issue.⁷⁵⁸ Ms Callahan also accepted that Allianz's past inadequate oversight of AWP was one of the causes of the misleading and deceptive content remaining on the travel insurance pages of the website.⁷⁵⁹

Ms Callahan accepted that, under the underwriting agreement between Allianz and AWP that was in force between 2010 and July 2018, Allianz's

⁷⁵² Transcript, Lori Callahan, 18 September 2018, 6020–1.

⁷⁵³ Transcript, Lori Callahan, 18 September 2018, 6020.

⁷⁵⁴ Transcript, Lori Callahan, 18 September 2018, 6023.

⁷⁵⁵ Transcript, Lori Callahan, 18 September 2018, 6009 (emphasis added).

⁷⁵⁶ Transcript, Lori Callahan, 18 September 2018, 6009.

⁷⁵⁷ Transcript, Lori Callahan, 18 September 2018, 6011.

⁷⁵⁸ Allianz, Module 6 Case Study Submission, 12–13 [71]–[79].

⁷⁵⁹ Transcript, Lori Callahan, 18 September 2018, 5994–5.

oversight of AWP was inadequate.⁷⁶⁰ Allianz's monitoring of AWP did not improve until Allianz and AWP entered into a new underwriting agreement in July 2018.⁷⁶¹

It is concerning that Allianz did not enter into a new underwriting agreement until July 2018 even though – and as Ms Callahan accepted⁷⁶² – during the period while the previous underwriting agreement was in force, Allianz was aware that there were issues with its oversight of AWP, and with AWP's compliance with its legal obligations. She also observed that, in 2016, an internal audit had identified that Allianz's monitoring and control of its underwriting agencies was not sufficient.⁷⁶³ Although steps were taken in 2017 to address those issues across other underwriting agencies, those steps did not include AWP.⁷⁶⁴

Ms Callahan said that Allianz's systems for monitoring and supervising third party distributors had been a broader problem that extended beyond AWP. She admitted that, as well as underwriting agencies, Allianz also had problems supervising car dealers and the financial institutions selling Allianz products.⁷⁶⁵ Ms Callahan gave evidence that Allianz was currently investing more in its compliance systems to improve its supervision and monitoring of third parties.⁷⁶⁶

Giving sufficient priority to compliance

Fourth, I consider that Allianz's conduct in relation to the travel insurance pages on its website was also attributable to Allianz's failure to give enough priority to compliance.

⁷⁶⁰ Transcript, Lori Callahan, 18 September 2018, 6027.

⁷⁶¹ Transcript, Lori Callahan, 18 September 2018, 6026.

⁷⁶² Transcript, Lori Callahan, 18 September 2018, 6026–8.

⁷⁶³ Transcript, Lori Callahan, 18 September 2018, 5996.

⁷⁶⁴ Transcript, Lori Callahan, 18 September 2018, 5995–6.

⁷⁶⁵ Transcript, Lori Callahan, 18 September 2018, 6030–1.

⁷⁶⁶ Transcript, Lori Callahan, 18 September 2018, 6030–1.

Ms Callahan accepted that one of the causes of the misleading and deceptive content remaining on the travel insurance pages of the website was that Allianz had an insufficient appreciation of the consequences for customers of this information being on the website.⁷⁶⁷ She said also said that this incident was an example of an instance where Allianz's management had not considered compliance to be a priority.⁷⁶⁸

In its submissions, Allianz conceded that both of these matters contributed to Allianz's conduct in relation to the travel insurance pages on its website.⁷⁶⁹

Ms Callahan said that, prior to her time as Chief Risk Officer, there had been instances where Allianz had focused on technical or legal compliance, rather than encouraging a culture that really looked to improve Allianz's processes.⁷⁷⁰ Other than clarifying that Ms Callahan's evidence on this point concerned the past, and did not refer to the current compliance culture at Allianz, Allianz's submissions did not seek to depart from this assessment.⁷⁷¹

Ms Callahan also accepted that, in the past, Allianz had not devoted adequate resources to compliance.⁷⁷² Ms Callahan gave evidence that Allianz only reached the point at which it was fully resourced for its compliance function one week before she gave evidence.⁷⁷³ Again, other than clarifying that Ms Callahan's evidence on this point concerned the past, Allianz's submissions did not seek to depart from this assessment.⁷⁷⁴

⁷⁶⁷ Transcript, Lori Callahan, 18 September 2018, 5994.

⁷⁶⁸ Transcript, Lori Callahan, 18 September 2018, 5996.

⁷⁶⁹ Allianz, Module 6 Case Study Submission, 13–14 [83]–[84].

⁷⁷⁰ Transcript, Lori Callahan, 18 September 2018, 5996.

⁷⁷¹ Allianz, Module 6 Case Study Submission, 14 [86].

⁷⁷² Transcript, Lori Callahan, 18 September 2018, 5991; see also Transcript, Lori Callahan, 18 September 2018, 6057.

⁷⁷³ Transcript, Lori Callahan, 18 September 2018, 6069.

⁷⁷⁴ Allianz, Module 6 Case Study Submission, 14 [87].

7.3.4 Reaction to external reports

It remains to say something about the way that Allianz reacted to the external reports from Ernst & Young (EY) and Deloitte that were considered in this case study.

The Commission heard that Allianz commissioned EY to prepare two reports – a risk report and a compliance report.⁷⁷⁵ Allianz commissioned the risk report for the purpose of complying with Prudential Standard CPS 220, and providing the report to APRA.⁷⁷⁶ After receiving draft copies of both reports, Allianz staff provided extensive feedback to EY. After receiving this feedback, EY changed the ratings in the compliance report, but did not change the ratings in the risk report.⁷⁷⁷

Ms Callahan accepted that it appeared that there were Allianz staff who did all they could to push for the ratings given by EY in the reports to be improved.⁷⁷⁸ Ms Callahan accepted that this was not appropriate.⁷⁷⁹ In relation to the risk report, she also accepted that Allianz was trying to influence and alter the content of a report that it was required to produce under CPS 220.⁷⁸⁰ Ms Callahan was shown an email from the Head of Risk Management to the Acting Head of Compliance, dated 29 September 2017, in relation to the risk report. In that email, in response to the question ‘How did the meeting with EY go?’ the Head of Risk management said:⁷⁸¹

Went ok ... they are going to rewrite with a more balanced view ...
we didn't get to finish the whole report though :(

[The Chief Risk Officer] tried to ask for a Mature rating for some elements
but didn't think it worked :P

⁷⁷⁵ Transcript, Lori Callahan, 18 September 2018, 6077.

⁷⁷⁶ Transcript, Lori Callahan, 18 September 2018, 6078.

⁷⁷⁷ Transcript, Lori Callahan, 18 September 2018, 6077.

⁷⁷⁸ Transcript, Lori Callahan, 18 September 2018, 6048.

⁷⁷⁹ Transcript, Lori Callahan, 18 September 2018, 6078.

⁷⁸⁰ Transcript, Lori Callahan, 18 September 2018, 6078.

⁷⁸¹ Exhibit 6.302, 29 September 2017, Emails Concerning Risk Report.

Ms Callahan accepted that it could be inferred from this email that there was an attempt to manipulate the content of EY's report.⁷⁸²

In closing, Counsel Assisting submitted that it was open to me to find that Allianz had engaged in conduct falling below community standards and expectations by 'seeking to manipulate the content of an independent report commissioned by Allianz for the purpose of satisfying the requirements of CPS 220 and which Allianz intended to provide to APRA'.⁷⁸³

In response to this submission, Allianz contended that the phrase 'rewrite with a more balanced view' does not suggest 'manipulation'. Allianz said that '[i]t lends itself more towards notions of reconsideration, or even correction'.⁷⁸⁴ However, this submission fails to grapple with the reference in the email to the Chief Risk Officer having 'tried to ask for a Mature rating for some elements'. In my view, the clear inference to be drawn from the email is that the Chief Risk Officer attempted to manipulate the content of the risk report. Whether or not she succeeded is beside the point – the attempt to do so was conduct that fell below what the community expects. It demonstrates a concerning attitude to the content of an independent report being prepared for the purpose of provision to the regulator.

For the avoidance of doubt, I emphasise that nothing I have said suggests that EY acted inappropriately in any way. My focus is only upon what Allianz sought to do.

A concerning attitude was also demonstrated by Allianz's reaction to a draft report prepared by Deloitte. In June 2018, Ms Callahan commissioned Deloitte to prepare a report addressing the compliance incidents that Allianz had recently reported to ASIC. On receiving a highly critical draft report, Ms Callahan's reaction was to ask Deloitte to retract the report.⁷⁸⁵ She agreed that this was 'not her finest moment',⁷⁸⁶ and that this matter would

⁷⁸² Transcript, Lori Callahan, 18 September 2018, 6078.

⁷⁸³ Transcript, Senior Counsel Assisting, 21 September 2018, 6497.

⁷⁸⁴ Allianz, Module 6 Case Study Submission, 9 [54].

⁷⁸⁵ Transcript, Lori Callahan, 18 September 2018, 6064.

⁷⁸⁶ Transcript, Lori Callahan, 18 September 2018, 6064.

be relevant to the risk governance written assessment that Allianz was then preparing for submission to APRA in November 2018.⁷⁸⁷ In its submissions, Allianz acknowledged that this aspect of Ms Callahan's reaction to the Deloitte report may reflect poorly on Allianz's compliance culture as a whole, and characterised it as 'a regrettable human error'.⁷⁸⁸ But it is a course of events that does not reflect well on Allianz or its compliance culture.

8 IAG

8.1 Background

Swann Insurance (Aust) Pty Ltd (Swann) is a general insurer and a subsidiary of Insurance Australia Group Limited (IAG).⁷⁸⁹ Swann sources and sells add-on insurance products. The Commission heard evidence from Mr Benjamin Bessell, the Executive General Manager Business Distribution and Group Executive within the Australia Division at IAG.⁷⁹⁰

8.2 Evidence

Mr Bessell described the relationship between IAG and Swann as a 'devolved business model',⁷⁹¹ where Swann was effectively a standalone business.⁷⁹² However, the person with ultimate responsibility for Swann was the head of the IAG division in which Swann sat,⁷⁹³ and at all times since 2013, the CEO of IAG has been a director of Swann.⁷⁹⁴

⁷⁸⁷ Transcript, Lori Callahan, 18 September 2018, 6079–80

⁷⁸⁸ Allianz, Module 6 Case Study Submission, 15 [94].

⁷⁸⁹ Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 1 [5].

⁷⁹⁰ Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 1 [1]; Transcript, Benjamin Bessell, 18 September 2018, 6082.

⁷⁹¹ Transcript, Benjamin Bessell, 18 September 2018, 6082.

⁷⁹² Transcript, Benjamin Bessell, 19 September 2018, 6137.

⁷⁹³ Transcript, Benjamin Bessell, 19 September 2018, 6137.

⁷⁹⁴ Transcript, Benjamin Bessell, 19 September 2018, 6138.

The case study focused on add-on sales in the period 2013 to 2017. In that period, Swann manufactured comprehensive motor insurance and eight add-on insurance products, some of which were variations on, or replacements of, others.⁷⁹⁵ The products were sold through its authorised representatives, which included car and motorcycle dealers.⁷⁹⁶

Between 2008 and 2018, Swann sold approximately 846,000 policies through car dealerships, received approximately \$1.07 billion in premiums, and paid out about 10% of that amount in claims.⁷⁹⁷ At its peak, Swann had approximately 3,000 authorised representatives selling its products throughout Australia.⁷⁹⁸

Three of the add-on products were a form of consumer credit insurance, namely Loan Protection Insurance, ‘walkaway’ insurance and Protection Plus Insurance.⁷⁹⁹ Swann also sold ‘Guaranteed Asset Protection’ or ‘GAP’ Insurance, Purchase Price Protection Insurance, which was similar to GAP insurance, Mechanical Breakdown Insurance, and Tyre and Rim Insurance.⁸⁰⁰

Swann’s add-on insurance products were added on to the purchase of a car or motorcycle.⁸⁰¹ Mr Bessell acknowledged that add-on insurance products were *sold* to customers, rather than *bought* by customers, and that, in many circumstances, the customer’s decision about whether or not to buy an add-on insurance product came after a customer had chosen the vehicle and agreed on the terms for finance.⁸⁰²

⁷⁹⁵ Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 6–7 [38]; Transcript, Benjamin Bessell, 18 September 2018, 6084–6.

⁷⁹⁶ Transcript, Benjamin Bessell, 18 September 2018, 6086; Exhibit 6.305, June 2014, Swann Channel Strategy Business Plan FY14–17.

⁷⁹⁷ See the figures in the tables in Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 20–3; Transcript, Benjamin Bessell, 18 September 2018, 6088–9.

⁷⁹⁸ Transcript, Benjamin Bessell, 19 September 2018, 6119.

⁷⁹⁹ Protection Plus Insurance replaced Walkaway Insurance from 1 February 2015.

⁸⁰⁰ Exhibit 6.304, Witness statement of Benjamin Bessell, 21 August 2018, 6–7 [38].

⁸⁰¹ Transcript, Benjamin Bessell, 18 September 2018, 6083.

⁸⁰² Transcript, Benjamin Bessell, 18 September 2018, 6083.

8.2.1 Authorised representatives and incentives

Swann generally engaged its authorised representatives through authorised representative agreements.⁸⁰³ Under those agreements, representatives were generally authorised to provide general advice (but never personal advice) and to deal in a financial product.⁸⁰⁴

The agreements required the authorised representatives to, among other things, comply with the applicable laws, including the Corporations Act, and comply with all policies, procedures, guidelines and any reasonable requirements or directions given by Swann.⁸⁰⁵ The agreements also provided Swann with the right to inspect the authorised representative's place of business, and to conduct audits.⁸⁰⁶ Mr Bessell said he did not know whether Swann had exercised rights under these clauses, but said that Swann regularly obtained information about, and visited premises of, authorised representatives.⁸⁰⁷

Under the authorised representative agreements, representatives were remunerated exclusively by commission, with different rates of commission attaching to different products.⁸⁰⁸ The agreement usually provided for more than one commission rate for GAP insurance, because the commission increased when the customer was sold a higher level of cover.⁸⁰⁹

⁸⁰³ Transcript, Benjamin Bessell, 18 September 2018, 6089; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement.

⁸⁰⁴ Transcript, Benjamin Bessell, 18 September 2018, 6090–1; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement, 1, 5, 25, 28.

⁸⁰⁵ Transcript, Benjamin Bessell, 18 September 2018, 6092; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement, 3.

⁸⁰⁶ Transcript, Benjamin Bessell, 18 September 2018, 6093; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement, 3–4.

⁸⁰⁷ Transcript, Benjamin Bessell, 18 September 2018, 6093.

⁸⁰⁸ Transcript, Benjamin Bessell, 18 September 2018, 6090–1; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement, 1, 5, 25, 28.

⁸⁰⁹ Transcript, Benjamin Bessell, 18 September 2018, 6091–2; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement, 28.

Swann also entered into ‘incentive scheme’ agreements with some authorised representatives.⁸¹⁰ These agreements were offered to dealers who Swann thought could ‘grow’ the business.⁸¹¹ Mr Bessell explained that agreements of this type were not uncommon in the market, and were used to ensure that Swann remained competitive.⁸¹²

The amounts paid under the ‘incentive scheme’ agreements were paid in addition to amounts paid under the authorised representative agreements.⁸¹³ Payments under the ‘incentive scheme’ agreements were calculated based on the gross written premiums for the financial year, and a factor called ‘Group Product Mix’, which was calculated by reference to the mix of different add-on products sold.⁸¹⁴ The rationale behind the Group Product Mix factor was that it would incentivise dealers to sell a variety of add-on products.⁸¹⁵

Under the ‘incentive scheme’ agreements, authorised representatives could also be paid a ‘Performance Bonus Commission’, and a ‘Product Mix Bonus’, which was based on the gross written premiums of consumer credit insurance and Tyre and Rim Insurance.⁸¹⁶ Generally, Tyre and Rim Insurance was difficult to sell.⁸¹⁷

In a letter to the Commission on 29 June 2018, IAG said that Swann may have breached section 145 of the National Credit Code in the course of making 153 payments to authorised representatives.⁸¹⁸ Section 145 prohibits consumer credit insurance commissions paid by an insurer to

⁸¹⁰ Exhibit 6.307, 2 July 2013, Incentive Scheme Agreement; Transcript, Benjamin Bessell, 18 September 2018, 6096.

⁸¹¹ Transcript, Benjamin Bessell, 18 September 2018, 6096.

⁸¹² Transcript, Benjamin Bessell, 18 September 2018, 6096.

⁸¹³ Transcript, Benjamin Bessell, 18 September 2018, 6094; Exhibit 6.307, 2 July 2013, Incentive Scheme Agreement.

⁸¹⁴ Transcript, Benjamin Bessell, 18 September 2018, 6094.

⁸¹⁵ Transcript, Benjamin Bessell, 18 September 2018, 6094.

⁸¹⁶ Transcript, Benjamin Bessell, 18 September 2018, 6094–5.

⁸¹⁷ Transcript, Benjamin Bessell, 18 September 2018, 6095.

⁸¹⁸ Exhibit 6.311, 29 June 2018, Letter IAG to Commission.

authorised representatives that exceed 20% of the premium (excluding government charges). In his oral evidence, Mr Bessell explained that the possible breaches were caused by the Product Mix Bonus offered to some authorised representatives.⁸¹⁹

Another way in which Swann incentivised sales was through the Swann 'Ignition Incentive Program'.⁸²⁰ That program had been running since 2004, and was designed to incentivise *employees* of authorised representatives by providing them with points when they sold add-on insurance products.⁸²¹ One point was equal to \$1.⁸²² The points were redeemable online, and could be exchanged for particular products.⁸²³ At least between 2014 and 2016, Swann also ran short-term bonus programs, which allowed employees to accrue more points when they sold a bundle of three or four products in the same transaction.⁸²⁴ Mr Bessell said that Swann was not the only market participant that provided incentives to employees of dealers.⁸²⁵

8.2.2 Swann's dealings with its authorised representatives

Swann was heavily reliant on its dealers to maintain its market share.⁸²⁶

A risk report from October 2014 recorded that Swann considered that one of its 'risks' was competitors' 'attacks' to its dealer market, resulting in reduced market share.⁸²⁷ One 'control' identified to protect against this risk was the

⁸¹⁹ Transcript, Benjamin Bessell, 19 September 2018, 6112.

⁸²⁰ Transcript, Benjamin Bessell, 18 September 2018, 6100.

⁸²¹ Exhibit 6.309, December 2014, Ignition Incentive Program Administrators Manual v4, 6; Transcript, Benjamin Bessell, 18 September 2018, 6100–2.

⁸²² Exhibit 6.309, December 2014, Ignition Incentive Program Administrators Manual v4, 6; Transcript, Benjamin Bessell, 18 September 2018, 6101.

⁸²³ Exhibit 6.309, December 2014, Ignition Incentive Program Administrators Manual v4, 6; Transcript, Benjamin Bessell, 18 September 2018, 6101.

⁸²⁴ Exhibit 6.310, February 2014, Ignition Super-Charged Multi-Policy Incentive; Transcript, Benjamin Bessell, 18 September 2018, 6103–4.

⁸²⁵ Transcript, Benjamin Bessell, 18 September 2018, 6102.

⁸²⁶ Transcript, Benjamin Bessell, 18 September 2018, 6097.

⁸²⁷ Transcript, Benjamin Bessell, 18 September 2018, 6097–8.

commission and incentive arrangements between Swann and its authorised representatives.⁸²⁸ That risk report did not record any explicit consideration of Swann's customers.⁸²⁹ Mr Bessell agreed that this was, at least in part, because Swann viewed the dealer as its customer.⁸³⁰

At all relevant times, Swann was obliged to have in place adequate arrangements for the management of conflicts of interest that may arise from the sale of its products.⁸³¹ The 'arrangements' that Swann had in place for that purpose were its training program and electronic questionnaires for authorised representatives, and the ability for employees to notify Swann of issues through a compliance mailbox.⁸³²

The purpose of Swann's remuneration and incentive arrangements was to incentivise sales – there was no intention to incentivise any other conduct.⁸³³ On occasions, these incentive programs incentivised sales practices that were inappropriate, and Swann's authorised representatives engaged in sales practices where consumers were sold products that were not appropriate.⁸³⁴

Between March 2013 and January 2017, Swann maintained a 'light touch' approach to the monitoring of authorised representatives,⁸³⁵ due in part to the prioritisation of 'scarce resources'.⁸³⁶

⁸²⁸ Transcript, Benjamin Bessell, 18 September 2018, 6098.

⁸²⁹ Exhibit 6.308, 13 October 2014, Swann Risk Profile, 5; Transcript, Benjamin Bessell, 18 September 2018, 6098.

⁸³⁰ Transcript, Benjamin Bessell, 18 September 2018, 6098.

⁸³¹ Transcript, Benjamin Bessell, 18 September 2018, 6104.

⁸³² Transcript, Benjamin Bessell, 18 September 2018, 6104.

⁸³³ Transcript, Benjamin Bessell, 18 September 2018, 6105.

⁸³⁴ Transcript, Benjamin Bessell, 18 September 2018, 6106.

⁸³⁵ Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 2; Transcript, Benjamin Bessell, 19 September 2018, 6113.

⁸³⁶ Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 2; Transcript, Benjamin Bessell, 19 September 2018, 6113–14, 6118.

As at January 2017, Swann had not responded to the changing level of risk that had arisen from the increased scrutiny of add-on products.⁸³⁷ At that time, Swann had no oversight of any issues that may be occurring, because Swann's authorised representatives were not actively recording potential breaches.⁸³⁸ In addition, Swann did not undertake any monitoring to ensure that refresher training was completed, nor any face-to-face audits.⁸³⁹ Swann's electronic questionnaire was limited in the level of detail it captured.⁸⁴⁰ Mr Bessell accepted that, at least between 2013 and January 2017, Swann did not have in place adequate risk management systems, particularly in light of the failure of authorised representatives to actively report breaches.⁸⁴¹

Mr Bessell said that, if he were running the business today, he would not be comfortable with the level of oversight that had been in place as at January 2017.⁸⁴² He agreed that this level of oversight would not have been considered appropriate in any year since 2013.⁸⁴³

8.2.3 IAG's awareness of issues with add-on insurance

IAG was aware from late 2013 that ASIC had concerns with add-on insurance products,⁸⁴⁴ and had understood since 2015 that ASIC's concerns related to product design and sales practices.⁸⁴⁵ Despite this, Swann did

⁸³⁷ Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 2; Transcript, Benjamin Bessell, 19 September 2018, 6113–14.

⁸³⁸ Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 3; Transcript, Benjamin Bessell, 19 September 2018, 6114–15.

⁸³⁹ Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 3; Transcript, Benjamin Bessell, 18 September 2018, 6114–15.

⁸⁴⁰ Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 3; Transcript, Benjamin Bessell, 18 September 2018, 6114–15.

⁸⁴¹ Transcript, Benjamin Bessell, 19 September 2018, 6121.

⁸⁴² Transcript, Benjamin Bessell, 19 September 2018, 6120–1.

⁸⁴³ Transcript, Benjamin Bessell, 19 September 2018, 6121.

⁸⁴⁴ Transcript, Benjamin Bessell, 19 September 2018, 6121.

⁸⁴⁵ Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, Exhibit BB-019 [IAG.502.002.0719]; Transcript, Benjamin Bessell, 18 September 2018, 6121–2.

not take any active steps to investigate the products or sales techniques of concern.⁸⁴⁶

By June 2015, IAG had begun individually engaging with ASIC about its concerns with the sale of add-on insurance as an industry participant through the Insurance Council of Australia.⁸⁴⁷ Mr Bessell said that at that time, the industry had generally acknowledged that commission structures were either inappropriate or not financially competitive for product providers, but that no-one was prepared to move first in reducing commissions.⁸⁴⁸ The view was that, unless there was industry reform, one particular insurer reducing commissions would not necessarily improve the customer experience.⁸⁴⁹

By September 2015, IAG was aware that ASIC held serious concerns about add-on insurance products.⁸⁵⁰ IAG acknowledged to ASIC at that time that many of IAG's consumer credit insurance products had 'not kept pace with social change [and] technological developments'.⁸⁵¹

In December 2015, Swann became aware that ASIC considered that the sale of Swann's products through motor dealers may have contravened 'regulatory requirements'.⁸⁵² Despite this, internal IAG documents showed that in May 2016, Swann's primary concern about product design risks was still profit-related, and there was no consideration of whether the design of Swann's products adversely affected consumers.⁸⁵³ Swann continued with

⁸⁴⁶ Transcript, Benjamin Bessell, 19 September 2018, 6129, 6134.

⁸⁴⁷ Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, Exhibit BB-001 [IAG.500.100.5078]; Transcript, Benjamin Bessell, 19 September 2018, 6123–7.

⁸⁴⁸ Transcript, Benjamin Bessell, 19 September 2018, 6126.

⁸⁴⁹ Transcript, Benjamin Bessell, 19 September 2018, 6126–7.

⁸⁵⁰ Transcript, Benjamin Bessell, 19 September 2018, 6128.

⁸⁵¹ Transcript, Benjamin Bessell, 19 September 2018, 6128; Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, Exhibit BB-016 [IAG.502.002.0711].

⁸⁵² Transcript, Benjamin Bessell, 19 September 2018, 6128; Witness statement of Benjamin Bessell, 27 August 2018, 6 [36]–[37].

⁸⁵³ Transcript, Benjamin Bessell, 19 September 2018, 6130–1; Exhibit 6.313, 2 5 May 2016, IAG Risk Profile – Swann.

its remuneration incentive programs until at least June 2016.⁸⁵⁴ Mr Bessell accepted that Swann's maintenance of its market share would not have been possible had it unilaterally decreased commissions.⁸⁵⁵

By July 2016, IAG was aware that it had limited oversight of car dealers' sales practices in relation to add-on insurance.⁸⁵⁶ IAG had not reviewed Swann's add-on insurance products to assess whether they provided sufficient benefit to customers.⁸⁵⁷

Mr Bessell attributed Swann's failure to take any active steps to investigate issues within its business to Swann's preference for an 'industry-wide approach' to ASIC's concerns.⁸⁵⁸ Mr Bessell agreed that Swann could have participated in the industry approach while also reviewing its own products and business practices.⁸⁵⁹

8.2.4 Remediation

From August 2016, IAG commenced negotiations with ASIC in relation to Swann's add-on insurance products.⁸⁶⁰ On 19 December 2017, ASIC announced that IAG would compensate just under 68,000 customers by paying approximately \$39 million in respect of Swann's add-on insurance products.⁸⁶¹ At the date of Mr Bessell's statement, both estimates had been revised down slightly: it was then estimated that just over 64,000 customers would be remediated \$37.1 million.⁸⁶² Swann was about half way through

⁸⁵⁴ Transcript, Benjamin Bessell, 19 September 2018, 6131.

⁸⁵⁵ Transcript, Benjamin Bessell, 19 September 2018, 6129.

⁸⁵⁶ Transcript, Benjamin Bessell, 19 September 2018, 6131–4; Exhibit 6.314, 27 July 2016, Report of IAG Risk Committee Review of CCI and Add-On Insurance, 7.

⁸⁵⁷ Transcript, Benjamin Bessell, 19 September 2018, 6131–4; Exhibit 6.314, 27 July 2016, Report of IAG Risk Committee Review of CCI and Add-On Insurance, 9.

⁸⁵⁸ Transcript, Benjamin Bessell, 19 September 2018, 6129.

⁸⁵⁹ Transcript, Benjamin Bessell, 19 September 2018, 6129.

⁸⁶⁰ Transcript, Benjamin Bessell, 19 September 2018, 6134; Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, Exhibit BB-199 [IAG.505.002.4355].

⁸⁶¹ Transcript, Benjamin Bessell, 19 September 2018, 6138.

⁸⁶² Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 7 [39], 16 [96].

the remediation program, and was expected to complete the program by 31 January 2019.⁸⁶³

The circumstances in which Swann is remediating customers who were sold add-on insurance include where: the customer was unlikely to be able to make a claim under the policy; the GAP cover sold to the customer was unnecessary because it duplicated existing cover; the customer did not receive a rebate under their GAP cover when they paid out their loan; the customer was sold a more expensive level of cover than they needed; the customer was sold Mechanical Breakdown Insurance for longer than they needed; the customer paid twice for roadside assistance; and life insurance was sold to young people who were unlikely to need it.⁸⁶⁴

Other than comprehensive motor vehicle or motorcycle insurance sold by Swann, all products sold by Swann are the subject of the remediation program agreed with ASIC.⁸⁶⁵

8.2.5 Current position

Swann ceased distributing its products through car dealers in August 2016,⁸⁶⁶ and through motorcycle dealers in October 2017.⁸⁶⁷ Swann no longer sells add-on insurance products, but continues to sell comprehensive motorcycle insurance.⁸⁶⁸

In 2017, Swann developed Product Design Principles applicable to its products.⁸⁶⁹ Mr Bessell said that, if Swann add-on insurance products were sold today, they would not meet the standards under those Principles.⁸⁷⁰

⁸⁶³ Transcript, Benjamin Bessell, 19 September 2018, 6140.

⁸⁶⁴ Transcript, Benjamin Bessell, 19 September 2018, 6138–40.

⁸⁶⁵ Transcript, Benjamin Bessell, 18 September 2018, 6084.

⁸⁶⁶ Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 17 [99].

⁸⁶⁷ Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 17 [100].

⁸⁶⁸ Transcript, Benjamin Bessell, 19 September 2018, 6142.

⁸⁶⁹ Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 15 [88].

⁸⁷⁰ Transcript, Benjamin Bessell, 19 September 2018, 6143.

The matter having been drawn to ASIC's attention, it is for ASIC to determine what further action it can and should take.

8.3 What the case study showed

Mr Bessell accepted that consumers were sold products that were of questionable or little value to them, and that the products could have been better explained by the dealers.⁸⁷¹ Mr Bessell agreed that the number and complexity of the products presented to the consumer, and the various options within the products, made it difficult for consumers to have a proper understanding of the products.⁸⁷²

8.3.1 Misconduct

In closing submissions, Counsel Assisting submitted that it was open to me to find that Swann may have engaged in misconduct by breaching the obligation in section 912A(1)(a) of the Corporations Act (in a number of distinct ways), the obligation in section 912A(1)(ca) of the Corporations Act, the obligation in section 912A(1)(aa) and the obligation in section 145 of the National Credit Code. In its written submissions, IAG resisted any finding of misconduct being made.⁸⁷³

Section 912A(1)(a)

Section 912A(1)(a) obliges Swann to do all things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly. Counsel Assisting submitted there were four matters that demonstrated that Swann's conduct may have breached that provision. The first was that Swann undertook no meaningful review of its products to determine whether they provided any value to customers.⁸⁷⁴ The second was that Swann continued to authorise the sale of those products after becoming aware that ASIC held concerns about their product design and

⁸⁷¹ Transcript, Benjamin Bessell, 19 September 2018, 6140–1.

⁸⁷² Transcript, Benjamin Bessell, 18 September 2018, 6086.

⁸⁷³ IAG, Module 6 Case Study Submission, 2–11 [6]–[55].

⁸⁷⁴ Transcript, Closing Submissions, 21 September 2018, 6503.

sales practices.⁸⁷⁵ The third was that Swann established and maintained arrangements that incentivised dealers to sell as many add-on products to consumers as possible, regardless of the suitability or value to consumers.⁸⁷⁶ The final basis was that Swann failed to establish systems to oversee and monitor the sales practices of its authorised representatives.⁸⁷⁷

I deal with each of the four matters in turn.

Swann undertook no meaningful review of its products to determine whether they provided any value to customers.⁸⁷⁸ In its submissions, IAG pointed to internal reviews of loan protection insurance and GAP products in July and August 2016. But those reviews came at least eight months after ASIC had raised its concerns with Swann that Swann's products may have contravened regulatory requirements. As at July 2016, Swann had not undertaken a 'deep technical review of all the products distributed by Swann through Motor Dealers'.⁸⁷⁹ Indeed, Swann's view was that 'ASIC's review of the [motor dealer] channel and products will highlight any issues in respect of product design negating the need for a further internal review'.⁸⁸⁰ Mr Bessell agreed that this was the position.⁸⁸¹

Swann continued to authorise the sale of those products after becoming aware that ASIC held concerns about their product design and sales practices.⁸⁸² IAG noted that after ASIC raised its concerns, Swann participated in an industry approach to the issue through the Insurance Council of Australia.⁸⁸³ It stated that '[w]hile with the benefit of hindsight,

⁸⁷⁵ Transcript, Closing Submissions, 21 September 2018, 6503.

⁸⁷⁶ Transcript, Closing Submissions, 21 September 2018, 6503.

⁸⁷⁷ Transcript, Closing Submissions, 21 September 2018, 6503–4.

⁸⁷⁸ Transcript, Closing Submissions, 21 September 2018, 6503.

⁸⁷⁹ Exhibit 6.314, 27 July 2016, Report of IAG Risk Committee Review of CCI and Add-On Insurance, 9.

⁸⁸⁰ Exhibit 6.314, 27 July 2016, Report of IAG Risk Committee Review of CCI and Add-On Insurance, 9.

⁸⁸¹ Transcript, Benjamin Bessell, 19 September 2018, 6134.

⁸⁸² Transcript, Closing Submissions, 21 September 2018, 6503.

⁸⁸³ IAG, Module 6 Case Study Submission, 3 [12].

reasonable minds could differ as to what approach Swann could or should have taken in and after September 2015, it is difficult to see that becoming involved in an industry wide solution through the Insurance Council of Australia was inefficient or unfair (let alone dishonest)'.⁸⁸⁴

There are two problems with this submission.

The first is that, as Mr Bessell recognised in his witness statement, the pursuit of an industry solution through the Insurance Council of Australia delayed Swann dealing directly with the issues in its own business.⁸⁸⁵ This approach by Swann, in circumstances where Swann lacked an understanding from (relevantly) September 2015 of the value of its products, does not point toward conduct consistent with the obligation imposed by section 912A(1)(a).

The second is that the submission seeks, impermissibly, to qualify Swann's statutory obligation in section 912A(1)(a). As IAG accepted, Swann continued to sell the products after ASIC raised its concerns in September 2015.⁸⁸⁶ Swann possessed all information necessary to ascertain those issues before ASIC's work. Upon becoming aware of ASIC's concerns, there were many options open to Swann to reduce the detriment to consumers. It took only one option, and that option was inadequate to ensure that the sale of the add-on insurance products was efficient, honest and fair.

The third matter referred to by Counsel Assisting was that Swann established and maintained arrangements that incentivised dealers to sell as many add-on products to consumers as possible, regardless of the suitability or value to consumers.⁸⁸⁷ In its submissions, IAG again pointed to the Insurance Council of Australia's attempts to develop an industry-wide solution.⁸⁸⁸ No doubt the market position made unilateral action difficult.

⁸⁸⁴ IAG, Module 6 Case Study Submission, 3 [12].

⁸⁸⁵ Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 18 [105(e)].

⁸⁸⁶ IAG, Module 6 Case Study Submission, 3 [12].

⁸⁸⁷ Transcript, Closing Submissions, 21 September 2018, 6503–4.

⁸⁸⁸ IAG, Module 6 Case Study Submission, 4 [16].

But market-wide misconduct cannot condition the statutory obligation. Compliance with the law will sometimes require entities to sacrifice revenue or profit, if that revenue or profit cannot be generated in a lawful way.

The final matter was that Swann failed to establish systems to oversee and monitor the sales practices of its authorised representatives.⁸⁸⁹ IAG pointed to the systems that it did have in place, presumably to suggest that they were adequate.⁸⁹⁰ That submission is at odds with Mr Bessell's acceptance that, at least between 2013 and January 2017, Swann did not have in place adequate risk management systems.⁸⁹¹ Given the significance of add-on insurance sales to Swann's total revenue, the sales practices of its authorised representatives was necessarily a significant risk. IAG's own internal report noted that the 'authorised representatives currently are not actively recording potential breaches and, therefore, Swann has no oversight on any issues that may be occurring. Promoting the importance of logging all potential breaches is required'.⁸⁹²

In combination, the four matters identified above are sufficient to find that Swann may have engaged in misconduct by breaching its obligation to do all things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly. Selling products through a heavily incentivised dealer network, as an add-on to another sale, creates very significant risk of unfairness for consumers. Doing so in circumstances where the conduct of the authorised representatives is not actively monitored and/or audited heightens the risk that the statutory standard of conduct will not be met. When the products are of low value, the risk of unfairness is compounded. And while industry-wide solutions will often be appropriate, participation through an industry group does not absolve a participating entity of its continuing legal obligations.

⁸⁸⁹ Transcript, Closing Submissions, 21 September 2018, 6504.

⁸⁹⁰ IAG, Module 6 Case Study Submission, 5–6 [17]–[26].

⁸⁹¹ Transcript, Benjamin Bessell, 19 September 2018, 6121.

⁸⁹² Exhibit 6.312, 9 January 2017, Oversight Report of Swann Authorised Representatives.

Section 912A(1)(ca)

IAG also resisted a finding that Swann may have breached its obligation under section 912A(1)(ca) of the Corporations Act – the requirement to take reasonable steps to ensure that its representatives complied with financial services laws – by failing to establish systems to oversee and monitor the sales practices of Swann’s authorised representatives.⁸⁹³ The matters I have mentioned already show that Swann may have breached this obligation.

Section 912A(1)(aa)

IAG did not accept that Swann may have breached section 912A(1)(aa) of the Corporations Act by failing to have in place adequate arrangements for the management of any conflicts of interest that arose through incentivising sales of its add-on insurance products.⁸⁹⁴

IAG sought to rely on the processes that may have been insufficient to prevent Swann from breaching its obligations under section 912A(1)(a) and (ca) to say that its processes for managing conflicts were adequate.⁸⁹⁵ The processes relied on operated together with Swann’s remuneration and incentive arrangements for its authorised representatives. Those arrangements were, by design, focused solely on sales volumes. The arrangements did not incentivise or promote *appropriate sales*; indeed, they encouraged the inappropriate conduct that has led to the remediation program. Mr Bessell accepted that the point of Swann’s remuneration and incentive arrangements was to incentivise sales.⁸⁹⁶ He accepted that, on occasion, these incentive programs incentivised inappropriate sales practices, and that Swann’s authorised representatives sold products that were not appropriate to the consumer.⁸⁹⁷

⁸⁹³ IAG, Module 6 Case Study Submission, 6–7 [27]–[29]; see also Transcript, Closing Submissions, 21 September 2018, 6504.

⁸⁹⁴ IAG, Module 6 Case Study Submission, 7 [30].

⁸⁹⁵ IAG, Module 6 Case Study Submission, 7 [31].

⁸⁹⁶ Transcript, Benjamin Bessell, 18 September 2018, 6105.

⁸⁹⁷ Transcript, Benjamin Bessell, 18 September 2018, 6106.

IAG did not explain how, in light of these remuneration arrangements, the initial training and electronic compliance questionnaire ensured conflicts would be managed. Indeed, even by January 2017, Swann had no knowledge of what issues may have been occurring. Swann's authorised representatives were not actively recording potential breaches and there was no monitoring in place to ensure that refresher training was completed. No face-to-face audits were being carried out. Swann's electronic questionnaire was limited in the level of detail it captured.⁸⁹⁸

In these circumstances, I find that Swann may not have had in place adequate arrangements for the management of any conflicts of interest.

Exceeding commission cap

Finally, as IAG accepted in its 29 June 2018 letter, Swann may have breached section 145 of the National Credit Code by authorising payments to 34 authorised representatives that may have exceeded the 20% cap on commissions imposed under that section.⁸⁹⁹

8.3.2 Conduct falling below community standards and expectations

Swann also engaged in conduct that fell below community standards and expectations by failing to take meaningful steps to ensure that its authorised representatives only sold add-on insurance products in circumstances where the product would be of value to the customer, by designing and implementing remuneration and incentive systems that promoted unfair sales practices; by failing to promote sales practices that focused on delivering value to customers and that met customer needs and expectations; by failing to investigate the appropriateness of its add-on insurance products or the sales practices of its authorised representatives in a timely manner; and by failing to redesign the add-on insurance products and the remuneration and incentive arrangements after first becoming

⁸⁹⁸ Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 3; Transcript, Benjamin Bessell, 18 September 2018, 6114–15.

⁸⁹⁹ Transcript, Benjamin Bessell, 19 September 2018, 6112.

aware of ASIC's concerns in late 2013. Swann largely accepted that it had failed to meet community standards and expectations in those ways.⁹⁰⁰

8.3.3 Causes of the conduct

Swann's conduct had various causes. One was Swann's remuneration and incentive arrangements for its authorised representatives. As I have noted above, those arrangements were, by design, focused solely on sales volumes.

The conduct was also attributable to Swann's culture in various ways. Swann's focus was profit and the maintenance of market share. Those were the goals pursued in the design of its remuneration and incentive arrangements, the prioritisation of the interests of motor dealers ahead of customers and the failure to design systems that properly supervised the work of the authorised representatives. Mr Bessell acknowledged that Swann viewed the motor dealers – not the ultimate consumer – as its customers.⁹⁰¹ In its initial submission to the Commission, IAG acknowledged that Swann's focus on motor dealers was a 'significant contributor' to the conduct now the subject of the remediation program.⁹⁰²

Mr Bessell acknowledged that there were two important features of the regulatory regime that facilitated the sale of add-on insurance: first, the point of sale exemption in the *National Consumer Credit Protection Regulations 2010* (Cth), relevant to consumer credit insurance products; and second, the ability for Australian financial services licensees to authorise representatives to provide general advice.⁹⁰³ Mr Bessell acknowledged that some industry participants considered it inappropriate for authorised representatives to determine whether an add-on insurance policy was suitable for the customer, in circumstances where authorised representatives were authorised to provide general advice only.⁹⁰⁴

⁹⁰⁰ IAG, Module 6 Case Study Submission, 8–9 [37]–[47].

⁹⁰¹ Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 18 [105(b)].

⁹⁰² IAG, *Initial Submissions*, 29 January 2018, 33 [Item 73].

⁹⁰³ Transcript, Benjamin Bessell, 18 September 2018, 6083–4.

⁹⁰⁴ Transcript, Benjamin Bessell, 19 September 2018, 6144.

9 Youi

9.1 Background

Youi Pty Ltd (Youi) issues general insurance products. The case study examined Youi's conduct in handling claims under home insurance policies following natural disasters. In particular, the Commission heard evidence about Youi's conduct in its handling of two insurance claims:

- a claim made by Ms Sacha Murphy, a Youi policyholder whose home was damaged in a hail storm in Broken Hill in November 2016; and
- a claim made by Mr Glenn Sutton, a Youi policyholder whose home was damaged in Tropical Cyclone Debbie in March 2017.

Both Ms Murphy and Mr Sutton gave evidence about their experiences with Youi. In relation to both claims, the Commission heard evidence from Mr Jason Storey, the Chief Operating Officer, Claims Services at Youi.

At the outset, it should be noted that counsel appearing for Youi did not seek to cross-examine either Ms Murphy or Mr Sutton. While counsel appearing for Youi did re-examine Mr Storey, that re-examination was limited to correcting certain errors in the arrangement of the exhibits to Mr Storey's statements, and tendering certain documents relevant to the handling by Youi of a complaint made by Ms Murphy.

That being so, it is surprising that Youi chose to criticise Counsel Assisting for failing to 'contextualise' particular matters,⁹⁰⁵ for '[f]ail[ing] to draw the Commission's attention' to particular matters.⁹⁰⁶ Youi had ample opportunity to contextualise or draw the Commission's attention to whatever matters it chose. It did not take that opportunity. Its criticisms were, therefore, not soundly based.

⁹⁰⁵ Youi, Module 6 Case Study Submission, 2 [10].

⁹⁰⁶ Youi, Module 6 Case Study Submission, 12 [44].

9.2 Evidence

9.2.1 Sacha Murphy

Ms Murphy took out a home and contents insurance policy with Youi in 2012.⁹⁰⁷

In November 2016, there was a severe hail storm in Broken Hill that caused damage to Ms Murphy's roof.⁹⁰⁸ In January 2017, Ms Murphy made a claim under her policy for damage to the roof.⁹⁰⁹ Ms Murphy's claim was accepted on 15 February 2017.⁹¹⁰ It took Ms Murphy and her partner several months to save up to pay the excess,⁹¹¹ which they paid in May 2017. In late May, Ms Murphy and her partner signed a scope of works and agreed for a building company chosen by Youi (Builder A) to complete the repairs.⁹¹²

By that time, Youi was aware of a number of issues in relation to Builder A's performance, specifically in relation to claims in Broken Hill.⁹¹³ Youi had formed the view that Builder A had breached the law by not taking out statutory insurance before commencing building jobs, and had suspended new jobs being allocated to Builder A.⁹¹⁴ Despite this, Youi did not reallocate Ms Murphy's claim to another builder, even though work had not yet commenced on her property.⁹¹⁵ Mr Storey acknowledged that, by not informing Ms Murphy about the issues it had identified with Builder A, or reallocating her claim to another builder, Youi failed to handle her claim in a fair and transparent manner, failed to act in an efficient, professional and practical manner, and breached Youi's duty of utmost good faith.⁹¹⁶

⁹⁰⁷ Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 1 [4].

⁹⁰⁸ Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 1 [5], [7].

⁹⁰⁹ Transcript, Sacha Murphy, 19 September 2018, 6157.

⁹¹⁰ Exhibit 6.334, Witness statement of Jason Storey, 17 September 2018, 32 [70(c)(ii)].

⁹¹¹ Transcript, Sacha Murphy, 19 September 2018, 6159.

⁹¹² Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 2 [10]; Transcript, Sacha Murphy, 19 September 2018, 6158.

⁹¹³ Transcript, Jason Storey, 19 September 2018, 6205.

⁹¹⁴ Transcript, Jason Storey, 19 September 2018, 6210.

⁹¹⁵ Transcript, Jason Storey, 19 September 2018, 6209–10.

⁹¹⁶ Transcript, Jason Storey, 19 September 2018, 6210–11.

In around May 2017, Ms Murphy's daughter's lead levels were tested.⁹¹⁷ Lead contamination is a particular issue in the Broken Hill community, and the lead levels of children under five are monitored regularly.⁹¹⁸ Ms Murphy's daughter's lead levels were above the prescribed level, and, as a result of this, the lead levels in Ms Murphy's backyard were tested. The lead level was found to be very high, and Ms Murphy was told that the soil in the backyard would need to be dug up and replaced with loam. However, this remediation work could not take place until her roof was repaired, because otherwise the lead dust in the roof cavity would re-contaminate the backyard.⁹¹⁹ Ms Murphy told the builder that, because of this, she wanted the repairs to the roof to be done quickly.⁹²⁰

Despite this, Builder A did not commence repairs until October 2017.⁹²¹ Mr Storey acknowledged that Youi did not do enough to address this delay,⁹²² and that, by not taking steps to ensure that Builder A complied with its obligations to commence repairs in the timeframe set by Youi's contractual agreements, Youi failed to handle Ms Murphy's claim in a timely manner.⁹²³

On 4 October 2017, Builder A commenced the repairs, and removed most of the roof of Ms Murphy's property, as well as the air-conditioner and solar panels. At the end of that day, however, the builders told Ms Murphy and her partner that they would not do any more work because there were structural issues with the roof that were too much for them, and they needed more money to deal with those issues. The builders left without covering the roof, and asked Ms Murphy and her partner to pay around \$1,800 before they

⁹¹⁷ Transcript, Sacha Murphy, 19 September 2018, 6159.

⁹¹⁸ Transcript, Sacha Murphy, 19 September 2018, 6156.

⁹¹⁹ Transcript, Sacha Murphy, 19 September 2018, 6160.

⁹²⁰ Transcript, Sacha Murphy, 19 September 2018, 6160.

⁹²¹ Transcript, Jason Storey, 19 September 2018, 6216.

⁹²² Transcript, Jason Storey, 19 September 2018, 6216.

⁹²³ Transcript, Jason Storey, 19 September 2018, 6216.

would return.⁹²⁴ Mr Storey acknowledged that it was not acceptable that Ms Murphy and her partner were left in this position.⁹²⁵

At this time, Ms Murphy was pregnant. Because the air-conditioner had been removed, it was hot inside the house, and lead dust was able to enter through the open air-conditioning vent. Ms Murphy was concerned about the impact of this on her family and unborn child.⁹²⁶

On 6 October 2017, Ms Murphy called Youi and told the representative that she was unhappy with how long it was taking for the roof to be repaired, and that she was pregnant and being exposed to high levels of lead.⁹²⁷ Youi didn't take any further action to cover the roof until 9 October 2017.⁹²⁸ On that day, it instructed Builder A to cover the roof, but did not check whether Builder A had done so.⁹²⁹ Builder A did not cover the roof. Mr Storey accepted that Youi did not do enough when it learned that Builder A had left the roof uncovered,⁹³⁰ and that Youi's response to the situation of Ms Murphy and her family was inadequate.⁹³¹

On 19 October 2017, just over two weeks after Builder A opened up the roof of Ms Murphy's home, Youi authorised Builder A's variation for the extra work to ensure that the roof complied with the building code.⁹³² On 20 October 2017, Builder A returned to commence the repair work but then told Youi that it had identified further difficulties with the roof, and that the repair cost would be significant.⁹³³ Ms Murphy called Youi later that day and

⁹²⁴ Transcript, Sacha Murphy, 19 September 2018, 6161, 6163.

⁹²⁵ Transcript, Jason Storey, 19 September 2018, 6217.

⁹²⁶ Transcript, Sacha Murphy, 19 September 2018, 6163–4.

⁹²⁷ Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 4 [23]; Transcript, Jason Storey, 19 September 2018, 6219.

⁹²⁸ Transcript, Jason Storey, 19 September 2018, 6219.

⁹²⁹ Transcript, Jason Storey, 19 September 2018, 6220.

⁹³⁰ Transcript, Jason Storey, 19 September 2018, 6220.

⁹³¹ Transcript, Jason Storey, 19 September 2018, 6220.

⁹³² Transcript, Jason Storey, 19 September 2018, 6220.

⁹³³ Transcript, Jason Storey, 19 September 2018, 6221.

told the Youi representative, among other things, that she was very upset about her family being exposed to lead dust.⁹³⁴

After this call, Youi agreed to arrange temporary accommodation for Ms Murphy and her family.⁹³⁵ Youi again requested that Builder A make the property safe for Ms Murphy and her family to live in, by closing the roof.⁹³⁶ After spending four nights in a caravan park, the family returned to the property.⁹³⁷

Ms Murphy told the Commission that it was clear on their first night back in the house that the roof had not been replaced properly as they could hear the noise of the loose metal roofing in the wind.⁹³⁸ Youi did not take any steps to check that the lead dust could no longer enter the property before the family went home.⁹³⁹

Ms Murphy made a formal complaint to Youi on 2 November 2017. Her letter was six pages long and raised a lengthy list of concerns.⁹⁴⁰ In response, a representative of Youi spoke to Ms Murphy's partner on the phone, and sent Ms Murphy a system-generated letter.⁹⁴¹ Mr Storey agreed that the letter was not an adequate response to the complaint made by Ms Murphy, and was not an appropriate way to deal with a customer who was clearly distressed by her experience with Youi.⁹⁴² He also agreed that the response did not comply with the requirements of the General Insurance Code of Practice.⁹⁴³

⁹³⁴ Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 4 [28].

⁹³⁵ Transcript, Sacha Murphy, 19 September 2018, 6166.

⁹³⁶ Transcript, Jason Storey, 19 September 2018, 6221–2.

⁹³⁷ Transcript, Sacha Murphy, 19 September 2018, 6166.

⁹³⁸ Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 5 [31].

⁹³⁹ Transcript, Jason Storey, 19 September 2018, 6222.

⁹⁴⁰ Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 5 [34]; Transcript, Jason Storey, 19 September 2018, 6222.

⁹⁴¹ Transcript, Jason Storey, 19 September 2018, 6224.

⁹⁴² Transcript, Jason Storey, 19 September 2018, 6227.

⁹⁴³ Transcript, Jason Storey, 19 September 2018, 6228.

The Commission heard that Youi's complaints and IDR process more generally is considered by its compliance area to be non-compliant with legal requirements.⁹⁴⁴

On 15 November 2017, it rained in Broken Hill.⁹⁴⁵ Ms Murphy told the Commission that water poured into the house through the lounge, kitchen, bathroom and hallway, because the roof had not been replaced properly.⁹⁴⁶ The water that got into the house caused internal damage, including cracks in the ceiling and mould.⁹⁴⁷ Mr Storey acknowledged that Youi had not checked that Builder A had put the roof on correctly before Ms Murphy and her family returned to the home, despite being responsible for the workmanship of the builder.⁹⁴⁸

The roof was ultimately repaired by a different company in May 2018, 18 months after the hail damage.⁹⁴⁹ Mr Storey acknowledged that the delays in dealing with Ms Murphy's claim have prevented the lead remediation works in Ms Murphy's backyard from proceeding.⁹⁵⁰

Mr Storey acknowledged that, in relation to Ms Murphy's claim, Youi failed to conduct its claims in an honest, fair, transparent and timely manner,⁹⁵¹ failed to respond to the catastrophe that was the Broken Hill storm in a way that was efficient, professional, practical and compassionate towards Ms Murphy,⁹⁵² and breached its duty of utmost good faith.⁹⁵³

⁹⁴⁴ Transcript, Jason Storey, 19 September 2018, 6230.

⁹⁴⁵ Transcript, Sacha Murphy, 19 September 2018, 6168.

⁹⁴⁶ Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 6 [39].

⁹⁴⁷ Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 6 [43].

⁹⁴⁸ Transcript, Jason Storey, 19 September 2018, 6232.

⁹⁴⁹ Transcript, Jason Storey, 19 September 2018, 6234.

⁹⁵⁰ Transcript, Jason Storey, 19 September 2018, 6234.

⁹⁵¹ Transcript, Jason Storey, 19 September 2018, 6234.

⁹⁵² Transcript, Jason Storey, 19 September 2018, 6234.

⁹⁵³ Transcript, Jason Storey, 19 September 2018, 6191.

9.2.2 Glenn Sutton

Like Ms Murphy, Mr Sutton had a home insurance policy with Youi.⁹⁵⁴

In late March 2017, Tropical Cyclone Debbie hit Queensland and caused damage to Mr and Mrs Sutton's home – including causing some of the roof sheeting to come off, leaving a hole in the roof.⁹⁵⁵ The damage caused by the storm meant that Mr and Mrs Sutton could not live in the home until it had been repaired.⁹⁵⁶

Mr and Mrs Sutton made a claim under their home insurance policy in March 2017.⁹⁵⁷ Mr Sutton told the Commission about three issues in connection with his claim with Youi: inadequate make safe works; delays in repairs; and delays in reimbursement for temporary accommodation.

Inadequate make safe works

In relation to the first of those issues, Mr Sutton said that, a few days after the cyclone, a building company attended his house to perform make safe works.⁹⁵⁸ The builder told Mr Sutton that they had only been allocated eight hours to do the job.⁹⁵⁹ The builders did not install a tarpaulin to cover the hole in the roof, or conduct any drying work, despite mould being a significant problem when houses in tropical areas like Airlie Beach have been inundated with water.⁹⁶⁰ Mr Storey said that Youi does not have any particular procedures for houses at risk of mould, but that this was something Youi was considering introducing.⁹⁶¹ He also said that Youi does not check, as part of its standard claims process, whether make safe work has happened.⁹⁶²

⁹⁵⁴ Transcript, Jason Storey, 19 September 2018, 6234.

⁹⁵⁵ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 1–2 [5]–[7].

⁹⁵⁶ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 2 [7].

⁹⁵⁷ Transcript, Jason Storey, 19 September 2018, 6235.

⁹⁵⁸ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 2 [12].

⁹⁵⁹ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 2 [13].

⁹⁶⁰ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 2 [13]; Transcript, Jason Storey, 19 September 2018, 6238.

⁹⁶¹ Transcript, Jason Storey, 19 September 2018, 6238–9.

⁹⁶² Transcript, Jason Storey, 19 September 2018, 6204.

Mr Sutton told the Commission that, around a month after the cyclone, a tarpaulin was fitted over the hole in the roof.⁹⁶³ However, within weeks, the tarpaulin was torn by the wind, and water was able to enter the house when it rained.⁹⁶⁴ Mr Sutton told Youi several times that the tarpaulin was not sufficient.⁹⁶⁵ Despite this, no-one replaced the tarpaulin in the second half of 2017.⁹⁶⁶ Over that time, mould continued to grow in the property.⁹⁶⁷ Mr Storey agreed that, by May 2017, Youi was on notice that the tarpaulin that had been fitted had become loose and that water would be able to enter the property.⁹⁶⁸ Mr Storey agreed that, despite being aware since May 2017 that the tarpaulin on the roof was only a temporary solution, Youi had not taken steps to check the tarpaulin or find a more permanent solution until January 2018.⁹⁶⁹

Mr Storey said that Youi accepted responsibility for failing to ensure that the property was covered and protected from the elements while the claim was being resolved.⁹⁷⁰

Delays in repairs

In relation to the second issue, Mr Sutton told the Commission that, in the weeks following the cyclone, several builders inspected his property to prepare reports.⁹⁷¹ In May 2017, Mr Sutton was sent a scope of works for the repairs. Mr Sutton was concerned that no-one had properly inspected

⁹⁶³ Transcript, Glenn Sutton, 19 September 2018, 6174.

⁹⁶⁴ Transcript, Glenn Sutton, 19 September 2018, 6174.

⁹⁶⁵ Transcript, Glenn Sutton, 19 September 2018, 6174–5.

⁹⁶⁶ Transcript, Glenn Sutton, 19 September 2018, 6175–6.

⁹⁶⁷ Transcript, Glenn Sutton, 19 September 2018, 6176.

⁹⁶⁸ Transcript, Jason Storey, 19 September 2018, 6240.

⁹⁶⁹ Transcript, Jason Storey, 19 September 2018, 6242, 6243.

⁹⁷⁰ Transcript, Jason Storey, 19 September 2018, 6236.

⁹⁷¹ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 3 [20].

the roof for structural damage.⁹⁷² He asked Youi to arrange for someone to inspect the roof.⁹⁷³ Youi arranged for a builder to inspect the roof, and this builder prepared a report. The builder told Mr Sutton that he had not inspected the roof cavity.⁹⁷⁴ Mr Sutton raised this with Youi and asked for an engineer to inspect the roof.⁹⁷⁵ Youi arranged for this to happen, and the engineer concluded that the roof needed to be replaced.⁹⁷⁶

In August 2017, Mr Sutton signed a building contract with the builder on the basis of an updated scope of works that included the replacement of the roof.⁹⁷⁷ Neither Youi nor the builder gave Mr Sutton a start date for the repairs.⁹⁷⁸

By October 2017, repair work still had not started.⁹⁷⁹ On 9 October, Mr Sutton sent a complaint to Youi about a number of matters, including the continuing delays.⁹⁸⁰ Youi did not provide a written response to that complaint.⁹⁸¹ Mr Storey accepted that Youi did not comply with the General Insurance Code of Practice in responding to this complaint.⁹⁸²

By November 2017, repair work still had not started. On 17 November 2017, Youi sent an email to Mr Sutton raising the possibility of cash settling the claim and advising that Mr Sutton would need to organise for an area of the house affected by termites to be repaired before any other repairs could

⁹⁷² Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 3–4 [21]–[22].

⁹⁷³ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 4 [22].

⁹⁷⁴ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 4 [23].

⁹⁷⁵ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 4 [24].

⁹⁷⁶ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 4 [25]. In its submissions, Youi emphasised that the engineer's conclusion that the roof needed to be replaced was based on the use of inadequate fixings in the original roof construction: see Youi, Module 6 Case Study Submission, 12 [43].

⁹⁷⁷ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 4 [27].

⁹⁷⁸ Transcript, Glenn Sutton, 19 September 2018, 6179.

⁹⁷⁹ Transcript, Glenn Sutton, 19 September 2018, 6179.

⁹⁸⁰ Transcript, Glenn Sutton, 19 September 2018, 6179–80.

⁹⁸¹ Transcript, Jason Storey, 19 September 2018, 6245.

⁹⁸² Transcript, Jason Storey, 19 September 2018, 6245.

proceed.⁹⁸³ Mr Sutton told the Commission that this was ‘out of the blue’ and that Youi had not previously discussed a cash settlement with him.⁹⁸⁴

When Mr Sutton gave evidence to the Commission, the house had still not been repaired. Mr Storey acknowledged that it is unacceptable that the Suttons were not yet back in their home, and said that Youi accepted responsibility for the extended delays in dealing with Mr and Mrs Sutton’s claim.⁹⁸⁵

Temporary accommodation

In relation to the third issue, Mr Sutton told the Commission that he and his wife have been living in temporary accommodation since the cyclone in March 2017.⁹⁸⁶ They have had to move four times,⁹⁸⁷ and each time have had to find the accommodation themselves, which has been difficult due to the limited availability of suitable accommodation in the Airlie Beach area since the cyclone.⁹⁸⁸

Mr Sutton told the Commission about his difficulties in getting reimbursement from Youi for temporary accommodation. Youi would regularly take weeks to reimburse costs and Mr Sutton had to follow up Youi when they failed to pay.⁹⁸⁹ Mr Storey agreed that Mr and Mrs Sutton were put under financial pressure because Youi delayed in reimbursing them for their temporary accommodation.⁹⁹⁰ At various times, Mr and Mrs Sutton were left thousands of dollars out of pocket. Mr Storey agreed that it was not acceptable that Youi repeatedly delayed in reimbursing Mr and Mrs Sutton for the temporary accommodation cost.⁹⁹¹

⁹⁸³ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 5 [31].

⁹⁸⁴ Transcript, Glenn Sutton, 19 September 2018, 6181.

⁹⁸⁵ Transcript, Jason Storey, 19 September 2018, 6235.

⁹⁸⁶ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 5 [35].

⁹⁸⁷ Transcript, Glenn Sutton, 19 September 2018, 6182.

⁹⁸⁸ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 5 [35].

⁹⁸⁹ Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 6 [36].

⁹⁹⁰ Transcript, Jason Storey, 19 September 2018, 6235.

⁹⁹¹ Transcript, Jason Storey, 19 September 2018, 6235.

Mr Sutton's 'claims adviser' at Youi, who had primary responsibility for organising the reimbursement of temporary accommodation expenses, was located in South Africa.⁹⁹² Mr Storey accepted that this resulted in delays in the handling of Mr Sutton's claim.⁹⁹³ Mr Storey told the Commission that it had been recognised within Youi in August 2017 that it was not ideal for claims advisers based in South Africa to be trying to manage claims outside of Australian business hours.⁹⁹⁴ Despite this, Youi did not transfer Mr Sutton's claim to a claims adviser based in Australia until January 2018.⁹⁹⁵

Mr Storey accepted that, in relation to Mr Sutton's claim, Youi failed to conduct its claims handling process in an honest, fair, transparent and timely manner, failed to respond to Tropical Cyclone Debbie in an efficient, professional and practical way and in a compassionate manner, and failed to comply with its duty of utmost good faith.⁹⁹⁶

9.3 What the case study showed

9.3.1 Ms Murphy's claim

In his evidence in relation to Ms Murphy's claim, Mr Storey accepted that:

- Youi failed to handle Ms Murphy's claim in an honest, fair and transparent manner, as required by clause 7.2 of the General Insurance Code of Practice;⁹⁹⁷

⁹⁹² Transcript, Jason Storey, 20 September 2018, 6257.

⁹⁹³ Transcript, Jason Storey, 20 September 2018, 6262.

⁹⁹⁴ Transcript, Jason Storey, 20 September 2018, 6261.

⁹⁹⁵ Transcript, Jason Storey, 20 September 2018, 6262.

⁹⁹⁶ Transcript, Jason Storey, 19 September 2018, 6236.

⁹⁹⁷ Transcript, Jason Storey, 19 September 2018, 6234.

- Youi failed to respond to the Broken Hill hail storm in an efficient, professional and practical way and in a compassionate manner, as required by clause 9.2 of the Code;⁹⁹⁸ and
- Youi breached its duty of utmost good faith to Ms Murphy.⁹⁹⁹

Despite these acknowledgments, Youi contended in its post-hearing submissions that none of the matters considered by the Commission in relation to Ms Murphy's claim supported a finding that Youi may have engaged in misconduct or conduct falling below community standards and expectations.¹⁰⁰⁰ That submission is contrary to the evidence, and must be rejected.

The key features of Youi's handling of Ms Murphy's claim may be summarised as follows. Youi selected a builder to undertake repairs at Ms Murphy's property despite being aware of numerous complaints in relation to the builder. When Youi subsequently formed the view that the builder had broken the law, and that no new jobs should be allocated to the builder, Youi did not allocate Ms Murphy's repairs to another builder. Nor did it tell Ms Murphy about these issues. A period of several months elapsed, during which no work was done at Ms Murphy's property. When work commenced, the builders walked off the job, leaving Ms Murphy and her family in a house with no roof and no air-conditioning, which was not protected from lead dust. When Ms Murphy told Youi on 6 October 2017 about her situation, including that she was pregnant and being exposed to lead dust, Youi did nothing until 19 October 2017, when it attempted to arrange make safe works. Those make safe works did not occur. Youi took no steps to check that they had occurred, or that Ms Murphy and her family were safe. It was only on 20 October, after Ms Murphy complained again, that she and her family were placed in temporary accommodation. After that, they were required to return to a home that had not properly been made safe for them. As a result of the builder's poor workmanship, further damage was done to the property when it rained. It was not until May 2018 that Ms Murphy's roof was properly repaired.

⁹⁹⁸ Transcript, Jason Storey, 19 September 2018, 6234.

⁹⁹⁹ Transcript, Jason Storey, 19 September 2018, 6191.

¹⁰⁰⁰ Youi, Module 6 Case Study Submission, 2–3 [5].

Youi sought to contend that this conduct did not breach clause 7.2 of the General Insurance Code of Practice. Clause 7.2 provides that ‘We will conduct claims handling in an honest, fair, transparent and timely manner, in accordance with this section’. Youi argued that the requirement to conduct claims handling in a ‘timely’ manner requires nothing more than for it to comply with the particular timeframes set out in other provisions of clause 7 of the Code.¹⁰⁰¹ I disagree. Consistently with the view taken by the Insurance Council of Australia and the Code Governance Committee,¹⁰⁰² I consider that the requirement to handle claims in an ‘honest, fair, transparent and timely manner’ has a broader application, and is capable of being breached independently of the other provisions of clause 7 of the Code.

It is clear that Youi may have breached that duty in relation to its handling of Ms Murphy’s claim, and that it therefore may have engaged in misconduct. Among other things, it was not fair or transparent for Youi not to reallocate Ms Murphy’s repairs to another builder in circumstances where it knew about significant issues with Builder A and did not inform Ms Murphy of those issues. When Youi took no steps to enforce the timelines in its agreement with Builder A, despite Builder A’s failure to commence work within those timelines, it failed to handle the claim in a timely manner. When Ms Murphy told Youi on 6 October that she was pregnant and being exposed to lead dust because of Builder A’s failure to complete the repairs, it was not fair for Youi to leave her and her family in their house – without a roof – for another two weeks before moving them into temporary accommodation.

For similar reasons, it is arguable that Youi may have breached its duty of utmost good faith to Ms Murphy, and therefore engaged in misconduct. As noted earlier in this chapter, the duty of utmost good faith may require an insurer to act, consistently with commercial standards of decency and fairness, with due regard to the interests of the insured.¹⁰⁰³ Throughout its handling of Ms Murphy’s claim, as summarised above, there were a number

¹⁰⁰¹ Youi, Module 6 Case Study Submission, 6–7 [17]–[18].

¹⁰⁰² Exhibit 6.404, Witness statement of Robert Whelan, 27 August 2018, Exhibit RW-33 [ICA.002.001.0538 at .0606–.0607].

¹⁰⁰³ *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1 at 12 [15] (Gleeson CJ and Crennan J).

of instances where Youi could be said to have failed to act with due regard to Ms Murphy's interests.

On the basis of the evidence before the Commission, I am not in a position to draw conclusions about Youi's response to the Broken Hill hail storm as a whole. However, I agree with Mr Storey that, at least in relation to its handling of Ms Murphy's claim, Youi failed to respond to that catastrophe in a way that was efficient, professional, practical and compassionate.

I refer Youi's conduct in connection with the duty of utmost good faith to ASIC, pursuant to paragraph (a) of the Commission's Terms of Reference, for ASIC to consider what action it can and should take.

I consider that the matters referred to above that may constitute misconduct were attributable, at least in part, to the way in which Youi remunerated its claims handling staff. At the time of Ms Murphy's claim, claims handling staff at Youi were responsible both for dealing with incoming claims and for managing existing claims. Mr Storey said that about 30% of the performance indicators for these staff related to dealing with new claims, and only 10% related to handling existing claims.¹⁰⁰⁴ This combination of roles, and the emphasis on dealing with new claims, contributed to claims staff feeling unable to spend time on dealing with their larger, more difficult claims.¹⁰⁰⁵ In August 2018, Youi introduced changes to address those issues.¹⁰⁰⁶

9.3.2 Mr Sutton's claim

In relation to Mr Sutton's claim, Mr Storey accepted that:

- Youi failed to handle Mr Sutton's claim in an honest, fair and transparent manner, as required by clause 7.2 of the Code;¹⁰⁰⁷

¹⁰⁰⁴ Transcript, Jason Storey, 20 September 2018, 6268.

¹⁰⁰⁵ Transcript, Jason Storey, 20 September 2018, 6269.

¹⁰⁰⁶ Transcript, Jason Storey, 20 September 2018, 6270.

¹⁰⁰⁷ Transcript, Jason Storey, 19 September 2018, 6236.

- Youi failed to respond to Tropical Cyclone Debbie in an efficient, professional and practical way and in a compassionate manner, as required by clause 9.2 of the Code;¹⁰⁰⁸ and
- Youi breached its duty of utmost good faith to Mr Sutton.¹⁰⁰⁹

Despite these acknowledgments, Youi contended in its post-hearing submissions that none of the matters considered by the Commission in relation to Mr Sutton's claim supported a finding that Youi may have engaged in misconduct or in conduct falling below community standards and expectations.¹⁰¹⁰ Again, that submission is contrary to the evidence, and must be rejected.

Youi's continuing failure to fix the tarpaulin over the hole in Mr Sutton's roof, or find a more permanent way to keep water out of Mr Sutton's house while repairs were taking place, was not professional or practical. Nor was it fair to Mr Sutton, in circumstances where Youi must have been aware that additional water entering Mr Sutton's property was likely to cause damage to that property, and to cause mould to grow. Youi's repeated delays in reimbursing Mr and Mrs Sutton for the cost of their temporary accommodation demonstrated a failure to deal with Mr and Mrs Sutton's claim in a timely manner. They also were not fair to Mr and Mrs Sutton, as those delays in organising reimbursement repeatedly put Mr and Mrs Sutton under financial pressure. As Mr Storey acknowledged, the Code emphasises the importance of not leaving a customer in financial hardship.¹⁰¹¹ While the delays in undertaking repairs to Mr Sutton's property were attributable to a number of factors, they were, at least in part, indicative of a failure by Youi to handle Mr Sutton's claim in an efficient or practical way, or in a timely manner.

Accordingly, I consider that, in relation to Mr Sutton's claim, Youi may have breached its obligation under clause 7.2 of the Code, and therefore may have engaged in misconduct. While I am not in a position to draw conclusions about Youi's response to Tropical Cyclone Debbie as a whole,

¹⁰⁰⁸ Transcript, Jason Storey, 19 September 2018, 6236.

¹⁰⁰⁹ Transcript, Jason Storey, 19 September 2018, 6236.

¹⁰¹⁰ Youi, Module 6 Case Study Submission, 1–2 [5].

¹⁰¹¹ Transcript, Jason Storey, 19 September 2018, 6188.

I agree with Mr Storey that, at least in relation to its handling of Mr Sutton's claim, Youi failed to respond to that catastrophe in a way that was efficient, professional, practical and compassionate. I also consider that it is arguable that Youi may have breached its duty of utmost good faith to Mr Sutton, and therefore engaged in misconduct. The evidence about Youi's handling of Mr Sutton's claim – particularly in relation to the make safe work and reimbursement for temporary accommodation – indicates that Youi failed in a number of ways to act with due regard to the interests of the insured.

I refer Youi's conduct in connection with the duty of utmost good faith to ASIC, pursuant to paragraph (a) of the Commission's Terms of Reference, for ASIC to consider what action it can and should take.

9.3.3 Effectiveness of mechanisms for response and redress

Youi's handling of both Ms Murphy's and Mr Sutton's claims highlighted issues in relation to Youi's IDR processes.

As noted above, Ms Murphy made a formal complaint to Youi on 2 November 2017, which was six pages long and raised a lengthy list of concerns.¹⁰¹² In response to this complaint, a representative of Youi spoke to Ms Murphy's partner on the phone, and then sent Ms Murphy a system-generated letter. This letter did not respond to the matters Ms Murphy had raised in her six-page complaint, did not explain how Youi had resolved that complaint, and did not set out Youi's reasons for any decision that it made in relation to the complaint. The phone call between the Youi representative and Ms Murphy's partner was not recorded, and the only available notes of that call were brief and inadequate.

Mr Storey accepted that Youi had failed to deal with Ms Murphy's complaint in accordance with the requirements of clause 10.13 of the Code.¹⁰¹³ In its submissions, Youi accepted that its response to Ms Murphy's complaint did not set out the matters required by clause 10.13 of the Code, but sought to argue that this did not constitute misconduct. Under the Commission's Terms of Reference, 'misconduct' includes conduct that breaches a

¹⁰¹² Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 5 [34]; Transcript, Jason Storey, 19 September 2018, 6222.

¹⁰¹³ Transcript, Jason Storey, 19 September 2018, 6228.

recognised and widely adopted benchmark for conduct. I consider that clause 10.13 represents such a benchmark and that, by breaching it, Youi has engaged in misconduct. Youi's submission to the contrary indicates a concerning failure to accord sufficient importance to the provisions of the Code dealing with the handling of disputes.

Youi's failure to comply with those provisions in this case had the result that, if Ms Murphy had taken her complaint to EDR, there would have been no way of testing any subsequent account given by Youi of what was said in the conversation with Ms Murphy's partner. The brief notes made by Youi of the telephone conversation were not adequate to allow that to occur. This state of affairs has the potential to undermine the effectiveness of EDR mechanisms, and underscores the importance of the requirement in the Code for general insurers to respond to complaints in writing.

In relation to the complaint made by Mr Sutton on 9 October 2017, the issue is presented even more starkly. Youi did not respond in writing to that complaint.¹⁰¹⁴ There is no record of how that complaint was resolved, or Youi's reasons for any decision it made in relation to that complaint. In the absence of any record of a decision, it is difficult to see how Mr Sutton could have escalated his complaint to EDR. Mr Storey rightly accepted that Youi failed to deal with Mr Sutton's complaint in accordance with the requirements of clause 10.13 of the Code.¹⁰¹⁵ Again, Youi's conduct had the potential to undermine the effectiveness of EDR mechanisms.

9.3.4 Conduct falling below community standards and expectations

Another matter addressed in Mr Storey's evidence was the term in Youi's home insurance policies that excluded from cover any 'additional costs resulting from your buildings or any part thereof not being compliant with the most recent building codes, laws and regulations'.

¹⁰¹⁴ In its submissions, Youi referred to four brief follow-up emails sent to Mr Sutton after he made this complaint: Youi, Module 6 Case Study Submission, 14 [59]. Those emails were not tendered in evidence at the hearing, and Youi did not seek leave to tender them after the hearing. It is clear on the face of those emails that none of them constituted a written response to Mr Sutton's complaint.

¹⁰¹⁵ Transcript, Jason Storey, 19 September 2018, 6245.

Mr Storey accepted that it would be impractical and unreasonable for the average person to stay abreast of changes to the building code and upgrade their house accordingly. He said that it would not be economical for any homeowner to do this.¹⁰¹⁶ He also accepted that Youi does not enforce this term in practice, but instead determines whether to cover a policyholder for additional costs associated with bringing a property up to code by applying a set of guidelines that are not made available to policyholders.¹⁰¹⁷

Mr Storey accepted that a Youi policyholder has no idea until after they make a claim and the damage is assessed whether or not he or she will be covered for these additional costs.¹⁰¹⁸ He accepted that this may not be satisfactory.¹⁰¹⁹ He also accepted that it might be possible for Youi to include a narrower exclusion in its home insurance policies, which reflected the circumstances in which the current exclusion is actually applied.¹⁰²⁰ In its submissions, Youi contends that attempting to collate the variables and discretionary matters currently applied by assessors into a simple term within its policies might cause uncertainty and confusion in the minds of customers.¹⁰²¹ However, I consider that enforcing the current term by reference to criteria in internal guidelines, which are not made available to policyholders, is what is likely to cause uncertainty and confusion in the minds of customers.

No doubt it may be said that Youi's policy of not relying on the strict terms of the policy works to the advantage of the insured. But I consider that the community would expect that the policy terms would explain clearly what is covered and what is not.

¹⁰¹⁶ Transcript, Jason Storey, 19 September 2018, 6196.

¹⁰¹⁷ Transcript, Jason Storey, 19 September 2018, 6197–200.

¹⁰¹⁸ Transcript, Jason Storey, 19 September 2018, 6200.

¹⁰¹⁹ Transcript, Jason Storey, 19 September 2018, 6200.

¹⁰²⁰ Transcript, Jason Storey, 19 September 2018, 6197.

¹⁰²¹ Youi, Module 6 Case Study Submission, 18 [77].

10 AAI Ltd (AAMI'S Complete Replacement Cover policy)

10.1 Background

AAI Limited (AAI) carries out the general insurance activities of Suncorp Group.¹⁰²² The case study focused upon AAI's handling of claims made following the Wye River bushfires on Christmas Day 2015, and the way in which AAI marketed its Complete Replacement Cover (CRC) home insurance product. The Commission heard evidence from Mr Gary Dransfield, Chief Executive Officer, Insurance, at Suncorp Group.¹⁰²³

10.2 Evidence

AAI issues 37 home and contents insurance products through 13 different brands, including AAMI.¹⁰²⁴

Generally speaking, AAI's home and contents policies are 'sum insured' policies, which require the policyholder to nominate the amount for which their home and contents will be insured.¹⁰²⁵ However, AAMI offers optional CRC on its building insurance and landlord insurance policies.¹⁰²⁶ CRC provides cover for the total amount that it would cost AAI to repair or rebuild a building.¹⁰²⁷ As a result, if a policyholder takes out CRC, there is no need for the policyholder to nominate a particular sum for which a building will be insured.¹⁰²⁸ When a claim is accepted under the CRC policy, AAI can choose

¹⁰²² Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 1 [1].

¹⁰²³ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 1 [1];
Exhibit 6.370, Witness statement of Gary Dransfield, 29 August 2018, 1 [1].

¹⁰²⁴ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 2 [10].

¹⁰²⁵ Transcript, Gary Dransfield, 20 September 2018, 6281.

¹⁰²⁶ Transcript, Gary Dransfield, 20 September 2018, 6281; see also AAI Ltd, Module 6 Case Study Submission, 2 [5].

¹⁰²⁷ Transcript, Gary Dransfield, 20 September 2018, 6281.

¹⁰²⁸ Transcript, Gary Dransfield, 20 September 2018, 6282.

to either repair or rebuild the property, or to cash settle the claim for the amount that it would cost AAI to do the work.¹⁰²⁹

AAI introduced CRC in September 2006.¹⁰³⁰ Between 1 January 2015 and 31 May 2018, AAI issued about 1.59 million policies in which customers had CRC, accounting for almost 70% of the policies in which CRC was available.¹⁰³¹ In the same period, AAI received more than \$1.48 billion in premiums in respect of those policies.¹⁰³²

While CRC was introduced to mitigate the risk of underinsurance,¹⁰³³ Mr Dransfield accepted that it would only achieve that purpose if the cash settlements offered by AAI represented the true cost of repairing or rebuilding the insured home.¹⁰³⁴

10.2.1 Wye River bushfires

AAI received 63 claims following the Wye River bushfires, 34 of which related to AAMI products.¹⁰³⁵ In 28 of those 34 claims, the policyholder had opted in to CRC.¹⁰³⁶ AAI settled the majority of contents claims within a few weeks, but the building claims and more complex contents claims took longer to settle. Despite having initially estimated that within a few months, claims would be cash settled or would have their scope of works and cost of repairs confirmed, Mr Dransfield accepted that those timelines were not met for the majority of the claims.¹⁰³⁷ Mr Dransfield did not consider that

¹⁰²⁹ Transcript, Gary Dransfield, 20 September 2018, 6283.

¹⁰³⁰ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 8 [19]; Transcript, Gary Dransfield, 20 September 2018, 6282.

¹⁰³¹ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 11 [31].

¹⁰³² Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 11 [31].

¹⁰³³ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 8 [19]; Transcript, Gary Dransfield, 20 September 2018, 6283.

¹⁰³⁴ Transcript, Gary Dransfield, 20 September 2018, 6283.

¹⁰³⁵ Transcript, Gary Dransfield, 20 September 2018, 6283.

¹⁰³⁶ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 27 [76]; Transcript, Gary Dransfield, 20 September 2018, 6284.

¹⁰³⁷ Transcript, Gary Dransfield, 20 September 2018, 6284.

AAI's actions were the cause of the delays,¹⁰³⁸ but he said that AAI could nonetheless have communicated better with customers and could have done more to keep them informed of the progress of their claims.¹⁰³⁹

On 8 November 2016, Ms Sarah Henderson MP gave a radio interview criticising AAMI's handling of the Wye River claims, and its CRC product more broadly.¹⁰⁴⁰ These criticisms related to a number of matters, including: delay in the resolution of claims; issues with AAI's advertising; and concerns that AAI was underquoting the cost of rebuilding.¹⁰⁴¹

Following these criticisms, Kelly O'Dwyer MP referred Ms Henderson's allegations to ASIC.¹⁰⁴² ASIC commenced an investigation into AAI's claims handling practices in connection with the Wye River bushfires,¹⁰⁴³ and its marketing of the CRC products.¹⁰⁴⁴ ASIC was limited in the actions that it could take in respect of the claims handling allegations, because the handling of insurance claims is excluded from the definition of a 'financial service' by regulation 7.1.33 of the *Corporations Regulations 2001* (Cth).¹⁰⁴⁵

¹⁰³⁸ Transcript, Gary Dransfield, 20 September 2018, 6286; see also AAI Ltd, Module 6 Case Study Submission, 3 [8].

¹⁰³⁹ Transcript, Gary Dransfield, 20 September 2018, 6286–7.

¹⁰⁴⁰ Transcript, Gary Dransfield, 20 September 2018, 6285; Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, Exhibit GCD-4 (Tab 29) [SUN.0760.0300.0464].

¹⁰⁴¹ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, Exhibit GCD-4 (Tab 29) [SUN.0760.0300.0464].

¹⁰⁴² Transcript, Gary Dransfield, 20 September 2018, 6293.

¹⁰⁴³ Transcript, Gary Dransfield, 20 September 2018, 6293–4.

¹⁰⁴⁴ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, Exhibit GCD-4 (Tab 41) [SUN.0760.0302.0500].

¹⁰⁴⁵ Transcript, Gary Dransfield, 20 September 2018, 6301; Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, Exhibit GCD-4 (Tab 41) [SUN.0760.0302.0508]; cf Insurance Contracts Act ss 11B and 14A.

10.2.2 Marketing of the CRC product

In May 2015, about six months prior to the Wye River bushfires, AAI ran a direct mail campaign that promoted its CRC to AAMI personal insurance customers.¹⁰⁴⁶ The mail-out included the following statement:¹⁰⁴⁷

... with our Complete Replacement Cover you can have peace of mind that we cover the repair or rebuilding of your home if it is damaged or destroyed by an insured event, *no matter the cost to us*.

In July 2015, AAI published similar representations on the AAMI website.¹⁰⁴⁸ The statements on the Home Building Insurance part of the website were:¹⁰⁴⁹

Optional extra: Complete Replacement Cover. Our best protection against underinsurance, *with no set limit. We cover the rebuilding of your home, no matter the cost to us*.

In November 2016, almost a year after the Wye River bushfires, AAI began a mass market radio campaign promoting its CRC option.¹⁰⁵⁰ The radio advertisement included the statement: 'we'll repair or rebuild your house – *no matter the cost*'.¹⁰⁵¹ At around the same time, AAI also introduced search engine marketing with the tagline: 'rebuild your house *regardless of cost* if damaged or destroyed by [an] insured event'.¹⁰⁵²

Mr Dransfield acknowledged that the clear message of the advertising material, both before and after the Wye River bushfires, was that AAI would *repair or rebuild* homes subject to CRC, *no matter the cost* to AAI.¹⁰⁵³ Mr Dransfield accepted that:¹⁰⁵⁴

¹⁰⁴⁶ Transcript, Gary Dransfield, 20 September 2018, 6303.

¹⁰⁴⁷ Transcript, Gary Dransfield, 20 September 2018, 6304 (emphasis added).

¹⁰⁴⁸ Transcript, Gary Dransfield, 20 September 2018, 6305.

¹⁰⁴⁹ Transcript, Gary Dransfield, 20 September 2018, 6305 (emphasis added).

¹⁰⁵⁰ Transcript, Gary Dransfield, 20 September 2018, 6305.

¹⁰⁵¹ Transcript, Gary Dransfield, 20 September 2018, 6306 (emphasis added).

¹⁰⁵² Transcript, Gary Dransfield, 20 September 2018, 6306 (emphasis added).

¹⁰⁵³ Transcript, Gary Dransfield, 20 September 2018, 6306–7 (emphasis added).

¹⁰⁵⁴ Transcript, Gary Dransfield, 20 September 2018, 6307.

- It was not correct that AAI would necessarily repair or rebuild homes covered by the CRC product, because AAI could choose to provide a cash settlement instead.¹⁰⁵⁵
- It was not correct that AAI would repair or rebuild, ‘no matter the cost’ to AAI.¹⁰⁵⁶ There were cost limits, both ‘in terms of the costs that AAI felt was fair and reasonable in relation to the scope of work’, and from the requirement that AAI was to repair or rebuild on a ‘new for old’ basis.¹⁰⁵⁷

More broadly, Mr Dransfield accepted that where AAI chose to cash settle a claim, it would generally do so on the basis of the lowest quote to AAI that was ‘sufficient and appropriate to complete the scope of works’.¹⁰⁵⁸ Mr Dransfield also accepted that in some circumstances, it may cost AAI less to perform works than it would cost a policyholder to do so. This could result in a cash settlement being insufficient for customers to repair or rebuild themselves.¹⁰⁵⁹ Mr Dransfield acknowledged that there were significant differences between the amounts offered by AAI to cash settle some Wye River claims, and the quotes that those policyholders had received from other builders.¹⁰⁶⁰

By late November 2016, AAI was aware that ASIC was looking into the way in which it was marketing the CRC product.¹⁰⁶¹ After deciding not to launch a new advertisement as planned in January 2017,¹⁰⁶² AAI sought ASIC’s views on its new advertising materials in February 2017.¹⁰⁶³ ASIC sent AAI an email in the following terms:¹⁰⁶⁴

¹⁰⁵⁵ Transcript, Gary Dransfield, 20 September 2018, 6307.

¹⁰⁵⁶ Transcript, Gary Dransfield, 20 September 2018, 6307.

¹⁰⁵⁷ Transcript, Gary Dransfield, 20 September 2018, 6307.

¹⁰⁵⁸ Transcript, Gary Dransfield, 20 September 2018, 6288; see also AAI Ltd, Module 6 Case Study Submission, 3 [9].

¹⁰⁵⁹ Transcript, Gary Dransfield, 20 September 2018, 6289.

¹⁰⁶⁰ Transcript, Gary Dransfield, 20 September 2018, 6289–90.

¹⁰⁶¹ Transcript, Gary Dransfield, 20 September 2018, 6309.

¹⁰⁶² Transcript, Gary Dransfield, 20 September 2018, 6309–12.

¹⁰⁶³ Transcript, Gary Dransfield, 20 September 2018, 6312–13.

¹⁰⁶⁴ Transcript, Gary Dransfield, 20 September 2018, 6315; Exhibit 6.378, 20–22 February 2017, Emails Between 20 and 22 February ‘17 Between AAI and ASIC Concerning Complete Replacement Cover Marketing Materials.

As you are already aware, we are currently conducting inquiries into the existing promotional and advertising materials relating to AAMI's Complete Replacement Cover feature. These inquiries have been focused on the existing materials, however having viewed the materials sent through yesterday, we note that there are similarities in the messaging of the previous advertising materials and some of the new materials.

Our inquiries relating to your existing promotional and advertising materials are ongoing at this time. As you would be aware, ASIC does not approve advertisements, and we are also unable to provide advice in relation to the proposed advertisements. However, we encourage you to consider the best practice guidelines in ASIC's Regulatory Guide 234, and/or to seek legal advice if you require further guidance.

Despite this, AAI launched its new advertising materials in early March 2017.¹⁰⁶⁵ Mr Dransfield told the Commission that it did this because there was a strong belief that the advertising material satisfactorily explained the way in which the CRC product worked, and that the material was not misleading.¹⁰⁶⁶ However, Mr Dransfield accepted that AAI 'could not have had certainty' that the material was not misleading in circumstances where ASIC was conducting an investigation into similar AAI advertising material.¹⁰⁶⁷ He also acknowledged that AAI launched the new campaign because the 'business imperative [to grow the home insurance portfolio] trumped any desire to ensure that [AAI's] marketing materials were not misleading to ... customers'.¹⁰⁶⁸

¹⁰⁶⁵ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 40 [110].

¹⁰⁶⁶ Transcript, Gary Dransfield, 20 September 2018, 6315–16.

¹⁰⁶⁷ Transcript, Gary Dransfield, 20 September 2018, 6316.

¹⁰⁶⁸ Transcript, Gary Dransfield, 20 September 2018, 6316, and more generally at 6317–18.

Between March and October 2017, ASIC and AAI continued to discuss ASIC's concerns with AAI's advertising.¹⁰⁶⁹ AAI maintained that its advertising was not misleading or deceptive, and that it did not contain false or misleading representations.¹⁰⁷⁰

At a meeting between ASIC and AAI on 30 October 2017, ASIC told AAI that it planned to issue infringement notices in respect of the advertising.¹⁰⁷¹ On 6 November 2017, ASIC issued four infringement notices alleging contraventions of section 12DB(1)(e) of the ASIC Act, relating to representations made in radio advertisements and on AAMI's website between late 2016 and mid-2017.¹⁰⁷² The infringement notices said that ASIC had reasonable grounds to believe that AAMI had contravened section 12DB(1)(e) of the ASIC Act by 'making false or misleading representations that services had particular benefits', namely, that AAMI would repair or rebuild an insured's house no matter the cost.¹⁰⁷³

The total value of the infringement notices was \$43,200,¹⁰⁷⁴ which AAI paid.¹⁰⁷⁵ Had the matters been litigated, the maximum penalty that a Court could have awarded in respect of each potential contravention would have been \$1.8 million.¹⁰⁷⁶ The effect of paying the infringement notices was that the Commonwealth and ASIC could not bring proceedings against AAI for the alleged contraventions.¹⁰⁷⁷

¹⁰⁶⁹ Transcript, Gary Dransfield, 20 September 2018, 6318.

¹⁰⁷⁰ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 41 [113]; Exhibit GCD-4 (Tab 63) [SUN.0760.0502.0141]; Transcript, Gary Dransfield, 20 September 2018, 6317.

¹⁰⁷¹ Transcript, Gary Dransfield, 20 September 2018, 6318–19.

¹⁰⁷² Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 44 [127]; Exhibit GCD-4 (Tab 58) [SUN.0760.0302.0656], (Tab 58) [SUN.0760.0302.0660], (Tab 58) [SUN.0760.0302.0653], (Tab 58) [SUN.0760.0302.0650].

¹⁰⁷³ Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, Exhibit GCD-4 (Tab 58) [SUN.0760.0302.0650].

¹⁰⁷⁴ Transcript, Gary Dransfield, 20 September 2018, 6321.

¹⁰⁷⁵ Transcript, Gary Dransfield, 20 September 2018, 6321.

¹⁰⁷⁶ Transcript, Gary Dransfield, 20 September 2018, 6321.

¹⁰⁷⁷ Transcript, Gary Dransfield, 20 September 2018, 6321.

Mr Dransfield told the Commission that AAI paid the infringement notices despite having maintained throughout the ASIC investigation, and still maintaining, that its advertising was not misleading or deceptive.¹⁰⁷⁸

The cost of paying the four infringement notices was approximately 0.01% of AAI's premium income from its CRC product in 2017.¹⁰⁷⁹

Mr Dransfield agreed that it could be concluded that the balancing of commercial risks and rewards paid off for AAI.¹⁰⁸⁰

In March 2018, at ASIC's request, AAI introduced a Supplementary PDS to make the features and operation of the CRC product more transparent.¹⁰⁸¹

The Supplementary PDS contained three key terms, which were said to reflect AAI's existing claims handling practices.¹⁰⁸² Mr Dransfield recognised that the Treasury proposals paper on the extension of the Unfair Contracts Terms regime referred to examples of potentially unfair contract terms, including a term that looked very similar to the second term in the Supplementary PDS.¹⁰⁸³ However, Mr Dransfield did not accept that this term was potentially unfair to AAI policyholders.¹⁰⁸⁴ The third term introduced a definition of 'reasonable cost', which was defined to mean the lesser amount of any quotes obtained by AAI.¹⁰⁸⁵ Mr Dransfield did not agree it would be confusing to customers to define 'reasonable cost' in this way.¹⁰⁸⁶

When asked about his broader views on the extension of unfair contract terms protections, Mr Dransfield said that there was no clear rationale for the extension, and that it would increase the underwriting risk borne by insurers without commensurate enhancement in protection for

¹⁰⁷⁸ Transcript, Gary Dransfield, 20 September 2018, 6321.

¹⁰⁷⁹ AAI Ltd, Module 6 Case Study Submission, 4 [14]; cf Transcript, Gary Dransfield, 20 September 2018, 6322.

¹⁰⁸⁰ Transcript, Gary Dransfield, 20 September 2018, 6323.

¹⁰⁸¹ Transcript, Gary Dransfield, 20 September 2018, 6323.

¹⁰⁸² Transcript, Gary Dransfield, 20 September 2018, 6323–4.

¹⁰⁸³ Transcript, Gary Dransfield, 20 September 2018, 6326.

¹⁰⁸⁴ Transcript, Gary Dransfield, 20 September 2018, 6326.

¹⁰⁸⁵ Transcript, Gary Dransfield, 20 September 2018, 6324.

¹⁰⁸⁶ Transcript, Gary Dransfield, 20 September 2018, 6325.

consumers.¹⁰⁸⁷ Mr Dransfield also expressed the view that section 13 of the Insurance Contracts Act, coupled with the dispute resolution environment, already afforded strong protections to consumers.¹⁰⁸⁸

Mr Dransfield accepted that he placed a heavy reliance on the EDR body in his assessment of customer protection.¹⁰⁸⁹

10.3 What the case study showed

The case study raised a number of distinct issues about AAI's marketing of the CRC policies and the operation of those policies in the context of the Wye River bushfires.

10.3.1 Misconduct

I consider that by representing in its CRC advertising materials that AAMI *would repair or rebuild* an insured's house, *no matter the cost*, AAI may have engaged in conduct that was misleading or deceptive in contravention of section 12DA of the ASIC Act, or may have made false or misleading representations in contravention of section 12DB(1)(e) of that Act. Mr Dransfield accepted that:

- it was not correct that AAI would necessarily *repair or rebuild homes* covered by the CRC product, because AAI could choose to provide a cash settlement instead;¹⁰⁹⁰ and
- it was not correct that AAI would repair or rebuild, 'no matter the cost' to AAI: that proposition was subject to at least two relevant (and significant) qualifications.¹⁰⁹¹

In its submissions, AAI strongly resisted such a finding.¹⁰⁹²

¹⁰⁸⁷ Exhibit 6.370, Witness statement of Gary Dransfield, 29 August 2018, 8 [30]; Transcript, Gary Dransfield, 20 September 2018, 6326.

¹⁰⁸⁸ Transcript, Gary Dransfield, 20 September 2018, 6327.

¹⁰⁸⁹ Transcript, Gary Dransfield, 20 September 2018, 6327.

¹⁰⁹⁰ Transcript, Gary Dransfield, 20 September 2018, 6307.

¹⁰⁹¹ Transcript, Gary Dransfield, 20 September 2018, 6307.

¹⁰⁹² AAI Ltd, Module 6 Case Study Submission, 4–6 [15]–[22].

In respect of the ‘repair or rebuild’ representation, AAI submitted that its advertising was not misleading or deceptive because:

- the possibility that claims would be cash settled would have been apparent from the PDS;¹⁰⁹³
- if customers insisted on AAI managing a rebuild, AAI would do so;¹⁰⁹⁴ and
- many policyholders prefer their claims to be resolved through a cash settlement.¹⁰⁹⁵

Taken together, AAI said that there could ‘have been no real doubt in the market that a cash settlement was a possibility under a CRC policy’.¹⁰⁹⁶ For my part, I am not so sure of this. The clear and repeated message of AAI’s advertising, as accepted by Mr Dransfield, was that AAI would ‘repair or rebuild’.¹⁰⁹⁷ That advertising material generally only contained a high-level warning to read the PDS – it did not specifically draw the audience’s attention to the fact that the PDS contained material qualifications to the representation.¹⁰⁹⁸ In my view, it is not reasonable to expect that persons hearing or seeing AAI’s advertising material would seek out the PDS to understand whether AAI’s central representation was subject to some qualification.

In respect of the ‘no matter the cost’ representation, the central thrust of AAI’s submissions appears to be that the representation ‘would be interpreted to mean that there was no cap by way of a “sum insured” on the repair or rebuild funds’.¹⁰⁹⁹ In my view, that is not how the representation would have been understood by a reasonable person. Rather, a reasonable person would have likely understood the representation as conveying that

¹⁰⁹³ AAI Ltd, Module 6 Case Study Submission, 5 [18].

¹⁰⁹⁴ AAI Ltd, Module 6 Case Study Submission, 5 [19].

¹⁰⁹⁵ AAI Ltd, Module 6 Case Study Submission, 5–6 [20].

¹⁰⁹⁶ AAI Ltd, Module 6 Case Study Submission, 6 [21].

¹⁰⁹⁷ Transcript, Gary Dransfield, 20 September 2018, 6306.

¹⁰⁹⁸ See, eg, Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 44 [127]; Exhibit GCD-4 (Tab 9) [SUN.0760.0302.0540], (Tab 58) [SUN.0760.0302.0656], (Tab 58) [SUN.0760.0302.0660].

¹⁰⁹⁹ AAI Ltd, Module 6 Case Study Submission, 6 [22].

AAI would cover the costs of ‘repair[ing] or rebuild[ing]’ a property so as to restore it to its ‘previous state’.¹¹⁰⁰ This would carry with it some natural limitations on the costs that AAI could be expected to bear – AAI would not be expected to ‘carry out whatever new and improved building might be desired’ by a policyholder¹¹⁰¹ – but it would not have conveyed that AAI would only be liable for *what it would cost AAI* to rebuild or repair. Accordingly, I consider that AAI may have also engaged in conduct that was misleading or deceptive, or have made false or misleading representations, in this respect.

The matter having been drawn to ASIC’s attention, it is for ASIC to determine what further action it can and should take.

10.3.2 Conduct falling below community standards and expectations

I consider that AAI’s conduct fell below community standards and expectations in three respects.

First, as Mr Dransfield acknowledged, and as AAI accepted in its written submissions,¹¹⁰² AAI could have done more to keep policyholders affected by the Wye River bushfires informed as to the progress of their claims,¹¹⁰³ and could have better explained the delays that it was facing when trying to complete the scope of works.¹¹⁰⁴

Second, AAI sent home and contents policy renewal letters to policyholders whose properties had been destroyed by the Wye River bushfires.¹¹⁰⁵ As a result, those policyholders were charged premiums for policies relating to properties that were destroyed or were no longer habitable.¹¹⁰⁶

¹¹⁰⁰ Cf AAI Ltd, Module 6 Case Study Submission, 6 [22].

¹¹⁰¹ Cf AAI Ltd, Module 6 Case Study Submission, 6 [22].

¹¹⁰² AAI Ltd, Module 6 Case Study Submission, 7 [23].

¹¹⁰³ Transcript, Gary Dransfield, 20 September 2018, 6286–7.

¹¹⁰⁴ Transcript, Gary Dransfield, 20 September 2018, 6286–7.

¹¹⁰⁵ Transcript, Gary Dransfield, 20 September 2018, 6299.

¹¹⁰⁶ Transcript, Gary Dransfield, 20 September 2018, 6299.

As acknowledged by Mr Dransfield, and by AAI in its written submissions, AAI should not have charged premiums on renewed home and/or contents policies for customers whose homes had been destroyed in the Wye River bushfires.¹¹⁰⁷

Third, despite ASIC drawing AAI's attention to similarities between the messaging of advertising materials that it was investigating and advertising materials that AAI was proposing to launch, AAI nonetheless proceeded to launch an advertising campaign featuring those materials in early March 2017.¹¹⁰⁸ In its submissions, AAI contended that its conduct did not fall below community standards and expectations, because ASIC had not yet reached a conclusion on the material, and AAI 'genuinely believed that the proposed advertising campaign satisfactorily and appropriately conveyed the way in which the CRC product worked'.¹¹⁰⁹ I do not consider that this submission sits comfortably with the concession made by Mr Dransfield that AAI launched its new campaign because the 'business imperative [to grow the home insurance portfolio] trumped any desire to ensure that [AAI's] marketing materials were not misleading to ... customers'.¹¹¹⁰ This was conduct that fell below community standards and expectations.

10.3.3 Causes of the conduct

I consider that one cause of the conduct of AAI in relation to its advertising material was an internal culture that favoured growing the business over legal and regulatory compliance. While AAI strongly resisted such a characterisation in its submissions,¹¹¹¹ Mr Dransfield's evidence was that the business imperative to grow the home insurance portfolio at AAI trumped the desire to ensure the marketing material was not misleading to customers.¹¹¹²

¹¹⁰⁷ AAI Ltd, Module 6 Case Study Submission, 7 [24]; Transcript, Gary Dransfield, 20 September 2018, 6299.

¹¹⁰⁸ Transcript, Gary Dransfield, 20 September 2018, 6315; Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 40 [110].

¹¹⁰⁹ AAI Ltd, Module 6 Case Study Submission, 10 [27].

¹¹¹⁰ Transcript, Gary Dransfield, 20 September 2018, 6316.

¹¹¹¹ AAI Ltd, Module 6 Case Study Submission, 12–13 [33]–[35].

¹¹¹² Transcript, Gary Dransfield, 20 September 2018, 6316.

11 AAI Ltd (Hunter Valley storm)

11.1 Background

This case study concerned the handling by AAI of an insurance claim arising out of storm damage. The Commission heard evidence from Ms Bernadette Heald and again from Mr Gary Dransfield, the Chief Executive Officer of Insurance at the AAI Group.¹¹¹³

11.2 Evidence

The Healds held a home and contents policy with AAI.¹¹¹⁴ The policy was branded as a Suncorp product.¹¹¹⁵ On 22 April 2015, they lodged a claim with AAI for damage to their property caused by a major storm in the Hunter Valley region.¹¹¹⁶

Ms Heald gave evidence about the severity of the storm and the damage caused to her home by the storm.¹¹¹⁷ Immediately after the storm, damage to the balcony railings, laundry and garage was evident.¹¹¹⁸ Over time, more damage became evident. Amongst other things, gyprock and brickwork began cracking and laundry tiles began popping off, exposing the property's slab.¹¹¹⁹ There was also a hairline crack in the slab that grew larger over

¹¹¹³ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 1 [1].

¹¹¹⁴ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, Exhibit GCD-2 (Tab 1) [SUN.0708.0001.0499], (Tab 2) [SUN.0703.0002.0165], (Tab 3) [SUN.0792.0901.0033].

¹¹¹⁵ Transcript, Bernadette Heald, 20 September 2018, 6330.

¹¹¹⁶ Transcript, Bernadette Heald, 20 September 2018, 6330.

¹¹¹⁷ Transcript, Bernadette Heald, 20 September 2018, 6330.

¹¹¹⁸ Transcript, Bernadette Heald, 20 September 2018, 6330.

¹¹¹⁹ Transcript, Bernadette Heald, 20 September 2018, 6332; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 4 [23].

time.¹¹²⁰ When it rained, dirty storm water would rise up through the slab and flow into the house.¹¹²¹

In about June or July 2015, the western wall of the property started coming away from its supports.¹¹²² Ms Heald kept AAI updated on the additional damage to her property as it occurred.¹¹²³

Ms Heald explained that the damage to the property had greatly affected her daughter, who suffers from anxiety.¹¹²⁴ At times her daughter would become so stressed by the popping and cracking noises made by the house that she would sometimes wake up during the night terrified that the house might collapse.¹¹²⁵

The day after Ms Heald lodged her claim, AAI appointed a building inspector to inspect the damage caused by the storm.¹¹²⁶ It also appointed a builder to undertake a make safe.¹¹²⁷

It took until mid-May 2015 before a builder attended at the property to fix the railing.¹¹²⁸ It took until mid-June for AAI to send a builder to complete a make safe on the railings.¹¹²⁹

¹¹²⁰ Transcript, Bernadette Heald, 20 September 2018, 6332; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 4 [23].

¹¹²¹ Transcript, Bernadette Heald, 20 September 2018, 6332; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 4 [23].

¹¹²² Transcript, Bernadette Heald, 20 September 2018, 6333.

¹¹²³ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 27 [74] [table entry 2].

¹¹²⁴ Transcript, Bernadette Heald, 20 September 2018, 6333; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 1 [2].

¹¹²⁵ Transcript, Bernadette Heald, 20 September 2018, 6333. The Healds' son is also a heart transplant recipient, a fact of which AAI was made aware on 19 May 2015: Transcript, Bernadette Heald, 20 September 2018, 6344–5.

¹¹²⁶ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 27 [74] [table entry 2].

¹¹²⁷ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 27 [74] [table entry 2].

¹¹²⁸ Transcript, Bernadette Heald, 20 September 2018, 6332.

¹¹²⁹ Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 5 [25].

There were also delays in having the damage assessed. Ms Heald said that she and her husband were frustrated by AAI's failure to properly assess the damage to their property.¹¹³⁰ Between May and October 2015, AAI sent a building inspector,¹¹³¹ a building assessor,¹¹³² and two engineers¹¹³³ to assess the damage. Each alluded to some possible structural damage, but no-one could properly explain what was wrong with the house.¹¹³⁴

When the first engineer came to the property, he undertook a half hour visual inspection and did no testing.¹¹³⁵ When the engineer's report was provided, the Healds disagreed with many aspects of it.¹¹³⁶ The report included a scope of works for the repair of superficial cracking, but recommended that the repairs not be undertaken for six to 12 months so as to allow the soils to dry.¹¹³⁷ The scope of works did not include any repairs to the foundation of the house.¹¹³⁸

The Healds requested that AAI appoint a new engineering firm to assess the property.¹¹³⁹ AAI rejected that request, but agreed to appoint a

¹¹³⁰ Transcript, Bernadette Heald, 20 September 2018, 6333.

¹¹³¹ Transcript, Bernadette Heald, 20 September 2018, 6331.

¹¹³² Transcript, Bernadette Heald, 20 September 2018, 6332.

¹¹³³ Transcript, Bernadette Heald, 20 September 2018, 6332, 6334.

¹¹³⁴ Transcript, Bernadette Heald, 20 September 2018, 6331, 6332–4;
Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 4 [18]–[19].

¹¹³⁵ Transcript, Bernadette Heald, 20 September 2018, 6332.

¹¹³⁶ Transcript, Bernadette Heald, 20 September 2018, 6334.

¹¹³⁷ Transcript, Bernadette Heald, 20 September 2018, 6333;
Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018,
Exhibit GCD-2 (Tab 76) [SUN.0702.0004.1289]

¹¹³⁸ Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 5 [24].

¹¹³⁹ Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 6 [29].

second engineer from the same firm to prepare a report.¹¹⁴⁰ This second engineer's report contained a revised scope of works, this time including the replacement of the slab in the laundry.¹¹⁴¹ The Healds' concerns were not allayed by the further report.¹¹⁴²

Because of the difficulty the Healds encountered in dealing with AAI, they contacted Brenda Staggs, a lawyer from Legal Aid.¹¹⁴³ Ms Heald said that she did not think they would have been able to deal with the claim without the assistance of a solicitor.¹¹⁴⁴ Ms Staggs first wrote to AAI on the Healds' behalf in May 2015, explaining the health problems faced by their children, and noting temporary accommodation may be needed.¹¹⁴⁵

Mr Dransfield gave evidence that upon receiving the email from Ms Staggs in May 2015, AAI should have ensured that the make safe was completed to the satisfaction of the family.¹¹⁴⁶ He said that AAI should then have sent an engineer to the property as soon as possible to assess the safety of the home, and that AAI should have been discussing temporary accommodation with the Healds.¹¹⁴⁷

Ms Heald advised AAI on several occasions that she had concerns that the property was not safe to live in,¹¹⁴⁸ and requested temporary accommodation on multiple occasions.¹¹⁴⁹ AAI agreed to move the Healds

¹¹⁴⁰ Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 6 [29].

¹¹⁴¹ Transcript, Bernadette Heald, 20 September 2018, 6335.

¹¹⁴² Transcript, Bernadette Heald, 20 September 2018, 6335.

¹¹⁴³ Transcript, Bernadette Heald, 20 September 2018, 6331.

¹¹⁴⁴ Transcript, Bernadette Heald, 20 September 2018, 6341–2.

¹¹⁴⁵ Transcript, Bernadette Heald, 20 September 2018, 6331; Transcript, Gary Dransfield, 20 September 2018, 6344–5.

¹¹⁴⁶ Transcript, Gary Dransfield, 20 September 2018, 6345.

¹¹⁴⁷ Transcript, Gary Dransfield, 20 September 2018, 6345.

¹¹⁴⁸ Transcript, Bernadette Heald, 20 September 2018, 6337–8.

¹¹⁴⁹ Transcript, Bernadette Heald, 20 September 2018, 6338.

into temporary accommodation in March 2017.¹¹⁵⁰ The Healds commenced living in temporary accommodation on 28 April 2017.¹¹⁵¹

AAI tried to cash settle the Healds' claim in October 2015 for around \$30,000.¹¹⁵² The Healds rejected that offer and lodged an internal complaint with AAI.¹¹⁵³ Ms Heald did not recall ever being told by AAI about IDR.¹¹⁵⁴ Mr Dransfield did not dispute that the Healds were not informed of AAI's IDR process.¹¹⁵⁵

Ms Staggs emailed AAI again in mid-October 2015, expressing concerns on the part of the Healds with the delay in attending to the repairs to the property.¹¹⁵⁶ The Healds were concerned that a wall might collapse and injure them, or their neighbour's children.¹¹⁵⁷ Mr Dransfield acknowledged that this concern held by the Healds was a very serious matter, and that at this time, again, AAI should have seriously considered temporary accommodation for the Healds.¹¹⁵⁸

On about 4 December 2015, Mr and Ms Heald lodged a complaint with FOS.¹¹⁵⁹

On 31 December 2015, AAI wrote to the Healds, notifying them that AAI would reimburse them the cost of having a local engineer attend

¹¹⁵⁰ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 32–3 [83(i)].

¹¹⁵¹ Transcript, Bernadette Heald, 20 September 2018, 6340; Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 33 [83(l)]; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 10 [52].

¹¹⁵² Transcript, Bernadette Heald, 20 September 2018, 6335.

¹¹⁵³ Transcript, Bernadette Heald, 20 September 2018, 6336.

¹¹⁵⁴ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 36 [88] [table entry 10].

¹¹⁵⁵ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 36 [88] [table entry 10].

¹¹⁵⁶ Transcript, Gary Dransfield, 20 September 2018, 6345–6.

¹¹⁵⁷ Transcript, Gary Dransfield, 20 September 2018, 6346.

¹¹⁵⁸ Transcript, Gary Dransfield, 20 September 2018, 6346.

¹¹⁵⁹ Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 8 [41].

the property and provide a further report.¹¹⁶⁰ Mr and Ms Heald appointed Burke Engineering Services Pty Ltd.¹¹⁶¹

This letter also made an offer of \$3,000 compensation for the frustration and inconvenience AAI had caused.¹¹⁶²

Burke Engineering provided a preliminary report on 25 January 2016,¹¹⁶³ advising that further investigations would be required before a detailed assessment could be provided.¹¹⁶⁴ In the meantime, it suggested that temporary fencing be installed.¹¹⁶⁵ Burke Engineering subsequently provided two further reports, in which it said that the issues with the foundation (including the footings and slab), coupled with the water inundation, had caused the damage to the property.¹¹⁶⁶ It recommended the footings and slab be replaced.¹¹⁶⁷

However, AAI maintained that it was entitled to settle the claim on the basis of its engineer's scope of works, which provided that the cracking could be repaired without needing to replace the foundations and that a complete demolition of the property was not warranted.¹¹⁶⁸

Mr Dransfield accepted that the engineers appointed by AAI to produce reports on the damage to the Heald property failed to produce thorough

¹¹⁶⁰ Exhibit 6.389, 31 December 2015, Letter Suncorp to Healds.

¹¹⁶¹ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 36 [89] [table entry 11].

¹¹⁶² Exhibit 6.389, 31 December 2015, Letter Suncorp to Healds.

¹¹⁶³ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 37 [92(a)].

¹¹⁶⁴ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 37 [91] [table entry 12].

¹¹⁶⁵ Exhibit 6.386, Witness statement of Gary Dransfield, 13 June 2018, 37 [91] [table entry 12].

¹¹⁶⁶ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 37 [91] [table entry 12].

¹¹⁶⁷ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 37 [91] [table entry 12].

¹¹⁶⁸ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 37 [91] [table entry 12], 37 [92(d)].

reports and that the conclusions they reached were ultimately incorrect.¹¹⁶⁹ The engineers AAI appointed were ‘panel’ experts. That is, they were experts drawn from a group of experts used by AAI to provide expert reports and advice. Mr Dransfield acknowledged the potential risk of subconscious bias, on behalf of panel firms, towards particular outcomes because of the panel arrangements.¹¹⁷⁰ Mr Dransfield accepted that there was a potential for this subconscious bias to have influenced the work of the panel engineers in the Healds’ case, given the significant divergence of views between the panel engineers and the independent engineer, Burke Engineering.¹¹⁷¹ That a panel firm could possibly exhibit subconscious bias as a consequence of an ongoing commercial relationship is entirely plausible. However in this case study, the matter was not explored beyond the hypothetical possibility, and I need not make any express findings about that issue.

In January 2017, FOS informed AAI that it considered that AAI was liable for the damage to the property, including to the foundations.¹¹⁷² FOS’s determination necessitated the preparation of a revised scope of works.¹¹⁷³

By April 2017, AAI had not obtained the fresh scope of works.¹¹⁷⁴ Mr Dransfield accepted that this delay was not acceptable.¹¹⁷⁵

AAI and the Healds subsequently made offers to settle the matter between 29 May 2017 and January 2018.¹¹⁷⁶

¹¹⁶⁹ Transcript, Gary Dransfield, 20 September 2018, 6372.

¹¹⁷⁰ Transcript, Gary Dransfield, 20 September 2018, 6372.

¹¹⁷¹ Transcript, Gary Dransfield, 20 September 2018, 6372–3.

¹¹⁷² Transcript, Gary Dransfield, 20 September 2018, 6364.

¹¹⁷³ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 32 [83(g)]; Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, Exhibit GCD-2 (Tab 92) [SUN.0702.0026.0022].

¹¹⁷⁴ Transcript, Gary Dransfield, 20 September 2018, 6365.

¹¹⁷⁵ Transcript, Gary Dransfield, 20 September 2018, 6365–6.

¹¹⁷⁶ Exhibit 6.328, Witness statement of Bernadette Heald, 30 August 2018, 10–11 [53]–[60]; Transcript, Bernadette Heald, 20 September 2018, 6340–1.

In January 2018, FOS made a determination in favour of Mr and Ms Heald, awarding them more than \$744,000.¹¹⁷⁷ This amount included interest from 5 August 2015, the date FOS held AAI was in a position to determine its liability under the policy (which, as FOS had found, included replacement of the foundations).¹¹⁷⁸

Mr Dransfield acknowledged that, overall, AAI had failed the Healds in the handling of their claim, and apologised for AAI's failures.¹¹⁷⁹ He specifically acknowledged that AAI failed the Healds by having too many people involved in the handling of their claim, and that AAI failed to show compassion to the Healds' situation.¹¹⁸⁰

Mr Dransfield accepted that AAI did not manage the Healds' claim in a satisfactory manner.¹¹⁸¹ In particular, he accepted that the following aspects of the handling of the claim were unsatisfactory: the delay in resolving whether a complete repair or rebuild was required;¹¹⁸² AAI's lack of effective and compassionate communication with the Healds regarding the extent of the damage to the property and the possibility of repairs;¹¹⁸³ the failure to appoint a dedicated claims handler to the Healds' claim;¹¹⁸⁴ AAI's processes for dealing with vulnerable customers like the Healds;¹¹⁸⁵ and AAI's failure to advise the Healds of its IDR process on 18 June 2015.¹¹⁸⁶

¹¹⁷⁷ Transcript, Bernadette Heald, 20 September 2018, 6341; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 11 [60].

¹¹⁷⁸ Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, Exhibit BJH-23 [FOS.0031.0001.3557 at .3560].

¹¹⁷⁹ Transcript, Gary Dransfield, 20 September 2018, 6343–4.

¹¹⁸⁰ Transcript, Gary Dransfield, 20 September 2018, 6343–4.

¹¹⁸¹ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 40 [100].

¹¹⁸² Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 40 [101(a)].

¹¹⁸³ Transcript, Gary Dransfield, 20 September 2018, 6344; Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 40 [101(b)].

¹¹⁸⁴ Transcript, Gary Dransfield, 20 September 2018, 6344; Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 40–1 [101(c)].

¹¹⁸⁵ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 40–1 [101(c)].

¹¹⁸⁶ Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 41 [101(d)].

Mr Dransfield also acknowledged that in 2016, FOS identified systemic issues within AAI, including:¹¹⁸⁷ a failure to comply with its obligation to provide information to policyholders about its IDR process;¹¹⁸⁸ delays in assessing damage and conducting repair or rectification works;¹¹⁸⁹ and a failure to ensure timely implementation of FOS determinations and negotiated settlement agreements.¹¹⁹⁰ Mr Dransfield accepted that the first two of those issues had affected the way in which the Healds' claim was handled.¹¹⁹¹

11.3 What the case study showed

11.3.1 Misconduct

AAI accepted that it had contravened the General Insurance Code of Practice in four ways in the course of its dealings with the Healds.

First, AAI accepted that it had breached clause 7.2, which required it to conduct claims handling in an honest, fair, transparent and timely manner.¹¹⁹² Second, it accepted that it had breached clause 7.13, which required AAI to keep the Healds informed about the progress of their claim at least every 20 business days.¹¹⁹³ Third, it accepted that it had breached clause 9.2, which required AAI to respond to catastrophes (as defined) in an efficient, professional and practical way.¹¹⁹⁴ Finally, it accepted that it had breached clause 10.5, which required it to make information available about

¹¹⁸⁷ Transcript, Gary Dransfield, 20 September 2018, 6381; see FOS, Terms of Reference (as amended 1 January 2015), cl 11.2 (definition 'systemic issues').

¹¹⁸⁸ Transcript, Gary Dransfield, 20 September 2018, 6375.

¹¹⁸⁹ Transcript, Gary Dransfield, 20 September 2018, 6378.

¹¹⁹⁰ Transcript, Gary Dransfield, 20 September 2018, 6380.

¹¹⁹¹ Transcript, Gary Dransfield, 20 September 2018, 6382.

¹¹⁹² Transcript, Gary Dransfield, 20 September 2018, 6372; see also AAI Ltd, Module 6 Case Study Submission, 17–18 [47]–[48].

¹¹⁹³ Transcript, Gary Dransfield, 20 September 2018, 6372; see also AAI Ltd, Module 6 Case Study Submission, 18 [48].

¹¹⁹⁴ Transcript, Gary Dransfield, 20 September 2018, 6372; see also AAI Ltd, Module 6 Case Study Submission, 18 [48].

the customer's right to make an internal complaint and about its processes for handling complaints.¹¹⁹⁵

The General Insurance Code of Practice is a recognised and widely adopted benchmark for conduct. It follows that each breach of the Code of Practice constituted misconduct within the meaning of the Commission's Terms of Reference.

11.3.2 Conduct falling below community standards and expectations

AAI also acknowledged that too many people were involved in the Healds' claim and complaint; that its failure to settle the matter promptly after the FOS determination caused delay and added to the strain on the Healds; that it could and should have moved more quickly to resolve the difference of opinion between the experts; and that it could and should have offered to fund the Healds to engage their own engineer earlier.¹¹⁹⁶ However AAI did not accept that those failings, alone or in combination, amounted to conduct that fell below community standards and expectations.¹¹⁹⁷

When the totality of the circumstances is considered, AAI's conduct is revealed to have been insufficiently compassionate – something accepted by Mr Dransfield¹¹⁹⁸ – and insufficiently diligent. The failure to act with appropriate compassion made the already difficult circumstances faced by the Healds worse. The lack of diligence prolonged their difficulties. AAI's conduct in handling of the Healds' claim did not meet community standards and expectations for those reasons.

¹¹⁹⁵ AAI Ltd, Module 6 Case Study Submission, 18 [48].

¹¹⁹⁶ AAI Ltd, Module 6 Case Study Submission, 18–19 [49]–[50].

¹¹⁹⁷ AAI Ltd, Module 6 Case Study Submission, 19 [52].

¹¹⁹⁸ Transcript, Gary Dransfield, 20 September 2018, 6343–4.

11.3.3 Causes of the conduct

AAI's conduct was largely attributable to its internal systems and processes for handling claims and disputes arising from those claims. A particularly significant factor was AAI's team management model, which diffused responsibility for claims across a team of employees.¹¹⁹⁹ As a result, no one person had direct responsibility for or deep knowledge of the circumstances of the claim.¹²⁰⁰ The difficulties caused by that system were made worse by the very high volume of claims being handled at that time.¹²⁰¹ An unusually large number of very significant weather events had occurred within a relatively short period of time and these events had caused many claims.¹²⁰²

Mr Dransfield accepted that AAI's team management model failed the Healds.¹²⁰³ Two of the systemic issues identified by FOS – failures to provide information to policyholders about IDR processes and delays in implementing the requirements of determinations and settlement agreements – demonstrated that AAI's systems for handling disputes arising from claims were also inadequate in each of the ways identified by FOS.¹²⁰⁴

¹¹⁹⁹ Transcript, Gary Dransfield, 20 September 2018, 6344; Exhibit 6.386, 23 December 2015, Email between Pugliese and Others.

¹²⁰⁰ Transcript, Bernadette Heald, 20 September 2018, 6344, 6252; Exhibit 6.386, 23 December 2015, Email between Pugliese and Others.

¹²⁰¹ AAI Ltd, Module 6 Case Study Submission, 19 [53].

¹²⁰² AAI Ltd, Module 6 Case Study Submission, 19 [53].

¹²⁰³ Transcript, Gary Dransfield, 20 September 2018, 6344.

¹²⁰⁴ See Exhibit 6.396, 20 December 2016, Letter FOS to AAI Limited; Exhibit 6.398, 6 February 2017, Letter FOS to AAI Limited; Exhibit 6.400, 20 September 2016, Letter FOS to AAI Limited.



Final Report

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

VOLUME 3:
APPENDICES

© Commonwealth of Australia 2019

ISBN:

978-1-920838-64-5 (print)

978-1-920838-65-2 (online)

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Appendix 1: Letters Patent



ENTERED ON RECORD by me in Register of Patents No. 52

page 67 on 14 December 2017

Secretary to the Federal Executive Council

Handwritten signature

ELIZABETH THE SECOND, by the Grace of God Queen of Australia and Her other Realms and Territories, Head of the Commonwealth:

TO

The Honourable Kenneth Madison Hayne AC QC

GREETING

WHEREAS Australia has one of the strongest and most stable banking, superannuation and financial services industries in the world, which performs a critical role in underpinning the Australian economy.

AND Australia's banking system is systemically strong with internationally recognised and world's best prudential regulation and oversight.

AND most Australians are consumers of banking, superannuation and other financial services. The superannuation system alone in Australia has created more than a \$2 trillion retirement savings pool, which continues to grow rapidly and which compels all working Australians to defer income today for their retirement.

AND all Australians have the right to be treated honestly and fairly in their dealings with banking, superannuation and financial services providers. The highest standards of conduct are critical to the good governance and corporate culture of those providers.

AND these standards should continue to be complemented by strong regulatory and supervisory frameworks that ensure that all Australian consumers, including business, have confidence and trust in the financial system.

NOW THEREFORE We do, by Our Letters Patent issued in Our name by Our Governor-General of the Commonwealth of Australia on the advice of the Federal Executive Council and under the Constitution of the Commonwealth of Australia, the *Royal Commissions Act 1902* and every other enabling power, appoint you to be a Commission of inquiry, and require and authorise you, to inquire into the following matters:

- (a) whether any conduct by financial services entities (including by directors, officers or employees of, or by anyone acting on behalf of, those entities) might have amounted to misconduct and, if so, whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, State or Territory agency;
- (b) whether any conduct, practices, behaviour or business activities by financial services entities fall below community standards and expectations;
- (c) whether the use by financial services entities of superannuation members' retirement savings, for any purpose, does not meet community standards and expectations or is otherwise not in the best interests of those members;
- (d) whether any findings in respect of the matters mentioned in paragraphs (a), (b) and (c):
 - (i) are attributable to the particular culture and governance practices of a financial services entity or broader cultural or governance practices in the relevant industry or relevant subsector; or
 - (ii) result from other practices, including risk management, recruitment and remuneration practices, of a financial services entity, or in the relevant industry or relevant subsector;
- (e) the effectiveness of mechanisms for redress for consumers of financial services who suffer detriment as a result of misconduct by financial services entities;
- (f) the adequacy of:
 - (i) existing laws and policies of the Commonwealth (taking into account law reforms announced by the Commonwealth Government) relating to the provision of banking, superannuation and financial services; and
 - (ii) the internal systems of financial services entities; and
 - (iii) forms of industry self-regulation, including industry codes of conduct;

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

- (g) the effectiveness and ability of regulators of financial services entities to identify and address misconduct by those entities;
- (h) whether any further changes to any of the following are necessary to minimise the likelihood of misconduct by financial services entities in future (taking into account any law reforms announced by the Commonwealth Government):
 - (i) the legal framework;
 - (ii) practices within financial services entities;
 - (iii) the financial regulators;
- (i) any matter that has occurred or is occurring overseas, to the extent the matter is relevant to a matter mentioned in paragraphs (a) to (h);
- (j) any matter reasonably incidental to a matter mentioned in paragraphs (a) to (i).

AND, without limiting the scope of your inquiry or the scope of any recommendations arising out of your inquiry that you may consider appropriate, for the purpose of your inquiry and recommendations in relation to the matter mentioned in paragraph (f):

- (k) We direct you to have regard to the implications of any changes to laws, that you propose to recommend, for the economy generally, for access to and the cost of financial services for consumers, for competition in the financial sector and for financial system stability; and
- (l) We authorise you to have regard to comparable international experience, practices and reforms.

AND We further declare that you are not required by these Our Letters Patent to inquire, or to continue to inquire, into a particular matter to the extent that you are satisfied that the matter has been, is being, or will be, sufficiently and appropriately dealt with by another inquiry or investigation or a criminal or civil proceeding.

AND We further declare that you are not required by these Our Letters Patent to inquire, or to continue to inquire, into a particular matter to the extent that the matter relates to macro-prudential policy and regulation.

AND We direct you to give priority to matters that in your opinion, have greater potential for harm if not addressed expeditiously.

AND We further declare that you may decide not to inquire into a particular matter falling within the scope of paragraphs (a) to (j), but any such decision is yours alone.

AND We further declare that you may inquire into any matter mentioned in paragraphs (a) to (j) to the extent that the matter relates to or is connected with the peace, order and good government of the Commonwealth and any public purpose or any power of the Commonwealth.

AND We direct you to make any recommendations arising out of your inquiry that you consider appropriate.

AND We declare that you are a relevant Commission for the purposes of sections 4 and 5 of the *Royal Commissions Act 1902*.

AND We declare that, in exercising your powers under Part 2 of the *Royal Commissions Act 1902*, you are to inquire into the matters falling within the scope of paragraphs (a) to (j) only to the extent that Commonwealth constitutional power extends to those subjects of inquiry.

AND We declare that you are a Royal Commission to which item 5 of the table in subsection 355-70(1) in Schedule 1 to the *Taxation Administration Act 1953* applies.

AND We declare that in these Our Letters Patent:

financial services entity means:

- (a) an ADI (authorised deposit-taking institution) within the meaning of the *Banking Act 1959*; or
- (b) an entity that carries on a business of undertaking liability, by way of insurance (including reinsurance), in respect of any loss or damage, including liability to pay damages or compensation, contingent upon the happening of a specified event, including:

- (i) a general insurer (within the meaning of the *Insurance Act 1973*); and
- (ii) an entity that carries on life insurance business (within the meaning of the *Life Insurance Act 1995*); or
- (c) a person or entity required by section 911A of the *Corporations Act 2001* to hold an Australian financial services licence, or who is exempt from the requirement to hold such a licence by virtue of being an authorised representative; or
- (d) a person or entity that:
 - (i) is an RSE licensee of a registrable superannuation entity (within the meaning of the *Superannuation Industry (Supervision) Act 1993*); or
 - (ii) has any connection (other than an incidental connection) to such an RSE licensee; or
- (e) a person or entity that acts or holds itself out as acting as an intermediary between borrowers and lenders;

but does not include an entity that is a Commonwealth company or Commonwealth entity (both within the meaning of the *Public Governance, Performance and Accountability Act 2013*).

macro-prudential policy and regulation means policy and regulation, including as to the structure, role and purpose of financial regulators, that is concerned with containing systemic risk, which can have widespread implications for the financial system as a whole.

misconduct includes conduct that:

- (a) constitutes an offence against a Commonwealth, State or Territory law, as in force at the time of the alleged misconduct; or
- (b) is misleading, deceptive, or both; or
- (c) is a breach of trust, breach of duty or unconscionable conduct; or
- (d) breaches a professional standard or a recognised and widely adopted benchmark for conduct.

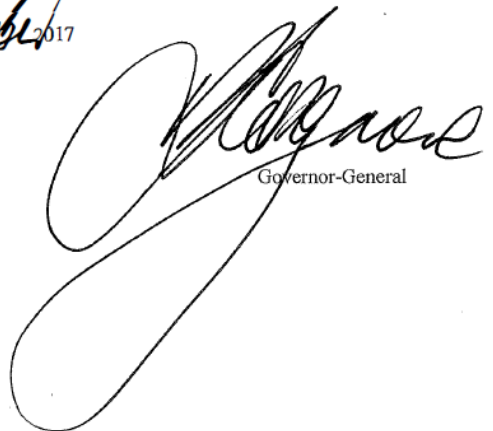
AND We:

- (m) require you to begin your inquiry as soon as practicable; and
- (n) require you to make your inquiry as expeditiously as possible; and
- (o) authorise you to submit to Our Governor-General an interim report, that you consider appropriate, not later than 30 September 2018; and
- (p) require you to submit to Our Governor-General a final report of the results of your inquiry, and your recommendations, not later than 1 February 2019.

IN WITNESS, We have caused these Our Letters to be made Patent

WITNESS General the Honourable Sir Peter Cosgrove AK MC
(Ret'd), Governor-General of the Commonwealth of Australia.

Dated *14th December* 2017



Governor-General

By His Excellency's Command



Prime Minister

Appendix 2: Hearing dates

Round	Dates	Location
Consumer lending	13-Mar-2018 – 23-Mar-2018	Commonwealth Law Courts Building, 305 William St, Melbourne VIC 3000
Financial advice	16-Apr-2018 – 27-Apr-2018	Commonwealth Law Courts Building, 305 William St, Melbourne VIC 3000
Small and medium enterprises	21-May-2018 – 01-Jun-2018	Commonwealth Law Courts Building, 305 William St, Melbourne VIC 3000
Regional and remote communities	25-Jun-2018 – 29-Jun-2018	Brisbane Magistrates Court, 363 George St, Brisbane QLD 4000
	02-Jul-2018 – 06-Jul-2018	Supreme Court Building, State Square, Darwin NT 0800
Superannuation	06-Aug-2018 – 17-Aug-2018	Commonwealth Law Courts Building, 305 William St, Melbourne VIC 3000
Insurance	10-Sep-2018 – 21-Sep-2018	Commonwealth Law Courts Building, 305 William St, Melbourne VIC 3000
Policy questions	19-Nov-2018 – 23-Nov-2018	Lionel Bowen Building, 97–99 Goulburn St, Sydney NSW 2000
	26-Nov-2018 – 30-Nov-2018	Commonwealth Law Courts Building, 305 William St, Melbourne VIC 3000

Appendix 3:

Public engagement

Introduction

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry was established on 14 December 2017.

From the outset, the Commission was committed to ensuring the public had easy access to information about the Commission and its work through a dedicated information line (phone and email), a website and email distribution services.

The Commission encouraged members of the public to contribute to its work by inviting submissions in relation to past conduct by financial services entities. The Commission received over 10,000 submissions from members of the public. These submissions played an important role in informing the Commission about the nature, magnitude and prevalence of misconduct and conduct falling below community standards in the financial services industry.

Following the closure of submissions on past conduct in late September, the Commission shifted its attention from past experiences to proposals on what should be done in response to the issues raised or conduct uncovered within the banking, superannuation and financial services industry.

To that end, the Commission invited submissions from the public in response to policy issues identified by Counsel Assisting during its fifth round of hearings on superannuation, its sixth round of hearings on insurance, and subsequently in response to issues identified in the *Interim Report*.

The Commission received almost 2,000 submissions in relation to policy issues, including 621 in relation to superannuation, 222 relating to insurance, and 1,114 in response to the *Interim Report*. Individuals making a submission were asked if the Commission could publish their submission. Where permission was given, these submissions have been published on the Commission's website except where matters were subject to a non-publication order or where there were concerns about privacy or fairness.

Information line and enquiries

The Commission operated an information line throughout the terms of its inquiry. The phone line was available during business hours, five days a week, while the email address for enquiries was available 24 hours a day, seven days a week.

The information line provided a range of services to support those with questions about the Commission, those needing assistance with making a submission, and those wishing to talk further about their concerns or share their stories of past conduct, and its impact.

As at 30 November 2018, the Commission's information line had taken over 4,600 phone calls and responded to over 8,200 emails. Throughout the year, the Commission received many calls and emails which provided additional information or raised concerns about conduct, including real-time responses from the public about issues being examined in the public hearings. These ongoing contributions assisted the Commission in its inquiry.

Website

For the period 18 December 2017 to 30 November 2018, the Financial Services Royal Commission website had over 4,373,000 page views.

With the exception of the home page, the top five pages based on number of page views were:

- 1 Public hearings
- 2 Webcast
- 3 Transcripts
- 4 Public Submissions/Submissions
- 5 Publications

The website provided easy access to a range of materials including over 20,500 exhibits, 30 background papers and over 1,600 submissions.

Public submissions – Past conduct

On 22 January 2018 the Commission invited submissions from the public in relation to past conduct by financial services entities. This invitation remained open until 28 September 2018.

The Commission's online web form asked people to complete a series of questions about the nature of their dealings with a financial services entity, the entity involved, and the nature and timing of the conduct.

The Commission received 10,323 submissions from individual consumers and business owners, former employees within the financial services industry, academics, and industry and consumer advocacy bodies. In addition to submissions received through the online form, the Commission also received submissions either by email or in hard copy where the submitter was not able to use the online form.

Each submission was analysed by the Commission and information was collected on the nature of the conduct identified, how the financial services entity or any other relevant body responded to reports of misconduct, and what the outcome had been for the submitter. This information and the submissions were provided to Counsel and Solicitors Assisting the Commission for further review and analysis alongside other information and consultations that were undertaken.

Information received in public submissions assisted the Commission with lines of inquiry in each of the rounds of public hearings, as well as informing the Commission's understanding of the extent of misconduct or conduct falling below community standards within the banking, superannuation and financial services industry.

The Commission continued to receive submissions in relation to the topics explored in its public hearings after those hearings had concluded. For example, issues in relation to consumer lending and personal finance continued to be the most frequent topics raised in submissions on past misconduct. The Commission continued to review and analyse those submissions, and used them to inform its understanding of issues throughout the year.

The following summaries provide detailed analysis of the issues and types of misconduct that were commonly raised in the public submissions. Discrepancies between totals and sums of components are due to rounding.

The Commission acknowledges that submissions on past conduct provided by members of the public often took significant time and effort to prepare, and in many cases involved revisiting difficult experiences. These submissions also often contained highly sensitive personal information, including financial and medical information. For that reason, the Commission has not published submissions on past conduct on its website.

Submissions by state/territory

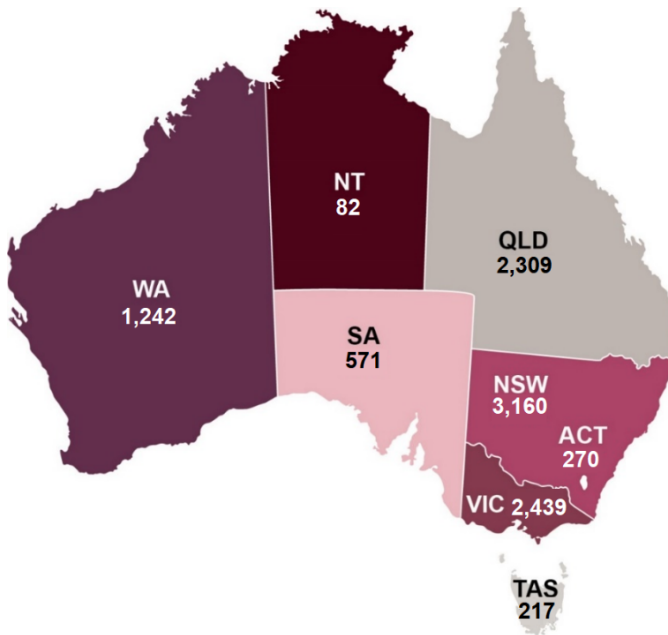


Figure 1: Number of submissions received from each state/territory

Submissions were received from all states and territories of Australia. The largest proportion of submissions came from New South Wales (31%), followed by Victoria (24%), Queensland (23%) and Western Australia (12%). A small number of submissions did not identify the State or Territory.

Submissions by industry

As part of the public submission process, people were asked to indicate the part of the financial services industry to which their matter related. Of all the submissions received, the largest proportion were received in relation to banking (61%), superannuation (12%) and financial advice (9%).

- Banking 61%
- Financial advice 9%
- General insurance 7%
- Intermediaries between borrowers and lenders 5%
- Life insurance 6%
- Superannuation 12%

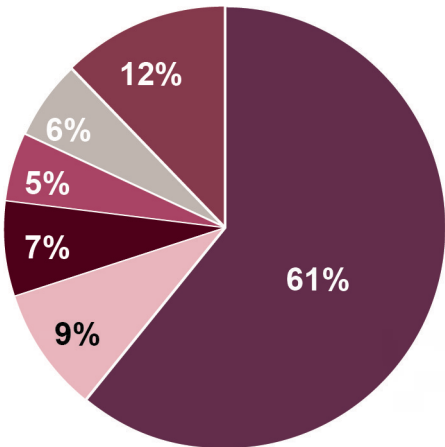


Figure 2: Submissions by industry

Submissions by nature of dealing

People were also asked to indicate in their submissions the nature of their dealings with an entity. The majority of people making submissions selected 'personal financial' as the relevant dealing (35%).

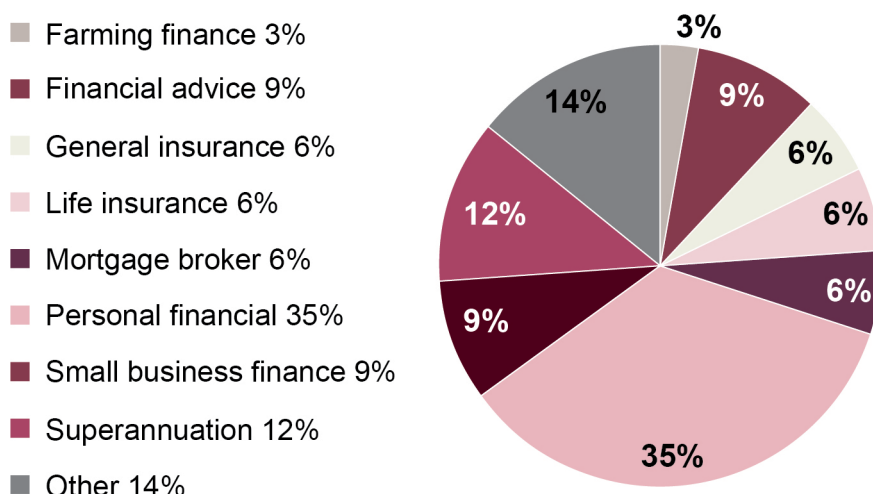


Figure 3: Submissions by nature of dealing

Submissions by complaint type

The Commission also invited information about experiences in dealing with complaints and dispute resolution mechanisms, including satisfaction with the outcome of any complaint they had made. Of the 10,323 submissions received from the public:

- 7,552 (73%) indicated that they had made a complaint in relation to their concerns; and
- Of those, 6,564 (87%) indicated that they were not satisfied with the outcome of the complaint.

Consumer lending and personal finance

Issues relating to consumer lending were examined in the Commission's first round of its public hearings, held in Melbourne from 13 March–23 March 2018.

The Commission inquired into aspects of the treatment of consumers by banking and financial services providers in connection with a number of credit products, including residential mortgages, car finance and credit cards. It also considered insurance sold in conjunction with a credit product and the arrangements and practices of banking and financial services providers and their intermediaries.

Total submissions

The Commission received a total of 5,099 submissions that identified consumer lending and personal finance as a relevant issue in their dealings with a financial services entity. This made up approximately 50% of the total of 10,323 submissions received by the Commission.

Submissions by state/territory

Submissions identifying consumer lending and personal finance as a relevant issue were received from all states and territories. The largest proportion of submissions relating to consumer lending and personal finance came from New South Wales (1,498 submissions), then Victoria (1,189 submissions), Queensland (1,131 submissions) and Western Australia (710 submissions).

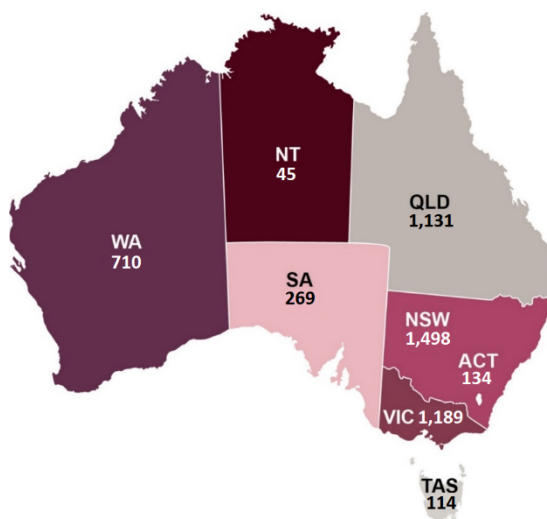


Figure 4: Number of submissions received from each state/territory: Consumer lending and personal finance

Overview

From the outset, consumer-related lending was a focus of concerns raised with the Commission about potential misconduct or conduct falling below community standards. This was reflected in the information received from members of the public, regulators, external dispute resolution bodies, consumer advocacy groups (notably CHOICE, the Consumer Action Law Centre and Financial Rights Legal Centre) and by the financial services entities.

These concerns were reflected in the Commission's decision to make consumer lending the subject of the first round of public hearings, with particular focus on:

- home loans;
- car loans;
- credit cards;
- offers of pre-approved overdrafts and credit cards;
- processing and administrative errors; and
- add-on insurance products.

In addition to these products, the Commission received many submissions relating to other personal finance issues, including transaction and savings accounts and associated fees, ATM fees and availability, and other general personal banking and finance services.

Many of the submissions that related to consumer lending and personal finance involved dealings with the big four banks. However, a wide range of smaller authorised deposit-taking institutions (ADIs), brokers and intermediaries were also mentioned.

These submissions ranged from people's experiences with making an application for a first home loan or a large personal loan through to experiences relating to everyday banking. The submissions included concerns about fees and charges, and the terms and conditions for consumer products, including changes made to these after a person had signed up to a product. The volume of submissions received highlighted not only the frequency of consumer engagement with financial services entities but also the impact of dealings where a consumer felt they had not been treated honestly or fairly.

The submissions included stories of the significant emotional toll of disputes with financial services entities where people had loans approved for which they were ultimately not able to meet the repayments. This often resulted in the loss of a family home, breakdowns in relationships, and ongoing debts arising from penalty interest rates, legal processes and other costs associated with pursuing redress. Some consumers reflected that they had been offered additional credit without asking for those funds, and regretted taking on larger loans than they could afford. Others spoke of being loyal customers for many years, and that such trust and loyalty was not reciprocated in their dealings with their bank.

Submission themes

The following summaries provide further analysis of the key themes or conduct that was raised in public submissions received by the Commission.

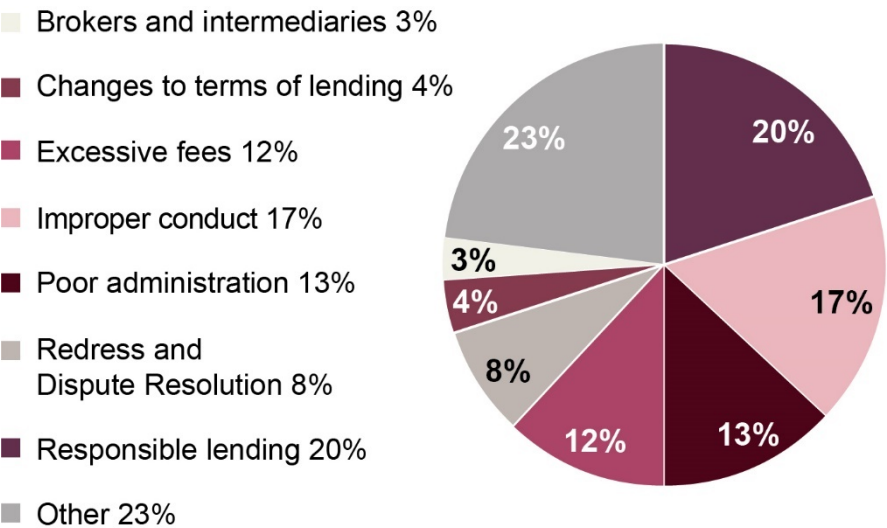


Figure 5: Consumer lending and personal finance submissions: Key themes

Responsible lending

The Commission received over 990 submissions relating to consumer lending issues which identified unfair or irresponsible lending practices by lenders. The primary concerns raised included:

- failure by lenders to take into account the financial or other circumstances of a borrower when approving a home or car loan, particularly where the borrower was a low income earner, on an aged or disability pension, or otherwise unlikely to be able to service the loan;
- failure by lenders to apply any criteria for suitability when offering credit products or increases to credit limits, including offering high-limit products to individuals who had disclosed gambling problems, or to students or other low income earners who had not demonstrated capacity that they would be able to meet repayments;
- recommending the sale of products to consumers that were not suitable for their needs and attracted additional fees, charges or risks, including offers of overdrafts, personal loans or credit products when applying for a home loan; and
- targeted marketing by lenders to vulnerable markets, including advertising reverse mortgages to elderly consumers.

Improper conduct

More than 870 submissions relating to consumer lending and personal finance primarily raised concerns about improper conduct by a financial services entity. Common types of improper conduct identified in public submissions included:

- falsification of loan application documents by bank employees, including inflation of income or asset values, forgery of signatures, and backdating of documents;
- intimidating or inappropriate behaviour by bank employees, often following the default of a loan, including consumers being harassed about repayments, or being coerced into signing a settlement agreement;

- unauthorised disclosure of a consumer's personal information to a third party, including disclosure to abusive parties in the context of family violence; and
- facilitation of unauthorised transactions by staff members, or failure to respond to reports of unauthorised or fraudulent transactions.

Poor administration

Over 650 submissions referred to poor administration or processing errors by financial services entities in relation to consumer lending and personal finance functions. Issues included:

- lenders setting up incorrect facilities for consumers, including approving a business loan when a consumer has sought to take out a domestic mortgage, or approval of a credit facility instead of a personal loan;
- incorrect calculation of interest or fees charged;
- loss of documents or records relating to a consumer's banking arrangements;
- closure of accounts without instruction from the account-holder, and in many cases this was said to have occurred without notification;
- general concerns about the training and expertise of staff involved in sales and approval of loans and credit products; and
- delays in responses from a financial services entity to address the consumer's concerns.

Excessive fees

The Commission received over 590 submissions that primarily related to excessive fees charged for consumer products. Issues related to fees and charges that often featured in submissions included:

- unreasonable discharge or break fees charged by lenders that submissions suggested had been used to dissuade the consumer from refinancing their loan;
- excessive fees charged for routine transactions, including foreign currency and international transaction fees;

- high interest rates being charged on loans or credit products despite lower interest rates being available to new customers or when requested;
- difficulties with finding information about fees and charges for a financial product within the product disclosure statement or the financial services entity's website;
- application of default interest rates, overdraft fees or other penalty charges without notification to the consumer; and
- failure by lenders to disclose adequately fees, charges and interest during the sale of a credit product or approval of a loan.

Redress and dispute resolution

Over 410 submissions were primarily about the experience of consumers with redress and dispute resolution processes. The issues raised included:

- difficulties arising from the jurisdiction of external dispute resolution bodies, including monetary limits or time limitations;
- lack of enforcement of determinations made by external dispute resolution bodies, including the Financial Ombudsman Service (FOS), often resulting in lenders failing to take any action in relation to redress;
- lenders failing to consider a complaint properly unless legal proceedings had been commenced;
- the ongoing costs for a consumer of pursuing legal action against a lender, and the disparity in legal resources available to consumers when compared to financial services entities; and
- lenders continuing to charge default or penalty rates while a matter was under consideration by an external dispute resolution body.

Changes to terms of lending

The Commission received more than 205 submissions that related to a lender making unilateral changes to the terms of a loan.

Key themes included:

- withdrawal of pre-approval or in-principle approval of a loan without explanation, often causing the loss of deposits or other financial hardship;

- substantial reductions in timeframes for repayment of a loan where there had been no breach of terms, in some cases requiring consumers to repay large amounts in under a month;
- lenders giving assurances about the rollover or continuation of loans that were then called in; and
- banks defaulting loans without giving any prior notification to the borrower, and subsequent concerns about the sale of property and enforcement of guarantees following default.

Brokers and intermediaries

In addition to submissions relating to conduct by ADIs, the Commission received over 130 submissions that focused specifically on conduct by intermediaries such as mortgage brokers, aggregators, and introducers. Many of these issues reflected concerns raised about conduct by lenders, but emphasised that the consumer had thought the broker or intermediary was acting on their behalf and in their best interests. Issues raised included:

- brokers encouraging consumers to take out loans they were not able to service;
- falsification of loan application information by mortgage brokers, including inflated income and asset valuations and forgery of signatures;
- conflicts of interest involving brokers only offering products from specific lenders, often seen to be related to commissions received; and
- the sale of credit products or loans by third party vendors such as car sales staff or staff of retail outlets.

Financial advice

The Commission explored issues relating to the financial advice industry in Round 2 of its public hearings, held in Melbourne from 16 April–27 April 2018.

The Commission's consideration of the financial advice industry focused on the conduct of financial services entities that provide financial advice to consumers, including the treatment of consumers, compliance with the law and community standards and expectations, and the sufficiency of the current legal and regulatory structure.

Total submissions

The Commission received a total of 1,139 submissions that identified financial advice as a relevant issue in the consumer's dealings with a financial services entity. This equated to approximately 11% of the total of 10,323 submissions received.

Submissions by state/territory

Submissions identifying financial advice as a relevant issue were received from all states and territories. The largest proportion of submissions relating to Financial Advice came from New South Wales (360 submissions), followed by Queensland (284 submissions), Victoria (266 submissions) and Western Australia (115 submissions).

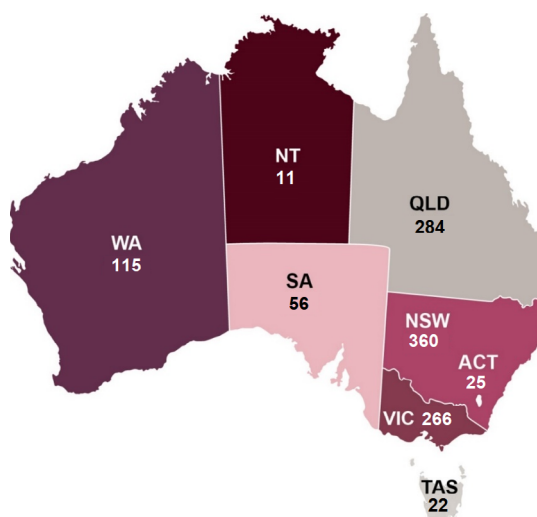


Figure 6: Number of submissions received from each state/territory: Financial advice

Overview

Submissions highlighted a range of concerns about the conduct of major banks or other large financial services entities as well as conduct by smaller financial planning or advice services. Over 300 different financial services entities were mentioned in the 1,139 submissions received.

Prior to the public hearings in relation to financial advice, the Commission received information from regulators and external dispute resolution bodies in relation to their experiences in dealing with the financial advice industry.

Submissions received by the Commission raised concerns about the type and extent of fees charged for financial advice. Many were charged fees despite never having met or spoken with a financial adviser, or were unable to identify what service was provided for the fee. Many wrote in frustration and shock that they discovered they had been charged 'fees for no service' for many years.

Of particular note were submissions recording the impact of poor financial advice on individuals, especially for older Australians relying on advice to support retirement plans. Many wrote about the financial hardship they experienced and a sense that they had misplaced trust in advisers who claimed to be experts and said they would act in the client's best interest.

Others spoke about the lack of transparency around the role of financial advisers and their remuneration, as well as concerns that advisers recommended in-house or commissioned products without proper consideration of a client's personal circumstances.

Submission themes

The following summaries provide further analysis of the key themes or conduct that was raised in public submissions received by the Commission.

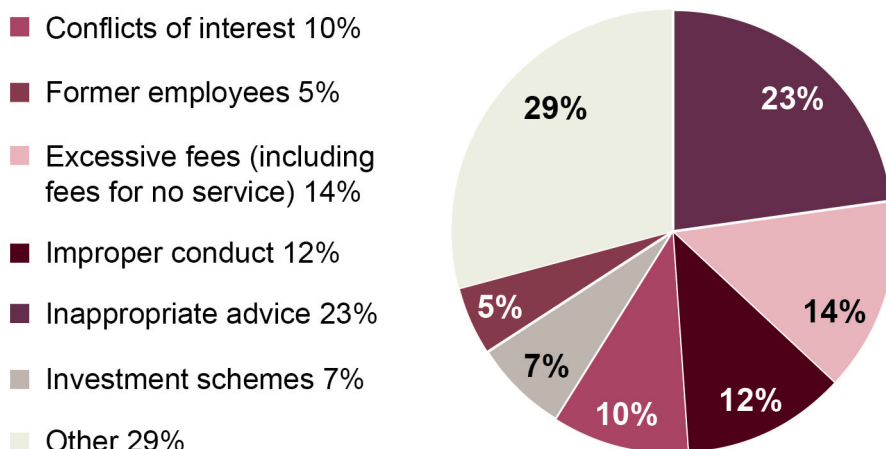


Figure 7: Financial advice submissions: Key themes

Inappropriate financial advice

Over 250 submissions related to financial losses or poor performance of investments that had been made based on financial advice that was not appropriate in the circumstances. Issues raised included:

- financial advice given without any reasonable basis and which resulted in poor outcomes
- failure by financial advisers to consider appropriately a person's financial or other personal circumstances when providing advice or structuring investments; and
- complex or high risk advice given to low-income earners, elderly people or people with a disability.

Excessive fees including fees for no service

The Commission received over 150 submissions where the key focus was unreasonably high fees for ongoing advice or management of investments.

Key themes raised in submissions about excessive fees, including fees for no service, mentioned:

- unreasonably high fees for ongoing advice or management of investments;

- fees being charged where no service was provided and consumers were unaware that fees were being charged at all;
- meeting with a financial adviser at the commencement or purchase of a new product, but never receiving any further statements, advice or contact from the adviser despite annual review charges; and
- consumers deciding they no longer needed financial advice and then being charged fees for exiting or rolling over into a new product.

Improper conduct

Improper conduct by financial services entities was raised in over 130 submissions. Within these submissions, there were claims that:

- financial advisers had engaged in falsification of documents or fraudulent conduct;
- financial advisers had acted without the consumer's authority in investing or handling money, or failed to act on clear instructions of the consumer;
- financial advisers being involved in using a consumer's assets as part of fraudulent activity;
- financial advisers targeting vulnerable members of the community, including low-income individuals receiving government benefits, elderly individuals or couples, or people with a disability; and
- consumers being signed up to high-risk investments that they were unable to understand or afford.

Conflicts of interest

The Commission received over 110 submissions detailing conflicts of interest involving financial advisers as a concern. These submissions detailed:

- conflicts of interest arising between financial advisers and the manufacturers of investment products they sell;
- financial advisers failing to act in the best interests of the consumer due to conflicted remuneration practices or due to relationships between providers and manufacturers of investment products;

- consumers being sold investment products that performed poorly or did not meet their needs; and
- consumers being unaware of commissions being paid to financial advisers who are integrated with the manufacturer of the product.

Managed investment schemes

The Commission received over 70 submissions specifically referring to financial advice relating to managed investment schemes which later failed. These submissions raised concerns about the:

- lack of information or communication provided in advance, or before the scheme collapsed; and
- limited redress options for investors in failed managed investments schemes.

Submissions from current and former financial advisers

Over 50 submissions were received from current or former financial advisers about practices and behaviour within the sector. These submissions referred to:

- a culture within the financial advice industry that is focused on sales targets and products that deliver higher commissions, without consideration for the best interests of the consumer;
- financial advisers being encouraged to transition consumers to products that generate higher commissions;
- restrictions being placed on advisers to ensure that they only recommend products on an approved product list which is limited to in-house or vertically integrated products; and
- financial advisers being forced to resign or being terminated if they refused to engage in certain practices.

General advice given by financial services entities

General advice given by financial services entities, as opposed to formal financial (or personal) advice, was the primary concern raised in over 120 submissions received. Of those, 80 related to mortgages and 40 to business loans. Key themes included:

- consumers suffering a loss following advice given by a person other than a licensed financial adviser or authorised representative (such as a bank manager or a broker);
- failure to explain properly the risks associated with certain products; and
- inadequate explanations given about the operation and costs associated with certain products.

Small and medium enterprises (SMEs)

The Commission explored issues relating to small and medium enterprises (SMEs) during Round 3 of its public hearings, held in Melbourne from 21 May–1 June 2018.

Round 3 focused on issues relating to the provision of loans and whether the legal frameworks governing SMEs were sufficient to protect small business owners, and in particular, whether any lending to SMEs should have similar protections to those afforded to individual consumers.

Total submissions

The Commission has received a total of 1,211 submissions that identified small business finance as a relevant nature of dealing, making up approximately 12% of the total 10,323 submissions received.

Submissions by state/territory

Submissions identifying small business finance as a relevant issue were received from all states and territories. The largest proportion of submissions relating to small business finance came from New South Wales (357 submissions), followed by Victoria (281 submissions), Queensland (272 submissions) and Western Australia (169 submissions).

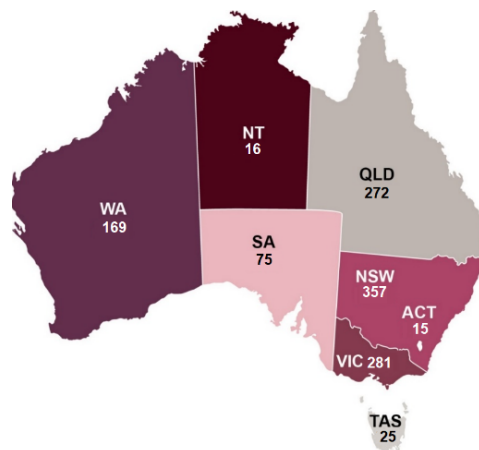


Figure 8: Number of submissions received from each state/territory: SMEs

Overview

The Commission received 1,211 public submissions identifying small business finance as part of their dealings with financial services. These submissions also included issues with larger lenders, smaller ADIs and intermediaries.

Issues raised in submissions were similar in nature to issues raised in relation to consumer lending and personal finance (including the issues examined in Round 1). This included concerns about the failure of banks (or other entities) to consider properly the borrower's circumstances or longer-term viability of a loan, inflating valuations and income to secure approval of a business loan, and the over-reliance on personal properties as security for lending.

Submissions were varied and included stories from individuals who ran, or had been seeking to start up a small family-owned business involving modest financial dealings through to businesses with multi-million dollar loans and other financial dealings and investments. While these stories emphasised the variation in both the size and scale of those who considered their businesses to be SMEs, submissions consistently highlighted concerns regarding dealings with banks and the impact of these dealings on the viability of a business, as well as the subsequent emotional stress on personal and professional relationships.

Many submissions detailed the financial and emotional impact of pursuing redress, either through external dispute resolution channels or taking legal action. Submissions referred to SME owners abandoning their efforts to seek redress as they could not afford to commence legal proceedings or could no longer afford ongoing legal action, which often compounded existing financial hardship and highlighted an imbalance in resources between the business and the financial services entity.

Prior to Round 3 of public hearings, the Commission engaged with a wide range of interested stakeholders, including the Financial Ombudsman Service, Phil Khoury, who had undertaken the Independent Review of the Code of Banking Practice during 2016 and 2017, the Council of Small Business Organisations Australia; Financial Counselling Australia; the Legal Advice for Small Business Clinic, which is a joint initiative of the University of Canberra and ACT Legal Aid; Legal Aid New South Wales; Legal Aid Queensland; and the Consumer Action Law Centre.

In addition, the Commission spoke to a range of statutory and government bodies about policy and regulation in relation to small business lending, including the Australian Securities and Investments Commission (ASIC), the Australian Competition and Consumer Commission (ACCC), the Australian Prudential Regulation Authority (APRA), the Australian Small Business and Family Enterprise Ombudsman, and Treasury. These consultations informed the lines of inquiry taken during the public hearings.

Submission themes

The following summaries provide further analysis of the key themes or conduct that was raised in public submissions received by the Commission.

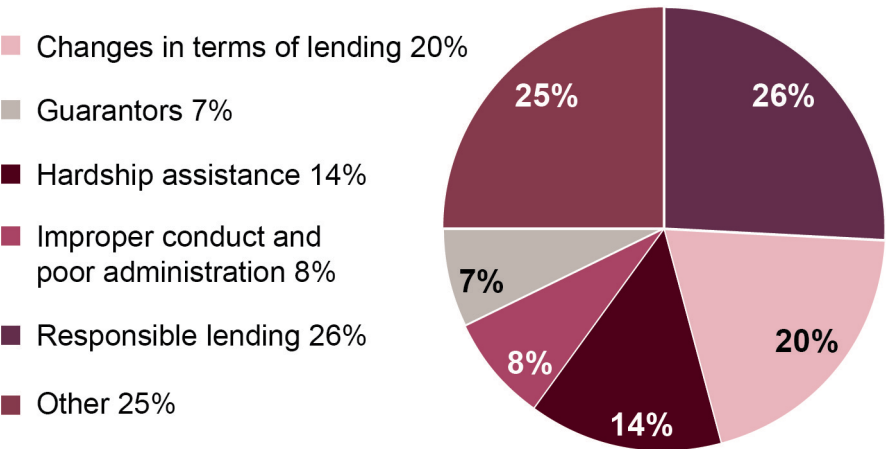


Figure 9: SMEs submissions: Key themes

Responsible lending

The Commission received over 315 submissions that focused on unfair or irresponsible small business lending practices. While these submissions raised similar concerns regarding responsible lending to those raised by individual consumers, there were some distinct themes. These included:

- the lender proceeding with approval of a small business loan where it should have been clear that the business would not succeed, either due to limited profitability or the borrower’s capacity to manage a business;

- the lender or broker inflating figures relating to the borrower's financial circumstances in order to secure lending; and
- the lender offering extensions to existing small business loans where there was no evidence the business was able to service the loan.

Changes in terms of lending

The Commission received more than 230 submissions referring to lenders changing the terms of SME loans unilaterally or without giving adequate notification to the borrower. These submissions often referred to a power imbalance between SME borrowers and lenders, with lenders able to decide the terms on which a loan may continue or should be terminated.

Issues in relation to changes in terms of lending included:

- lenders giving verbal approval for a loan and subsequently rejecting a formal loan application, in some circumstances after the borrower had already entered into contracts with service providers;
- lenders altering repayment or review timeframes, often involving unreasonable timeframes for repayment of a loan;
- false assurances made to borrowers about the rollover or renewal of their loans; and
- substantial increases to interest rates, merchant fees or other fees and charges without notice to the small business owner.

The Commission also received 68 submissions from former customers of Bankwest, which substantially related to decisions to call in loans following the acquisition of Bankwest by CBA. These, along with other submissions and information received by the Commission, informed the lines of inquiry considered and undertaken by the Commission in relation to changed terms of lending. At the commencement of the fourth round of hearings, Bankwest complainants were invited to lodge further submissions.

Hardship assistance and enforcement of defaults

The Commission received over 160 submissions in relation to SME lending that related to the lack of available assistance for SMEs experiencing financial difficulties, and the approach taken by banks to taking enforcement action on defaulted loans. The following issues arose in relation to hardship assistance and default:

- lenders failing to respond to early requests for assistance from small business lenders experiencing financial difficulties prior to default;
- lack of notice prior to enforcement action being taken to appoint receivers or to require the sale of a business;
- refusal of offers to refinance or pay down debt once a loan had been defaulted; and
- sale of property by lenders or receivers at substantially below perceived market value, sometimes involving refusal to accept offers from a borrower to refinance with another lender.

Improper conduct and poor administration

The Commission received more than 90 submissions which identified concerns about improper conduct or poor administrative practices that arose in relation to SME lending. Issues raised in relation to improper conduct and poor administration included:

- falsification of documents, including loan application information, valuations, or other documents required to secure approval of a business loan;
- failure by lenders to obtain appropriate authority from all business owners in relation to significant transactions, particularly in the context of failing businesses;
- alleged breaches of the borrower's privacy by lenders, including disclosure of personal information to joint account holders; and
- errors or delays in processing of deposits, payments and settlements, in many cases affecting relationships with contractors and service providers of SMEs.

Guarantors

Over 80 submissions about SME lending primarily raised concerns about third party guarantees. Submissions often referred to SME loans that were guaranteed by family members of the small business owner using their primary residence. Key issues raised included:

- defects with the guarantor's consent, such as where guarantor agreements were signed without the guarantor fully understanding the effect of the agreement or where there was pressure placed on the guarantor to sign;
- falsification of guarantor documents or failure to provide complete documents to a guarantor for consideration before signing; and
- the consequences of enforcement of a guarantee over a primary residence of a third party, particularly where they were elderly or a low income earner and the financial and personal impact on guarantors and their families.

Experiences with financial services entities in regional and remote communities

Round 4 of the Commission's public hearings explored issues affecting Australians living in remote and regional communities, including agricultural lending and issues affecting Aboriginal and Torres Strait Islander people. The hearings were held in Brisbane (25–29 June 2018) and Darwin (2–6 July 2018).

These topics were selected on the basis that they are significant issues within regional and remote communities with the potential to affect the financial wellbeing of Australians who live in those communities disproportionately.

Issues relating to natural disaster insurance, originally proposed for Round 4, were moved to Round 6 of the hearings, which focused on the insurance industry.

Agricultural lending

Total submissions

The Commission received a total of 410 submissions that identified agricultural lending as a relevant nature of dealing, making up 4% of the total of 10,323 submissions received.

Submissions by state/territory

Submissions identifying agricultural lending as a relevant issue were received from all states and territories. The largest proportion of submissions relating to agricultural lending came from Queensland (125 submissions), followed by New South Wales (107 submissions) and Western Australia (75 submissions).

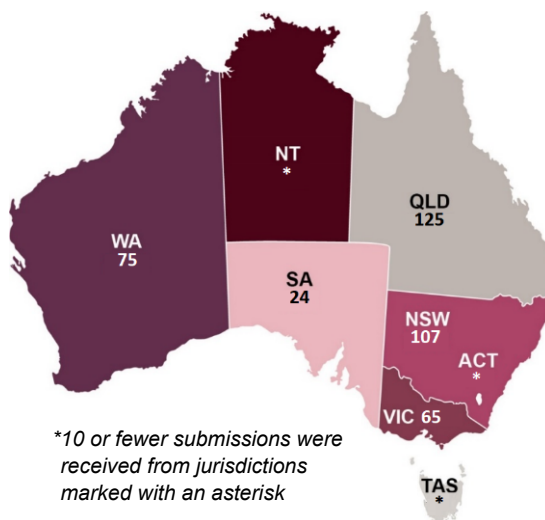


Figure 10: Number of submissions received from each state/territory: Agricultural lending

Overview

In addition to submissions received by the Commission, the Commission also consulted broadly with a number of industry participants, rural financial counsellors, legal aid commissions, regulators and affected consumers to inform its lines of inquiry. Based on this information, the Commission identified significant concerns about the conduct of the major banks and medium-sized financial services entities that specialised in agricultural lending.

In reviewing the public submissions, the Commission noted that a number of submissions raised issues that were relevant to other hearing rounds including issues already explored about responsible lending and poor administration of loans and accounts in earlier rounds (consumer lending, Round 1, and small and medium enterprises, Round 3).

Many public submissions highlighted the emotional and reputational impact of the financial difficulties faced by farmers, and in the worst case scenarios, the impact of losing the family farm.

Submission themes

The following summaries provide further analysis of the key themes or conduct that was raised in public submissions received by the Commission.

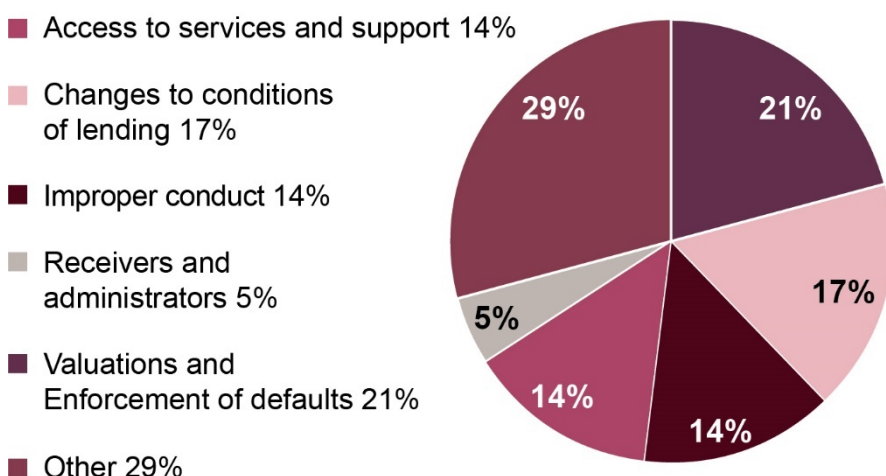


Figure 11: Agricultural lending submissions: Key themes

Valuations and enforcement of defaults

Over 85 submissions raised concerns about practices involving the valuation of properties, including primary residences and security properties associated with loans, and enforcement action taken following default of loans. Key themes raised in submissions referring to valuations included:

- banks inflating the value of security properties to facilitate the approval of loans, sometimes where properties were subsequently revalued at substantially lower values following loan approval;
- borrowers being encouraged to take out additional loans or overdrafts to fund expansion, equipment or stock only to be defaulted shortly after doing so;
- banks revaluing security properties at substantially lower values, resulting in a breach of loan-to-value ratio (LVR) terms of a loan;

- in-house valuations performed by bank staff who did not have sufficient expertise about the agricultural industry;
- failure to discuss alternative options with borrowers who were unable to service agricultural loans leading up to default, and refusal to negotiate once the bank had ordered that assets be sold; and
- sale of assets or properties at values below what the farmer considered to be the market value of the property, often supported by independent valuations obtained by the farmer.

Changes to conditions of lending

Over 65 submissions received in relation to agricultural finance claimed lenders unilaterally made changes to the terms on which a loan was offered. Key concerns raised included:

- changes to the expiry period for loans, the amount of the loan and the types of facilities offered (such as overdrafts, trading facilities and lines of credit) which were seen as unfair, or meant the borrower was unable to meet the repayments required;
- significant changes to guarantees of finance for new or existing agricultural businesses, or refusing to renew or allow such guarantees to the detriment of the borrower; and
- withdrawal of verbal offers of finance after the borrower had entered into funding agreements with suppliers or buyers.

Improper conduct

At least 60 submissions claimed that actions by a financial services entity were misleading, fraudulent or otherwise inappropriate. Key themes raised in submissions referring to improper conduct included:

- allegations that financial services entities falsified documents, including loan application information, valuations, and documents relating to the disposal or sale of properties following default;
- allegations of intimidating or threatening behaviour once a loan had been placed in default; and
- financial services entities requiring borrowers to sign documentation while they were seriously ill or receiving medical treatment which impaired the borrower's ability to understand any risks involved.

Difficulty in obtaining access to banking services and appropriate support

Over 55 submissions referred to issues with obtaining appropriate access to banking services, failure to respond to requests for hardship assistance, or inadequate support from lenders following default. These issues included:

- failure to respond to contact from borrowers in a timely manner, including requests for assistance, provision of documents, or delays in settling finance;
- claims that financial services entities lacked understanding of the seasonal nature of farming operations, and the impact of drought on cashflows;
- enforcement of default where borrowers considered they would be able to trade out of debt had the bank supported their operation over the short-term, based on projected income;
- failure by lenders to give any advance notification that a loan was considered to be impaired; and
- banks enforcing unreasonable timeframes for repayment of loans or sale of assets following default, and in some cases requiring repayment of several million dollars in less than 30 days.

Receivers and administrators

Individuals also raised issues about receivers and administrators. As noted in the *Interim Report*, receivers and administrators are not financial services entities as defined in the Letters Patent and so their conduct does not fall directly within the scope of the Commission's inquiries. However, issues relating to the appointment of receivers by banks were considered by the Commission in its Round 4 public hearings on the basis that they concerned the conduct of financial services entities and so fell within the Terms of Reference.

While a number of people included comments about the conduct of an administrator or receiver as part of their submission, there were 20 submissions that primarily focused on the appointment and subsequent conduct of receivers and administrators. Many of these submissions raised concerns about the conduct of receivers and administrators both in their dealings with borrowers, as well as their management of properties and stock.

Farm debt mediation

In addition to the themes above, over 45 submissions referred to the farmer's participation in farm debt mediation. These submissions generally raised concerns about the process, suggesting that the process favoured the financial services entity or did not lead to satisfactory outcomes from the farmer involved, or that the financial services entity had not agreed to participate in voluntary farm debt mediation processes when requested.

Aboriginal and Torres Strait Islander people

Overview

While the Commission received a relatively small number of submissions from individuals identifying as Aboriginal or Torres Strait Islander, the Commission consulted widely in order to identify and understand the issues that arise for Aboriginal and Torres Strait Islander people in their dealings with financial services entities.

These consultations included financial counsellors and lawyers from organisations across Australia who work closely with this group including staff from various regional offices of the North Australian Aboriginal Justice Agency (NAAJA); Financial Counselling Australia; representatives of Save The Children in Katherine; the Indigenous Consumer Assistance Network (ICAN), including with financial counsellors who work with consumers on Palm Island; the First Nations Foundation; the Consumer Action Law Centre; the Financial Rights Legal Centre and NSW Legal Aid.

The Commission also sought information from ASIC's Indigenous Outreach Program about what it considered to be issues of particular concern affecting Aboriginal and Torres Strait Islander people in their dealings with financial services entities.

The concerns that were consistently raised included aggressive sales tactics, complexity of product disclosure statements and cancellation of policies or products and excessive fees for services in rural and regional areas.

As Senior Counsel Assisting noted in her opening address, the Aboriginal and Torres Strait Islander population is as diverse as the broader Australian population, and not all Aboriginal and Torres Strait Islander people living in these communities will experience the same obstacles as outlined in the case studies.

Consumer themes

Concerns were consistently raised in relation to funeral insurance products, access to superannuation benefits and entitlements, consumer lending and banking fees and practices. Another primary issue of concern was access to financial products and services for Aboriginal and Torres Strait Islander people, including the complexity and language barriers associated with product design and disclosure statements.

Issues about superannuation products for Aboriginal and Torres Strait Islander people were explored during Round 5 of the Commission's hearings.

Redress

Language and cultural barriers, including increased difficulty in navigating complaints and dispute resolution processes, are some of the issues that were identified by submissions as arising from remoteness. Of the small number of submissions received by the Commission in relation to Aboriginal and Torres Strait Islander consumers, very few indicated that they had made a complaint about the conduct or that any action was taken in response to the matter.

During the Commission's public hearings, Senior Counsel Assisting referred to complaints received by ASIC in relation to issues affecting Aboriginal and Torres Strait Islander people, with many made by stakeholder networks of indigenous consumer advocates, financial counsellors, community legal centres, and other government agencies. Primary areas of concern raised in complaints referred to by ASIC included:

- inappropriate sale of funeral insurance policies;
- difficulty accessing superannuation;
- access to ADIs; and
- excessive bank fees and charges, including ATM fees.

Superannuation

The Commission explored issues relating to the superannuation industry in Round 5 of its public hearings, held in Melbourne from 6 August–17 August 2018.

The Commission's consideration of the superannuation industry focused on how registerable superannuation entity (RSE) licensees fulfil their duties to members of regulated superannuation funds, structural and governance issues, sales practices, the relationship between trustees and financial advisers, the current legal regime and the effectiveness of regulators.

Total submissions

The Commission received a total of 1,626 submissions that identified superannuation as a relevant issue in their dealings with a financial services entity, which equated to approximately 16% of the total of 10,323 submissions received.

Submissions by state/territory

Submissions identifying superannuation as a relevant issue were received from all states and territories. The largest proportion of submissions relating to superannuation came from New South Wales (536 submissions), followed by Victoria (380 submissions), Queensland (357 submissions) and Western Australia (159 submissions).

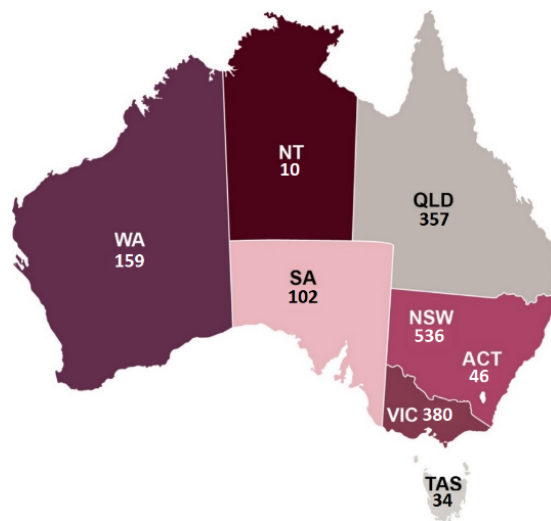


Figure 12: Number of submissions received from each state/territory: Superannuation

Overview

Submissions highlighted a range of concerns about the conduct of RSEs, banks, and financial advisers with which they had dealings relating to their superannuation. Over 150 different financial services entities were mentioned in the 1,626 submissions that were received.

Notably, a number of public submissions on superannuation also indicated other related dealings with the financial services entity. Of the 1,626 submissions on superannuation, over 340 also related to financial advice, and over 270 related to life insurance associated with a superannuation account.

In addition to individual submissions, the Commission also received submissions from interested groups such as the Association of Superannuation Funds of Australia; the Australian Council of Superannuation Investors; the Australian Institute of Superannuation Trustees; the Financial Services Council; the Financial Services Institute of Australasia; and the Responsible Investment Association of Australia. The Commission also received information from consumer bodies which assist consumers in relation to their dealings with superannuation entities, including the Consumer Action Law Centre and CHOICE. The Commission also consulted with officers from ASIC, APRA and the Productivity Commission.

Submissions raised concerns about the impact of fees for add-on financial services such as life insurance or financial advice, which had reduced the balance of their superannuation, or in some cases left the person with a zero balance in their account. A number of submissions mentioned the fund member's frustration with contacting their superannuation fund (and delays which often followed) if they sought to switch funds; tried to obtain additional information; or queried fees associated with their fund.

Fund members often raised concerns about the complexity of their superannuation accounts, and in many cases, indicated that they were unaware they were subject to additional fees or were being charged fees without receiving any service in return. Many submissions received were from individuals who had retired, or were close to retirement and who were concerned about their financial security. Others felt embarrassed that they lacked the financial literacy skills and/or had misplaced their trust in a particular superannuation fund.

A number of submissions also raised concerns about conduct by Commonwealth, state or territory superannuation entities. These entities either did not fall within the definition of a financial services entity under the Commission’s Terms of Reference, or were not entities of focus for the Commission.

Submission themes

The following summaries provide further analysis of the key themes or conduct that was raised in public submissions received by the Commission.

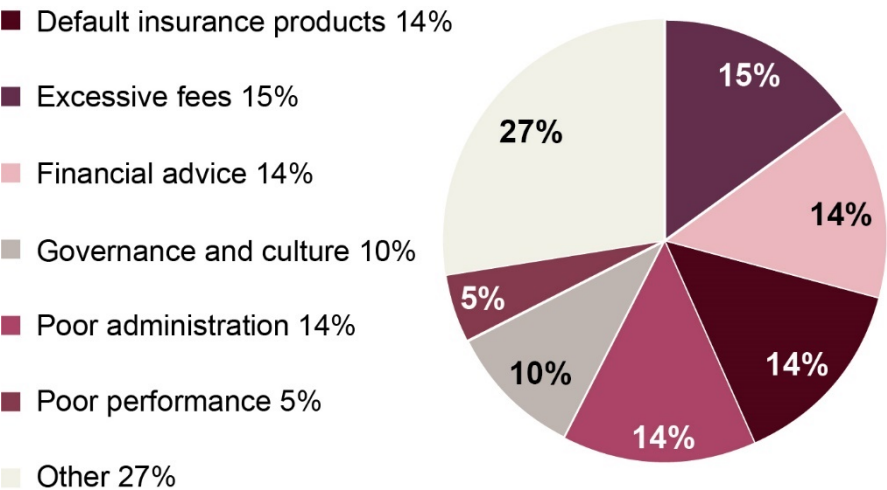


Figure 13: Superannuation submissions: Key themes

Excessive fees

The Commission received over 250 submissions focused on unreasonably high fees being charged for financial products or services associated with a superannuation account. Key themes included:

- excessive fees being charged (when compared to the balance of a superannuation account) for:
 - contributions into the fund
 - roll-over into another fund
 - termination or exit of an account;
- management, administration, or advice fees being charged without the knowledge of the consumer, or any ongoing service having been provided; and
- failure to disclose fee structures to fund members, or disclosure of fee structures through complex product disclosure statements.

Inappropriate financial advice

Over 235 of the submissions on superannuation received by the Commission related to conduct by a financial adviser in relation to investment of superannuation. Issues raised in these submissions included:

- failure by financial advisers to explain risk or fees associated with investment of superannuation;
- provision of poor or misleading advice, including advice about investment of superannuation in vertically integrated products;
- failure by financial advisers to follow instructions of the account holder on how to invest superannuation; and
- investing superannuation of consumers with low income or a relatively low superannuation balance in high risk investments.

Default insurance products

More than 220 submissions related to superannuation funds providing life insurance products to members on a default or opt-out basis. These submissions detailed:

- fees for life insurance products substantially or entirely depleting the balance of superannuation accounts, in some cases without the knowledge of the account holder;
- duplication of life insurance products for individuals who hold accounts with multiple superannuation funds, including duplicate income protection insurance; and
- inclusion of life insurance products that the account holder was not eligible to claim under.

Poor administration

Poor administration of superannuation was raised in at least 220 submissions. These submissions detailed:

- delays in processing disbursements, transfer of pensions from other jurisdictions, or release of balances on roll-over into another fund;
- delays by superannuation funds in processing claims against life insurance policies;
- failure by superannuation funds to respond to requests to cancel life insurance products or financial advice options; and
- delays and administrative errors involved in release of superannuation as part of deceased estate dealings.

Governance and culture

Over 150 submissions referred to issues with governance and regulatory frameworks relating to the superannuation sector, or the sales culture within superannuation funds. Issues raised in these submissions included:

- general submissions highlighting a lack of regulation or enforcement of breaches in the superannuation industry by ASIC and APRA;
- lack of transparency about how member funds are used by superannuation trustees, including using funding for corporate entertainment and advertising; and
- submissions from former staff in the financial services industry highlighting sales focus in relation to advice and insurance products within superannuation accounts.

Poor performance

Over 85 submissions were received in relation to the poor financial performance of superannuation accounts. These submissions referred to:

- consumers being encouraged to invest superannuation in products that achieved very low or nil returns across long periods of time, despite assurances of high percentage returns;
- returns for 'premium' products being less than the fees paid for management and advice; and
- failure by superannuation funds to explain adequately poor performance or losses on specific products.

Insurance

The Commission explored issues relating to the insurance industry in Round 6 of its public hearings, held in Melbourne from 10 September–21 September 2018.

In particular, this round of hearings focused on issues associated with the sale and design of life insurance and general insurance products, the handling of claims under life insurance and general insurance policies, the administration of life insurance by superannuation trustees, and the appropriateness of the current regulatory regime for the insurance industry.

The issue of natural disaster insurance, which was initially scheduled to be considered as part of the Commission's hearings into regional and remote consumer issues, was also considered during Round 6.

Total submissions

The Commission received a total of 1,527 submissions that identified insurance as a relevant issue in their dealings with a financial services entity, which equated to approximately 15% of the total of 10,323 submissions received. Of those, over 840 submissions indicated that they were concerned with life insurance, and over 820 submissions identified that they were concerned with general insurance (with some identifying both).

Submissions by state/territory

Submissions identifying insurance as a relevant issue were received from all states and territories. The largest proportion of submissions relating to insurance came from New South Wales (442 submissions), followed by Queensland (385 submissions), Victoria (369 submissions) and Western Australia (141 submissions).

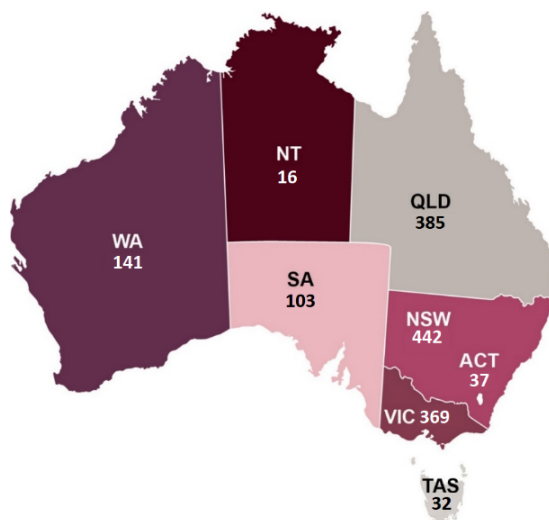


Figure 14: Number of submissions received from each state/territory: Insurance

Overview

The Commission received 1,527 submissions identifying insurance as part of their dealings with financial services. Submissions referred to insurance products offered by insurers ranging from small to very large companies, products sold by the big four banks and other ADIs, and financial advisers and superannuation funds that acted as sales channels for life insurance.

The submissions received were varied and raised concerns across a spectrum of insurance products, including income protection, total and permanent disability (TPD) insurance, trauma and accident insurance, home and contents insurance, travel insurance, and comprehensive and compulsory third party motor vehicle insurance.

The Commission also received a number of submissions in relation to claims under state and territory workers compensation schemes. Issues relating to these schemes were not an area of focus for the Commission.

Submissions emphasised the impact of insurance claims being rejected, or of ongoing disputes with insurance companies, at times when the consumer was already vulnerable due to illness, injury, the death of a family member, or, in the context of general insurance, when a home was uninhabitable. Submissions also spoke about being unable to afford mounting costs for life insurance, particularly for older Australians reliant on their superannuation to support them.

Prior to the Round 6 public hearings, the Commission consulted with a number of community organisations, financial services entities, regulators and dispute resolution bodies in relation to consumer experiences with the life insurance and general insurance industry. This included consultations with, or information provided by ASIC; the Financial Ombudsman Service; the General Insurance Code Compliance Committee; Legal Aid NSW; Legal Aid QLD; the Financial Rights Legal Centre; the Consumer Law Action Centre; the Public Interest Advocacy Centre; beyondblue; and CHOICE. Information provided by these bodies assisted the Commission in identifying key issues and lines of inquiry.

Submission themes

The following summaries provide further analysis of the key themes or conduct that was raised in public submissions received by the Commission.

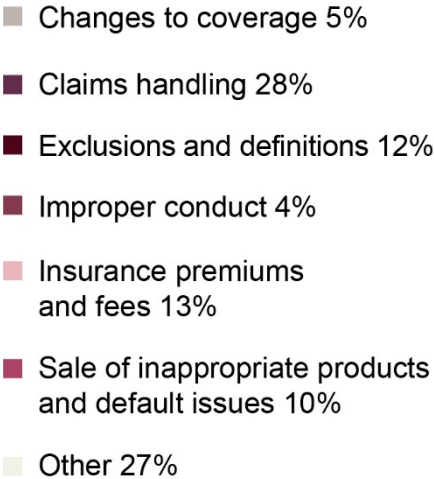


Figure 15: Insurance submissions: Key themes

Claims handling

The Commission received over 430 submissions that primarily focused on issues relating to claims handling and administration in relation to a number of insurance product types. Key themes raised in these submissions included:

- substantial delays to processing and payment of claims under life policies, resulting in significant financial hardship for consumers whose incomes were affected by illness or injury;
- delays in arranging critical repairs under home and contents insurance policies, often leaving consumers without a safe or secure place to live and the stress of finding and maintaining temporary accommodation;
- reliance by an insurer on evidence that was unfavourable to the consumer's claim, particularly where the independent expert evidence supported the claim. This included medical evidence in relation to life insurance claims, and evidence from engineers and builders in relation to general insurance claims; and
- failure by insurers to provide adequate explanation of why a claim had been rejected. A number of stories raised concerns that consumers had felt intimidated by the process, with a number saying that they were left to feel that they were responsible for the damage.

Insurance premiums and fees

More than 190 submissions related primarily to issues around insurance premiums, fees and charges. Concerns raised in these submissions included:

- default life insurance products depleting the balance of superannuation accounts, often without the consumer knowing they were paying for life insurance;
- sharp increases in premiums for life insurance policies without notice or explanation to consumers, particularly for elderly consumers on stepped premium life insurance policies. A particular concern related to consumers who were unable to change provider due to pre-existing conditions; and
- concerns about lack of transparency in relation to the calculation of premium increases on motor vehicle and home and contents policies, including the application of no-claim bonuses.

Exclusions and definitions

Over 185 submissions dealt primarily with issues relating to exclusions or definitions in insurance policies. While these largely related to life insurance policies, issues with definitions also arose in relation to home and contents policies. Some of these issues included:

- concerns about automatic exclusions in life insurance policies for mental health issues such as anxiety, depression and fatigue where those conditions are being successfully managed by the consumer or occurred a long time ago;
- cessation of coverage or denial of insurance claims on the basis that the insured had a pre-existing mental health condition where there has been no previous diagnosis of that condition;
- rejection of claims against life insurance policies based on medically inaccurate or outdated definitions around medical conditions, including cardiac arrest; and
- rejection of general insurance claims following natural disasters due to disputes about definitions and causes of damage, particularly in relation to water damage and flooding.

Sale of inappropriate products

The Commission received over 160 submissions which identified concerns about the sale of insurance products that were not appropriate for the needs of the consumer, including issues with default insurance products under superannuation funds. This made up 10% of submissions received relating to insurance. Issues highlighted in these submissions included:

- sale of income protection insurance to students, casual workers and retirees who would be ineligible to claim under those policies;
- inclusion of default life insurance products in superannuation accounts of low income earners or those with low superannuation balances, causing depletion of superannuation balances; and
- sale of high premium products that offered unsuitable coverage by financial advisers, raising concerns about conflicts of interest.

Changes to coverage

The Commission received over 75 submissions that focused on changes to a consumer's insurance coverage without their authority or knowledge. The following issues arose in these submissions:

- cancellation of general and life insurance policies without notification to the consumer until they sought to make a claim;
- insurers unilaterally altering coverage on general and life insurance policies, often without notification to the customer, including removal of specific types of damage from home and contents insurance, or changes in type of life insurance policy;
- insurers or superannuation funds reinstating cancelled insurance policies without authorisation from the consumer; and
- changes to the extent of coverage offered when an insurance company was acquired by another financial services entity.

Improper conduct

Over 65 submissions identified inappropriate or improper conduct by insurers or other financial services entities involved in handling insurance issues. Types of conduct that were raised included:

- disclosure of personal information including medical records and financial information to third parties without authorisation;
- falsification of documents by insurers, including insurance contracts and independent expert reports; and
- intimidating behaviour or harassment by investigators contracted to conduct surveillance on insurance claimants, particularly where the claim related to a mental health condition.

Appendix 4:

The Commission team

The following provided assistance during some or all of the term of the inquiry.

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Albert Dinelli
Eloise Dias
Mark Costello

Other Counsel

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Claire Schneider
Sarah Zeleznikow
Tim Farhall

Special Advisor to Commissioner

David Borthwick AO

Office of the Royal Commission

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Elizabeth Brayshaw
Eva Logan
Jamie Collins
Owen Lodge
Janice Nand
Tara Philip
Alicia Da Costa
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Sophie Vasenszky
Tracey Grobbelaar
Anatoli Shapiro
Rhiannon Scully

Alexandra Ashcroft
Alana Brennan
Corinne Adams
Jennifer Garbode
Erica Weatherly
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Cecilia Barber
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Anna Dearman
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Lewis Winter
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Michael Kingston
Stephen Spargo AM

Officers of the Commonwealth Attorney-General's Department provided enabling services to the Royal Commission

External providers

Court technology provider

Law in Order

Transcription services

Auscript

Editorial, design and printing

Information Access Group
Rothfield Print & Image Management (with assistance from Fluid)

Appendix 5: Witnesses

Consumer lending

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
1. Karen Cox	1.2	Statement of Karen Cox – 10-Mar-2018	13-Mar-2018	P-49
2. Anthony Waldron	1.4	Statement of Anthony Waldron – 02-Mar-2018	13, 14-Mar-2018	P-63
	1.18	Exhibits to the statement of Anthony Waldron – 02-Mar-2018		
3. Angus Gilfillan	1.20	Statement of Angus Gilfillan – 05-Mar-2018	14-Mar-2018	P-196
4. Mark Harris	1.24	Statement of Mark Harris – 07-Mar-2018	14-Mar-2018	P-215
	1.25	Supplementary statement of Mark Harris – 12-Mar-2018		
5. Daniel Huggins	1.27	Statement of Daniel Huggins – 02-Mar-2018	15-Mar-2018	P-228
	1.28	Supplementary statement of Daniel Huggins – 07-Mar-2018		
6. Lynda Harris	1.41	Statement of Lynda Harris – 07-Mar-2018	15, 16-Mar-2018	P-309
7. Giles Boddy	1.73	Statement of Giles Boddy – 05-Mar-2018	16-Mar-2018	P-390
8. David Smith	1.78	Statement of David Smith – 06-Mar-2018	N/A	
9. Robert Regan	1.82	Statement of Robert Regan – 08-Mar-2018	16-Mar-2018	P-434
10. William Ranken	1.86	Statement of William Ranken – 04-Mar-2018	19-Mar-2018	P-453

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
11. Irene Savidis	1.92	Statement of Irene Savidis – 09-Mar-2018	19-Mar-2018	P-491
12. Clive van Horen	1.95	Statement of Clive van Horen – 09-Mar-2018	19, 20, 22-Mar-2018	P-499
	1.96	Statement of Clive van Horen – 09-Mar-2018		
	1.97	Supplementary statement of Clive van Horen – 05-Mar-2018		
	1.113	Statement of Clive van Horen – 09-Mar-2018		
	1.161	Statement of Clive van Horen – 22-Mar-2018		
13. Heang Forbes	1.122	Statement of Heang Forbes – 01-Mar-2018	20-Mar-2018	P-623
14. Sarah Stubbings	1.126	Statement of Sarah Stubbings – 05-Mar-2018	20, 21-Mar-2018	P-647
15. Nalini Thiruvangadam	1.138	Statement of Nalini Thiruvangadam – 15-Mar-2018	21-Mar-2018	P-716
16. Phillip Godkin	1.141	Statement of Phillip Godkin – 05-Mar-2018	21-Mar-2018	P-731
	1.142	Statement of Phillip Godkin – 05-Mar-2018		
17. Guy Mendelson	1.149	Statement of Guy Mendelson – 04-Mar-2018	22-Mar-2018	P-795
18. Michael Saadat	1.158	Statement of Michael Saadat – 05-Mar-2018	01-Jun-2018	P-2965
19. David Harris	1.160	Statement of David Harris – 18-Mar-2018	22-Mar-2018	P-861

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
20. William Malcolm	1.164	Statement of William Malcolm – 19-Mar-2018	23-Mar-2018	P-904
	1.165	Further statement of William Malcolm – 21-Mar-2018		
21. Carol Separovich	1.178	Statement of Carol Separovich – 12-Mar-2018	23-May-2018	P-2264
	1.179	Further statement of Carol Separovich – 22-Mar-2018		
22. Gareth Russell	1.181	Statement of Gareth Russell – 22-Mar-2018	N/A	
23. Alan Machet	1.183	Witness statement of Alan Machet – 28-Feb-2018	N/A	
	1.184	Further statement of Alan Machet – 22-Mar-2018	N/A	

Financial advice

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
24. Peter Kell	2.1	Statement of Peter Kell – 12-Apr-2018	16-Apr-2018	P-1029
25. Donald Sillar	2.3	Statement of Donald Sillar – 11-Apr-2018	N/A	
26. Bradley Green	2.4	Statement of Bradley Green – 12-Apr-2018	N/A	
27. Hugh Humphrey	2.5	Statement of Hugh Humphrey – 13-Apr-2018	N/A	
28. Mark Ballantyne	2.6	Statement of Mark Ballantyne – 13-Apr-2018	N/A	
29. Linda Elkins	2.7	Statement of Linda Elkins – 13-Apr-2018	18-Apr-2018	P-1240
	2.71	Witness statement of Linda Elkins – 05-Apr-2018		
30. Ross Barnwell	2.8	Statement of Ross Barnwell – 13-Apr-2018	N/A	
31. Matthew Lawrance	2.9	Statement of Matthew Lawrance – 15-Apr-2018	N/A	
32. Michael Wright	2.10	Statement of Michael Wright – 16-Apr-2018	19, 20-Apr-2018	P-1375
	2.101	Statement of Michael Wright – 05-Apr-2018		
	2.102	Second statement of Michael Wright – 05-Apr-2018		
33. Constandina Kotsopoulos	2.11	Statement of Constandina Kotsopoulos – 16-Apr-2018	N/A	

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
34. Anthony Regan	2.13	Statement of Anthony Regan – 11-Apr-2018	16, 17-Apr-2018	P-1103
	2.171	Statement of Anthony Regan – 11-Apr-2018		
35. John Keating	2.69	Statement of John Keating – 09-Apr-2018	18-Apr-2018	P-1209
36. Marianne Perkovic	2.73	Statement of Marianne Perkovic – 03-Apr-2018	18, 19-Apr-2018	P-1264
	2.74	Supplementary statement of Marianne Perkovic – 04-Apr-2018		
	2.75	Further statement of Marianne Perkovic – 03-Apr-2018		
	2.76	Further statement of Marianne Perkovic – 04-Apr-2018		
	2.77	Further statement of Marianne Perkovic – 03-Apr-2018		
	2.78	Further statement of Marianne Perkovic – 09-Apr-2018		
	2.79	Further statement of Marianne Perkovic – 05-Apr-2018		
	2.172	Statement of Marianne Perkovic – 13-Apr-2018		
	2.196	Statement of Marianne Perkovic – 13-Apr-2018		
37. Darren Williams	2.92	Statement of Darren Williams – 13-Apr-2018	N/A	
38. Adrian Kwa	2.93	Statement of Adrian Kwa – 10-Apr-2018	N/A	

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
39. Sarah Britt	2.94	Statement of Sarah Britt – 10-Apr-2018	23-Apr-2018	P-1591
	2.161	Statement of Sarah Britt – 10-Apr-2018		
40. Mark Pankhurst	2.95	Statement of Mark Pankhurst – 13-Apr-2018	N/A	
41. Cameron Garrett	2.96	Statement of Cameron Garrett – 14-Apr-2018		
42. Michelle Weber	2.97	Statement of Michelle Weber – 16-Apr-2018	N/A	
	2.174	Statement of Michelle Weber – 13-Apr-2018		
	2.175	Second statement of Michelle Weber – 13-Apr-2018		
43. Jacqueline McDowall	2.98	Statement of Jacqueline McDowall – 04-Apr-2018	19-Apr-2018	P-1353
45. Darren Whereat	2.129	Statement of Darren Whereat – 05-Apr-2018	20-Apr-2018	P-1484
46. Kylie Rixon	2.152	Statement of Kylie Rixon – 05-Apr-2018	23-Apr-2018	P-1555
	2.153	Supplementary statement of Kylie Rixon – 18-Apr-2018		
47. Renato Mota	2.173	Statement of Renato Mota – 12-Apr-2018	N/A	
49. Marti Crane	2.176	Statement of Marti Carne – 13-Apr-2018		P-1651
50. Andrew Hagger	2.178	Statement of Andrew Hagger – 05-Apr-2018	23, 24-Apr-2018	P-1652
	2.179	Statement of Andrew Hagger – 13-Apr-2018		P-1654

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
51. Kieran Forde	2.194	Statement of Kieran Forde – 12-Apr-2018	24-Apr-2018	P-1709
	2.195	Supplementary statement of Kieran Forde – 23-Apr-2018		
52. Donna McKenna	2.197	Statement of Donna McKenna – 16-Apr-2018	24-Apr-2018	P-1725
53. Sam Henderson	2.200	Statement of Sam Henderson – 29-Mar-2018	24-Apr-2018	P-1743
	2.201	Second statement of Sam Henderson – 05-Apr-2018		
	2.202	Corrections to statements of Sam Henderson (Exhibits 2.200 and 2.201) – 29-Mar-2018		
54. Dante De Gori	2.219	Statement of Dante De Gori – 20-Apr-2018	26-Apr-2018	P-1787
55. Philip Kewin	2.230	Statement of Philip Kewin – 04-Apr-2018	26-Apr-2018	P-1825
56. Terrence McMaster	2.236	Statement of Terrence McMaster – 10-Apr-2018	26-Apr-2018	P-1843
57. Louise Macaulay	2.247	Statement of Louise Macaulay – 25-Apr-2018	27-Apr-2018	P-1902

Small and medium enterprises

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
58. Philip Khoury	3.4	Statement of Philip Khoury – 18-May-2018	21-May-2018	P-2020
59. Carolyn Flanagan	3.6	Statement of Carolyn Flanagan – 14-May-2018	21-May-2018	P-2041
60. Dana Beiglari	3.8	Statement of Dana Beiglari – 16-May-2018	21-May-2018	P-2050
61. Alastair Welsh	3.10	Statement of Alastair Welsh (Rubric 3-12) – 15-May-2018	21, 22-May-2018	P-2059
	3.22	Statement of Alastair Welsh (Rubric 3-11) – 19-May-2018		
	3.59	Statement of Alastair Welsh (Rubric 3-10) – 17-May-2018		
	3.132	Statement of Alastair Welsh (Rubric 3-3) – 08-May-2018		
62. Kate Gibson	3.15	Statement of Kate Gibson (Rubric 3-7) – 17-May-2018	22, 23-May-2018	P-2146
	3.148	Statement of Kate Gibson (Rubric 3-2) – 17-May-2018		
63. Marion Messih	3.17	Statement of Marion Messih – 16-May-2018	22-May-2018	P-2173
64. Carol Separovich	3.27	Statement of Carol Separovich (Rubric 3-10) – 21-May-2018	23-May-2018	P-2264
	3.28	Statement of Carol Separovich (Rubric 3-11) – 21-May-2018		

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
65. Suzanne Riches	3.30	Statement of Suzanne Riches – 18-May-2018	23-May-2018	P-2275
66. Douglas Snell	3.34	Statement of Douglas Snell (Rubric 3-8) – 15-May-2018	24-May-2018	P-2302
	3.133	Statement of Douglas Snell (Rubric 3-6) – 08-May-2018		
67. Clive van Horen	3.42	Statement of Clive van Horen (Rubric 3-15) – 15-May-2018	24-May-2018	P-2356
	3.43	Statement of Clive van Horen (Rubric 3-16) – 14-May-2018		
68. Bradley Wallis	3.54	Statement of Bradley Wallis – 22-May-2018	24-May-2018	P-2398
69. Rien Low	3.73	Statement of Rien Low – 23-May-2018	25-May-2018	P-2469
70. David Carter	3.75	Statement of David Carter (Rubric 3-21) – 21-May-2018	25-May-2018	P-2493
71. Philip Field	3.84	Witness statement of Philip Field (Part A) – 18-May-2018	28-May-2018	P-2538
	3.85	Witness statement of Philip Field (Part B) – 18-May-2018		
72. Michael Kelly	3.88	Statement of Michael Kelly – 24-May-2018	28-May-2018	P-2554
73. Brett Perry	3.93	Statement of Brett Perry (Rubric 3-26) – 18-May-2018	28-May-2018	P-2584
74. Stephen Weller	3.97	Statement of Stephen Weller – 21-May-2018	28-May-2018	P-2617
75. Michael Doherty	3.99	Statement of Michael Doherty – 24-May-2018	28, 29-May-2018	P-2631

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
76. Peter Clark	3.101	Statement of Peter Clark (Rubric 3-24) – 27-May-2018	29-May-2018	P-2664
	3.102	Statement of Peter Clark (Rubric 3-25) – 27-May-2018		
77. Sinead Taylor	3.104	Statement of Sinead Taylor (Rubric 3-13) – 17-May-2018	28, 29-May-2018	P-2699
	3.134	Statement of Sinead Taylor (Rubric 3-1) – 08-May-2018		
78. Brendan Stanford	3.106	Statement of Brendan Stanford – 24-May-2018	29-May-2018	P-2701
79. David Cohen	3.111	Statement of David Cohen (Rubric 3-13) – 17-May-2018	29-May-2018	P-2723
	3.112	Statement of David Cohen (Rubric 3-13) – 17-May-2018		
80. Issac Rankin	3.129	Statement of Isaac Rankin (Rubric 3-2) – 08-May-2018	N/A	
81. Joanna White	3.130	Statement of Joanna White (Rubric 3-1) – 08-May-2018	N/A	
82. Howard Silby	3.131	Statement of Howard Silby (Rubric 3-4) – 23-May-2018	N/A	
	3.184	Statement of Howard Silby (Rubric 3-19) – 22-May-2018		
83. Ross Dillion	3.136	Statement of Ross Dillon – 28-May-2018	30, 31-May-2018	P-2826
84. Shaun Bassett	3.137	Statutory declaration of Shaun Bassett – 18-May-2018	31-May-2018	P-2878
85. Ross McNaughton	3.140	Statement of Ross McNaughton – 22-May-2018	31-May-2018	P-2885

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
86. Anna Bligh	3.144	Statement of Anna Bligh – 17-May-2018	31-May-2018	P-2910
87. Brian Zacharias	3.145	Statement of Brian Zacharias (Rubric 3-6) – 15-May-2018	N/A	
88. Sean Cash	3.146	Statement of Sean Cash (Rubric 3-4) – 16-May-2018	N/A	
89. Chris Williams	3.147	Statement of Chris Williams (Rubric 3-1) – 16-May-2018	N/A	
90. Ivan Mardjetko	3.149	Statement of Ivan Mardjetko (Rubric 3-4) – 16-May-2018	N/A	
91. Kristen O'Donoghue	3.151	Statement of Kirsten O'Donoghue – 18-May-2018	31-May-2018	P-2930
92. Steven Kluss	3.157	Statement of Steven Kluss – 28-May-2018	31-May-2018	P-2935
93. Scott Gregson	3.160	Statement of Scott Gregson – 23-May-2018	31-May-2018	P-2948
94. Michael Saadat	3.162	Statement of Michael Saadat – 18-May-2018	01-Jun-2018	P-2965
	3.163	Further statement of Michael Saadat – 24-May-2018		
95. Timothy Mullaly	3.171	Statement of Timothy Mullaly – 30-May-2018	01-Jun-2018	P-3008

Regional and remote communities

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
96. Dennis McMahon	4.2	Statement of Dennis McMahon – 19-Jun-2018	25-Jun-2018	P-3086
97. Chris Wheatcroft	4.4	Statement of Chris Wheatcroft – 15-Jun-2018	25-Jun-2018	P-3086
98. Warren Day	4.6	Statement of Warren Day – 08-Jun-2018	25-Jun-2018	P-3087
99. Benjamin Steinberg	4.8	Statement of Benjamin Steinberg (Rubric 4-1) – 18-Jun-2018	25, 26, 27-Jun-2018	P-3123
	4.9	Statement of Benjamin Steinberg (Rubric 4-20) – 20-Jun-2018		
	4.9A	Benjamin Steinberg Annexure A – 20-Jun-2018		
	4.9B	Benjamin Steinberg Annexure B – 20-Jun-2018		
	4.9C	Benjamin Steinberg Annexure C – 20-Jun-2018		
	4.9D	Benjamin Steinberg Annexure D – 20-Jun-2018		
	4.9E	Benjamin Steinberg Annexure E – 20-Jun-2018		
	4.10	Statement of Benjamin Steinberg (Rubric 4-38) – 21-Jun-2018		
	4.10F	Benjamin Steinberg Annexure F – 21-Jun-2018		
	4.10G	Benjamin Steinberg Annexure G – 21-Jun-2018		

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
	4.11	Supplementary statement of Benjamin Steinberg (Rubric 4-38) – 22-Jun-2018		
	4.20	Statement of Benjamin Steinberg (Rubric 4-17) – 18-Jun-2018		
100. Michael Hirst	N/A	N/A	27-Jun-2018	P-3314
101. Wendy Brauer	4.31	Statement of Wendy Brauer – 21-Jun-2018	27-Jun-2018	P-3319
102. Bradley James	4.33	Statement of Bradley James (Rubric 4-16) – 15-Jun-2018	27, 28-Jun-2018	P-3399
	4.34	Supplementary statement of Bradley James (Rubric 4-16) – 22-Jun-2018		
103. Melville Ruddy	4.90	Statement of Melville Ruddy – 21-Jun-2018	28-Jun-2018	P-3429
104. Sinead Taylor	4.92	Statement of Sinead Taylor – 24-Jun-2018	28, 29-May-2018	P-3452
105. Deborah Smith	4.110	Statement of Deborah Smith – 22-Jun-2018	29-Jun-2018	P-3537
106. Ross McNaughton	4.112	Statement of Ross McNaughton – 18-Jun-2018	29-Jun-2018	P-3566
	4.113	Supplementary statement of Ross McNaughton – 25-Jun-2018		
107. Alexandra Gartmann	4.121	Statement of Alexandra Gartmann (Rubric 4-36) – 20-Jun-2018	02-Jul-2018	P-3611
108. Grant Cairns	4.133	Statement of Grant Cairns – 16-Jun-2018	N/A	
109. Mark Wlossak	4.134	Statement of Mark Wlossak – 19-Jun-2018	N/A	

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
110. Johanna White	4.135	Statement of Johanna White – 21-Jun-2018	N/A	
	4.136	Statement of Johanna White – 29-Jun-2018		
111. Nathan Boyle	4.138	Statement of Nathan Boyle – 25-Jun-2018	03-Jul-2018	P-3712
112. Lynda Edwards	4.140	Statement of Lynda Edwards – 22-Jun-2018	03-Jul-2018	P-3712
113. Tracey Walsh	4.144	Statement of Tracey Walsh – 26-Jun-2018	03-Jul-2018	P-3764
114. Bryn Jones	4.146	Statement of Bryn Jones – 13-Jun-2018	03, 04-Jul-2018	P-3784
	4.147	Statement of Bryn Jones – 11-Jun-2018		
115. Kathy Marika	4.171	Statement of Kathy Marika – 19-Jun-2018	04-Jul-2018	P-3879
116. Russell Howden	4.173	Statement of Russell Howden (Rubric 4-23) – 13-Jun-2018	04, 05-Jul-2018	P-3893
	4.174	Statement of Russell Howden (Rubric 4-31) – 13-Jun-2018		
	4.175	Statement of Russell Howden (Rubric 4-42) – 28-Jun-2018		
117. Thy Do	4.198	Statement of Thy Do – 30-Jun-2018	05-Jul-2018	P-3986
118. Philip Bowden	4.200	Statement of Phillip Bowden – 04-Jul-2018	05-Jul-2018	P-4012
119. Tony Tapsall	4.202	Statement of Tony Tapsall (Rubric 4-13) – 21-Jun-2018	05, 06-Jul-2018	P-4021

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
	4.204	Statement of Tony Tapsall (Rubric 4-41) – 25-Jun-2018		
	4.205	Supplementary statement of Tony Tapsall – 04-Jul-2018		
120. Sian Lewis	4.220	Statement of Sian Lewis – 28-Jun-2018	N/A	
121. Robert Musgrove	4.221	Statement of Robert Musgrove – 15-Jun-2018	N/A	
122. Anthony Hampton	4.222	Statement of Anthony Hampton – 19-Jun-2018	N/A	
123. Gavin Teichner	4.223	Statement of Gavin Teichner – 22-Jun-2018	N/A	

Superannuation

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
124. Paul Carter	5.2	Statement of Paul Carter – 30-Jul-2018	06, 07-Aug-2018	P-4178
125. Nicole Smith	5.43	Statement of Nicole Smith – 01-Aug-2018	07, 08, 09-Aug-2018	P-4308
		Statement of Nicole Smith – 03-Aug-2018		
126. Jason Peasley	5.62	Statement of Jason Peasley – 01-Aug-2018	08-Aug-2018	P-4432
127. Peggy O'Neal	5.84	Statement of Peggy O'Neal – 19-Jul-2018	N/A	
	5.85	Statement of Peggy O'Neal – 23-Jul-2018		
	5.86	Statement of Peggy O'Neal – 03-Aug-2018		
128. Ian Silk	5.88	Statement of Ian Silk – 30-Jul-2018	09-Aug-2018	P-4520
	5.89	Further statement of Ian Silk – 31-Jul-2018		
129. Paul Schroder	5.90	Statement of Paul Schroder – 01-Aug-2018	N/A	
130. Mark Oliver	5.99	Statement of Mark Oliver – 26-Jul-2018	09,10-Aug-2018	P-4557
131. Christopher Kelahe	5.115	Statement of Christopher Kelahe – 26-Jul-2018	10-Aug-2018	P-4601
	5.116	Statement of Christopher Kelahe – 26-Jul-2018		
132. Scott Wilson	5.131	Statement of Scott Wilson – 26-Jul-2018	10-Aug-2018	P-4663

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
	5.132	Statement of Scott Wilson – 26-Jul-2018		
133. Andrew Hagger	N/A	N/A	13-Aug-2018	P-4730
134. Lynette Melcer	5.139	Statement of Lynette Melcer – 30-Jul-2018	13-Aug-2018	P-4710
135. Maurizio Pinto	5.164	Statement of Maurizio Pinto – 05-Aug-2018	13,14-Aug-2018	P-4804
	5.165	Statement of Maurizio Pinto – 06-Aug-2018		
136. David Elia	5.172	Statement of David Elia – 01-Aug-2018	14-Aug-2018	P-4842
137. Linda Elkins	5.179	Statement of Linda Elkins – 26-Jul-2018	14,15-Aug-2018	P-4876
	5.180	Statement of Linda Elkins – 26-Jul-2018		
	5.181	Statement of Linda Elkins – 30-Jul-2018		
	5.182	Statement of Linda Elkins – 07-Aug-2018		
138. Peter Chun	5.232	Statement of Peter Chun – 31-Jul-2018	15-Aug-2018	P-4978
	5.233	Statement of Peter Chun – 07-Aug-2018		
	5.234	Statement of Peter Chun – 12-Aug-2018		
139. Peter Haysey	5.237	Statement of Peter Haysey – 24-Jul-2018	N/A	P-4995
	5.238	Second statement of Peter Haysey – 03-Aug-2018		

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
140. David Hartley	5.248	Statement of David Hartley – 13-Aug-2018	N/A	
141. Greg Cantor	5.249	Statement of Greg Cantor – 06-Aug-2018	N/A	
142. Victoria Weekes	5.251	Statement of Victoria Weekes – 14-Aug-2018	15-Aug-2018	P-5024
143. Mark Pankhurst	5.256	Statement of Mark Pankhurst – 01-Aug-2018	15,16-Aug-2018	P-5036
	5.257	Statement of Mark Pankhurst – 14-Aug-2018		
144. Richard Allert	5.265	Statement of Richard Allert – 25-Jul-2018	16-Aug-2018	P-5068
	5.266	Supplementary statement of Richard Allert – 15-Aug-2018		
	5.267	Statement of Richard Allert – 25-Jul-2018		
	5.268	Statement of Richard Allert – 01-Aug-2018		
145. Rachel Sansom	5.277	Statement of Rachel Sansom – 09-Aug-2018	16-Aug-2018	P-5107
146. Helen Rowell	5.298	Statement of Helen Rowell – 14-Aug-2018	17-Aug-2018	P-5161
147. Stephen Glenfield	5.302	Statement of Stephen Glenfield – 14-Aug-2018	17-Aug-2018	P-5199
148. Timothy Mullaly	5.310	Statement of Timothy Mullaly – 03-Aug-2018	17-Aug-2018	P-5222
149. Peter Kell	5.318	Statement of Peter Kell – 13-Aug-2018	17-Aug-2018	P-5246
150. Edward Cooley	5.320	Statement of Edward Cooley – 25-Jul-2018	N/A	

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
151. David Elmslie	5.321	Statement of David Elmslie – 26-Jul-2018	N/A	
152. Umberto Mecchi	5.322	Statement of Umberto Mecchi – 31-Jul-2018	N/A	
153. Sam Sicillia	5.323	Statement of Sam Sicillia – 01-Aug-2018	N/A	
154. Scott Tully	5.324	Statement of Scott Tully – 26-Jul-2018	N/A	
155. Gareth Russell	5.325	Statement of Gareth Russell – 26-Jul-2018	N/A	
156. Hugh Humphrey	5.326	Statement of Hugh Humphrey – 26-Jul-2018	N/A	
157. Dr Lisa Butler Beatty	5.327	Statement of Lisa Beatty – 26-Jul-2018	N/A	
158. Tara Steyn	5.328	Statement of Tara Steyn – 26-Jul-2018	N/A	
159. Peter Mullin	5.329	Statement of Peter Mullin (Rubric 5-28) – 25-Jul-2018	N/A	
	5.330	Statement of Peter Mullin (Rubric 5-29) – 25-Jul-2018		
160. Andrew Fraser	5.331	Statement of Andrew Fraser – 30-Jul-2018	N/A	
	5.332	Statement of Andrew Fraser – 04-Aug-2018		
161. Benjamin Walsh	5.333	Statement of Benjamin Walsh – 25-Jul-2018	N/A	
		Statement of Benjamin Walsh – 30-Jul-2018		
		Statement of Benjamin Walsh – 03-Aug-2018		

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
162. Stephen Bracks AC	5.336	Statement of Stephen Bracks AC – 25-Jul-2018	N/A	
	5.337	Statement of Stephen Bracks AC – 03-Aug-2018		
163. Jarrod Coysh	5.338	Statement of Jarrod Coysh – 31-Jul-2018	N/A	
164. Kristian Fok	5.339	Statement of Kristian Fok – 31-Jul-2018	N/A	
165. Robbie Campo	5.340	Statement of Robbie Campo – 03-Aug-2018	N/A	
166. David Gallbally AM QC	5.341	Statement of David Gallbally AM QC – 25-Jul-2018	N/A	
167. Geoff Lake	5.342	Statement of Geoff Lake – 24-Jul-2018	N/A	
168. Melinda Howes	5.343	Statement of Melinda Howes – 18-Jul-2018	N/A	
	5.414	Statement of Melinda Howes – 22-Aug-2018		
169. Mark Lennon	5.344	Statement of Mark Lennon – 17-Aug-2018	N/A	
170. Jayson Walker	5.345	Statement of Jayson Walker – 26-Jul-2018	N/A	
171. Adrian Rees	5.346	Statement of Adrian Rees – 15-Aug-2018	N/A	
172. Jennifer Dean	5.392	Statement of Jennifer Dean – 03-Aug-2018	N/A	

Insurance

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
173. Timothy Thorne	6.7	Statement of Timothy Thorne – 22-Aug-2018	N/A	
	6.8	Supplementary statement of Timothy Thorne – 07-Sep-2018		
	6.10	Further statement of Timothy Thorne – 07-Sep-2018		
174. Jennifer Oliver	6.9	Statement of Jennifer Oliver – 23-Aug-2018	N/A	
175. Michael Thornton	6.11	Statement of Michael Thornton – 21-Aug-2018	N/A	
	6.12	Supplementary statement of Michael Thornton – 06-Sep-2018		
	6.124	Statement of Michael Thornton – 27-Aug-2018		
176. Sean McCormack	6.13	Statement of Sean McCormack – 21-Aug-2018	N/A	
	6.105	Statement of Sean McCormack – 03-Sep-2018		
	6.125	Statement of Sean McCormack – 27-Aug-2018		
177. Ross Barnwell	6.14	Statement of Ross Barnwell – 03-Sep-2018	N/A	
178. Geoffrey Rogers	6.15	Statement of Geoffrey Rogers – 03-Sep-2018	N/A	
179. Susan Houghton	6.16	Statement of Susan Houghton – 07-Sep-2018	N/A	

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
	6.109	Statement of Susan Houghton – 30-Aug-2018		
	6.128	Statement of Susan Houghton – 28-Aug-2018		
	6.260	Statement of Susan Houghton – 30-Aug-2018		
	6.326	Statement of Susan Houghton – 22-June-2018		
	6.411	Supplementary statement of Susan Houghton – 19-Sep-2018		
	6.420	Statement of Susan Houghton – 19-Sep-2018		
180. Michael Wright	6.17	Statement of Michael Wright – 23-Aug-2018	N/A	
	6.410	Supplementary statement of Michael Wright – 21-Sep-2018		
181. Tim Bailey	6.18	Statement of Tim Bailey – 21-Aug-2018	N/A	
182. Chesne Stafford	6.19	Statement of Chesne Stafford – 21-Aug-2018	N/A	
183. Helen Troup	6.20	Statement of Helen Troup – 21-Aug-2018	12, 13-Sep-2018	P-5545
	6.103	Statement of Helen Troup – 27-Aug-2018		
	6.137	Statement of Helen Troup – 07-Sep-2018		
	6.138	Statement of Helen Troup – 28-Aug-2018		

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
	6.139	Statement of Helen Troup – 11-Sep-2018		
	6.322	Statement of Helen Troup – 12-Jun-2018		
	6.323	Second statement of Helen Troup – 12-Jun-2018		
	6.324	Supplementary statement of Helen Troup – 22-Jun-2018		
184. Maria Lykouras	6.21	Statement of Maria Lykouras – 21-Aug-2018	N/A	
185. Mark Ballantyne	6.22	Statement of Mark Ballantyne – 21-Aug-2018	N/A	
186. Hugh Humphrey	6.23	Statement of Hugh Humphrey – 21-Aug-2018	N/A	
187. Gavin Pearce	6.24	Statement of Gavin Pearce – 21-Aug-2018	N/A	
	6.107	Statement of Gavin Pearce – 27-Aug-2018	N/A	
188. Christopher McHugh	6.25	Statement of Christopher McHugh – 27-Aug-2018	N/A	
	6.108	Statement of Christopher McHugh – 04-Sep-2018		
	6.134	Statement of Christopher McHugh – 27-Aug-2018		
189. Gregory Johnson	6.26	Statement of Gregory Johnson – 10-Sep-2018	N/A	
190. Gregory Martin	6.28	Statement of Gregory Martin – 21-Aug-2018	10, 11-Sep-2018	P-5304
	6.29	Statement of Gregory Martin – 27-Aug-2018		

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
191. Allison Smith	6.62	Statement of Allison Smith – 27-Aug-2018	N/A	
192. Bruce Stewart	6.64	Statement of Bruce Stewart – 04-Sep-2018	11-Sep-2018	P-5405
193. Craig Orton	6.66	Statement of Craig Orton – 24-Aug-2018	11, 12-Sep-2018	P-5418
	6.67	Statement of Craig Orton – 27-Aug-2018		
194. Warren McAlpine	6.102	Statement of Warren McAlpine – 27-Aug-2018	N/A	
195. Brenard Grobler	6.104	Statement of Brenard Grobler – 27-Aug-2018	N/A	
196. Natalie Cameron	6.106	Statement of Natalie Cameron – 03-Sep-2018	N/A	
	6.126	Statement of Natalie Cameron – 28-Aug-2018		
197. Timothy Howell	6.110	Statement of Timothy Howell – 03-Sep-2018	N/A	
	6.129	Statement of Timothy Howell – 23-Aug-2018		
198. Luke Hyde	6.115	Statement of Luke Hyde – 28-Aug-2018	N/A	
199. Malcolm Weir	6.118	Statement of Malcolm Weir – 28-Aug-2018	N/A	
200. Justin Delaney	6.123	Statement of Justin Delaney – 27-Aug-2018	N/A	
201. Russell Jansen	6.127	Statement of Russell Jansen – 06-Sep-2018	N/A	
202. Sheriff Hamza	6.130	Statement of Sheriff Hamza – 23-Aug-2018	N/A	

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
203. Gary Bailison	6.131	Statement of Gary Bailison – 23-Aug-2018	N/A	
204. Mark Raberger	6.132	Statement of Mark Raberger – 23-Aug-2018	N/A	
	6.209	Further statement of Mark Raberger – 28-Aug-2018		
205. Gerard Kerr	6.133	Statement of Gerard Kerr – 23-Aug-2018	N/A	
206. Megan Beer	6.135	Statement of Megan Beer – 31-Aug-2018	N/A	
207. Sally Phillips	6.177	Statement of Sally Phillips – 06-Sep-2018	N/A	
208. Loraine van Eeden	6.179	Statement of Loraine van Eeden – 31-Aug-2018	13, 14-Sep-2018	P-5658
	6.180	Statement of Loraine van Eeden – 05-Sep-2018		
209. Andrew Morrison	6.210	Statement of Andrew Morrison – 03-Sep-2018	N/A	
210. Melinda Howes	6.211	Statement of Melinda Howes – 31-Aug-2018	N/A	
211. Peter Chun	6.212	Statement of Peter Chun – 31-Aug-2018	N/A	
	6.213	Statement of Peter Chun – 31-Aug-2018		
212. Dr Lisa Butler Beatty	6.214	Statement of Dr Lisa Beatty – 21-Aug-2018	N/A	
213. Thomas Garde	6.125	Statement of Thomas Garde – 31-Aug-2018	N/A	

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
214. Caroline James	6.216	Statement of Caroline James – 31-Aug-2018	N/A	
215. Paul Schroder	6.217	Statement of Paul Schroder – 30-Aug-2018	N/A	
216. Jason Sommer	6.218	Statement of Jason Sommer – 12-Sep-2018	N/A	
	6.219	Statement of Jason Sommer – 31-Aug-2018		
217. Noel Lacey	6.220	Statement of Noel Lacey – 12-Sep-2018	N/A	
	6.221	Statement of Noel Lacey – 31-Aug-2018		
218. Colin Cassidy	6.222	Statement of Colin Cassidy – 31-Aug-2018	N/A	
219. Lachlan Ross	6.224	Statement of Lachlan Ross – 31-Aug-2018	N/A	
	6.225	Statement of Lachlan Ross – 07-Sep-2018		
220. Natalie Binns	6.229	Statement of Natalie Binns – 31-Aug-2018	N/A	
221. Paul Howard	6.230	Statement of Paul Howard – 07-Sep-2018	N/A	
	6.422	Statement of Paul Howard – 20-Sep-2018		
222. Joseph De Bruyn	6.231	Statement of Joseph De Bruyn – 12-Sep-2018	N/A	
223. Paul Sainsbury	6.233	Statement of Paul Sainsbury – 10-Sep-2018	17-Sep-2018	P-5859
	6.234	Statement of Paul Sainsbury – 05-Sep-2018		

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
224. Gary Dransfield	6.251	Statement of Gary Dransfield – 11-Sep-2018	N/A	P-6277
	6.325	Statement of Gary Dransfield – 13-Jun-2018		
	6.368	Statement of Gary Dransfield – 13-Jun-2018		
	6.369	Statement of Gary Dransfield – 24-Jun-2018		
	6.370	Statement of Gary Dransfield – 29-Aug-2018		
225. Michael Winter	6.252	Statement of Michael Winter – 30-Aug-2018	17, 18-Sep-2018	P-5909
	6.263	Statement of Michael Winter – 24-Aug-2018		
	6.282	Further statement of Michael Winter – 17-Sep-2018		
	6.414	Statement of Michael Winter – 19-Sep-2018		
226. David Krawitz	6.253	Statement of David Krawitz – 30-Aug-2018	N/A	
	6.319	Statement of David Krawitz – 13-Jun-2018		
	6.320	Further statement of David Krawitz – 25-Jun-2018		
	6.412	Supplementary statement of David Krawitz – 20-Sep-2018		
227. Mark Milliner	6.254	Statement of Mark Milliner – 30-Aug-2018	N/A	

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
	6.315	Supplementary statement of Mark Milliner – 14-Sep-2018		
	6.415	Statement of Mark Milliner – 19-Sep-2018		
228. Miles Sowden	6.255	Statement of Miles Sowden – 30-Aug-2018	N/A	
	6.416	Statement of Miles Sowden – 19-Sep-2018		
229. Sinead Taylor	6.256	Statement of Sinead Taylor – 30-Aug-2018	N/A	
230. Gareth Russell	6.257	Statement of Gareth Russell – 30-Aug-2018	N/A	
	6.417	Statement of Gareth Russell – 20-Sep-2018		
231. Christopher Killourhy	6.258	Statement of Christopher Killourhy – 30-Aug-2018	N/A	
	6.418	Statement of Christopher Killourhy – 19-Sep-2018		
232. David Roberts	6.259	Statement of David Roberts – 30-Aug-2018	N/A	
	6.419	Statement of David Roberts – 19-Sep-2018		
233. Bert Bakker	6.261	Statement of Bert Bakker – 30-Aug-2018	N/A	
	6.327	Statement of Bert Bakker – 08-Jun-2018		
	6.328	Supplementary statement of Bert Bakker – 21-Jun-2018		
	6.421	Statement of Bert Bakker – 19-Sep-2018		

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
234. Lori Callahan	6.284	Statement of Lori Callahan – 24-Aug-2018	18-Sep-2018	P-5986
	6.321	Statement of Lori Callahan – 13-Jun-2018		
235. Benjamin Bessell	6.304	Statement of Benjamin Bessell – 27-Aug-2018	18, 19-Sep-2018	P-6080
236. Declan Moore	6.316	Statement of Declan Moore – 30-Aug-2018	N/A	
237. Paul Holmes	6.317	Statement of Paul Holmes – 11-Jun-2018	N/A	
238. Brenda Staggs	6.318	Statement of Brenda Staggs – 11-Sep-2018	N/A	
239. Sacha Murphy	6.330	Statement of Sacha Murphy – 20-Jun-2018	19-Sep-2018	P-6154
240. Glen Sutton	6.332	Statement of Glen Sutton – 20-Jun-2018	19-Sep-2018	P-6171
241. Jason Storey	6.334	Statement of Jason Storey – 17-Sep-2018	19, 20-Sep-2018	P-6185
	6.335	Statement of Jason Storey – 17-Sep-2018		
242. Bernadette Heald	6.382	Statement of Bernadette Heald – 30-Aug-2018	20-Sep-2018	P-6328
243. Lynelle Briggs	6.401	Statement of Lynelle Briggs – 14-Sep-2018	N/A	
244. Anne Brown	6.402	Statement of Anne Brown – 28-Aug-2018	N/A	
245. Robert Whelan	6.404	Statement of Robert Whelan – 27-Aug-2018	21-Sep-2018	P-6391
246. Sally Loane	6.409	Statement of Sally Loane – 30-Aug-2018	21-Sep-2018	P-6432
247. Andrew Mair	6.413	Statement of Andrew Mair – 19-Sep-2018	N/A	

Policy questions

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
248. Matthew Comyn	7.2	Statement of Matthew Comyn – 11-Nov-2018	19, 20-Nov-2018	P-6514
249. Catherine Livingston	N/A	N/A	20, 21-Nov-2018	P-6687
250. David Abusah	7.47	Statement of David Abusah – 02-Nov-2018	N/A	
251. Brett Tollman	7.48	Statement of Brett Tollman – 06-Nov-2018	N/A	
252. Brian Hartzler	7.50	Statement of Brian Hartzler – 16-Nov-2018	21, 22-Nov-2018	P-6790
253. Nicholas Moore	7.60	Statement of Nicholas Moore (Rubric 7-06) – 19-Nov-2018	22-Nov-2018	P-6882
	7.61	Statement of Nicholas Moore (Rubric 7-16) – 19-Nov-2018		
254. James Shipton	7.63	Statement of James Shipton – 07-Nov-2018	22, 23-Nov-2018	P-6901
	7.64	Supplementary statement of James Shipton – 12-Nov-2018		
255. Andrew Thorburn	7.80	Statement of Andrew Thorburn – 19-Nov-2018	26-Nov-2018	P-7029
	7.81	Supplementary statement of Andrew Thorburn – 24-Nov-2018		

Witness	Exhibit no.	Statement	Oral evidence given	Transcript reference
256. Dr Kenneth Henry	N/A	N/A	26, 27-Nov-2018	P-7098
257. Lynda Dean	7.108	Statement of Lynda Dean – 02-Nov-2018	N/A	
	7.109	Second statement of Lynda Dean – 16-Nov-2018		
258. Fiona Wardlaw	7.110	Statement of Fiona Wardlaw – 02-Nov-2018	N/A	
259. Michael Wilkins	7.112	Statement of Michael Wilkins – 21-Nov-2018	27, 28-Nov-2018	P-7187
260. Shayne Elliott	7.120	Statement of Shayne Elliott – 08-Nov-2018	28, 29-Nov-2018	P-7247
	7.121	Statement of Shayne Elliott – 16-Nov-2018		
261. Robert Johanson	7.141	Statement of Robert Johanson – 07-Nov-2018	29-Nov-2018	P-7358
262. Wayne Byres	7.145	Statement of Wayne Byres – 12-Nov-2018	29, 30-Nov-2018	P-7384

Some witnesses gave evidence in more than one round of hearings.

Appendix 6: Submissions

Consumer lending

Received from	Date
ASIC	03-Apr-2018
Aussie Home Loans – Part A	03-Apr-2018
Aussie Home Loans – Part B	03-Apr-2018
Australia and New Zealand Banking Group Limited	Not dated
Australian Prudential Regulation Authority (APRA)	Not dated
Choice	03-Apr-2018
Citi International	03-Apr-2018
Commonwealth Bank of Australia	03-Apr-2018
Consumer Action Law Centre	03-Apr-2018
Finance Sector Union	Not dated
Legal Aid NSW	Not dated
National Australia Bank	03-Apr-2018
National Australian Bank – Introducer case study	Not dated
Smartline Home Loans Pty Ltd	03-Apr-2018
Westpac	03-Apr-2018
Westpac – Auto Finance	03-Apr-2018
Westpac – Credit Card Credit Limit Increases	03-Apr-2018

Financial advice

Received from	Date
AMP – Submission – General Questions	07-May-2018
AMP – Case Study 1 – Fees for no service	04-May-2018
AMP – Case Study 2 – Investment platform fees	04-May-2018
AMP – Case Study 3 – Inappropriate Financial Advice	04-May-2018
Andrew Smith - Submission	Not dated
APRA	Not dated
ASIC	07-May-2018
Association of Financial Advisers (AFA)	07-May-2018
Australia and New Zealand Banking Group Limited (ANZ)	07-May-2018
Choice	07-May-2018
Commonwealth Bank of Australia (CBA) – Part A Wealth Management	04-May-2018
Commonwealth Bank of Australia (CBA) – Part B	07-May-2018
Dover Financial Advisers	Not dated
Finance Sector Union (FSU)	Not dated
Financial Planners Association of Australia (FPA) – Part A	Not dated
Financial Planners Association of Australia (FPA) – Part B	04-May-2018
Henderson Maxwell Entities	04-May-2018
M3 and RI – Case Study Submissions	Not dated
M3 and RI – Supplementary Case Study Submission	09-May-2018
Mr John Doyle – Submission	04-May-2018
National Australia Bank – General Questions	07-May-2018
National Australia Bank – Case Study Submissions	04-May-2018
National Australia Bank – Case Study Supplementary Submissions	09-May-2018
Treasury	Not dated
Westpac Banking Corporation – General Submission	04-May-2018
Westpac Banking Corporation – Financial Advice Case Study	07-May-2018

Small and medium enterprises

Received from	Date
ABA written submission	08-Jun-2018
ANZ written submission	12-Jun-2018
ANZ case study submission	08-Jun-2018
APRA written submission	Not dated
ASIC written submission	12-Jun-2018
BOQ written submission	12-Jun-2018
BOQ case study submission	08-Jun-2018
CBA written submission	Not dated
CBA case study submission	Not dated
CBA written response to Doherty submission	19-Jun-2018
Consumer Action Law Centre written submission	12-Jun-2018
Doherty written submission	19-Jun-2018
Finance Sector Union written submission	Not dated
FOS case study submission	08-Jun-2018
Legal Aid NSW case study submission	Not dated
Mr Dillon case study submission	08-Jun-2018
NAB written submission	12-Jun-2018
NAB case study submission	08-Jun-2018
Suncorp case study submission	08-Jun-2018
Treasury written submission	Not dated
Westpac written submission	12-Jun-2018
Westpac case study submission – Flanagan	08-Jun-2018
Westpac case study submission – Marjo	08-Jun-2018
Westpac case study submission – Thir	08-Jun-2018

Regional and remote communities

Received from	Date
ACBF case study submission	13-Jul-2018
ANZ written submission	16-Jul-2018
ANZ case study submission	13-Jul-2018
APRA written submission	Not dated
ASIC written submission	16-Jul-2018
Bendigo Bank (Rural Bank) written submission	16-Jul-2018
Bendigo Bank (Rural Bank) case study submission	13-Jul-2018
CBA written submission	Not dated
CBA case study submission	Not dated
Consumer Action Law Centre written submission	16-Jul-2018
Consumer Action Law Centre case study submission	13-Jul-2018
Financial Counselling Australia written submission	16-Jul-2018
Financial Counselling Australia written submission	16-Jul-2018
Finance Sector Union written submission	Not dated
Legal Aid NSW written submission	Not dated
Legal Aid NSW case study submission	Not dated
NAB written submission	16-Jul-2018
NAB case study submission	13-Jul-2018
Rabobank Australia Limited written submission	16-Jul-2018
Rabobank Australia Limited case study submission	13-Jul-2018
St Andrews Life Insurance (AFSL) case study submission	13-Jul-2018
Westpac written submission	16-Jul-2018

Superannuation

No.	Received from
1	Geoffrey Alexander Adams
2	Thomas Ronald Adams
3	William Adams
4	Alan
5	Max Aleckson
6	John Alexander
7	All Members of Energy Industries Superannuation Scheme Pool B
8	Anthony Allison
9	Derek Vincent Amos
10	AMP Limited
11	Lesley Jeannette Anderson
12	Elizabeth Andrews
13	Anthony
14	Tom Anthony Arnold
15	Anthony Asher
16	Association of Financial Advisers Limited
17	Association of Independent Retirees
18	Australia And New Zealand Banking Group Limited and Its Associated Entities (ANZ)
19	Australian Greens
20	Australian Institute of Company Directors
21	Australian Institute of Superannuation Trustees
22	Australian Prudential Regulation Authority (APRA)
23	Australian Securities and Investments Commission

No.	Received from
24	Australian Super
25	Michael Ayling
26	Dr Kim Backhouse
27	Dr Kim Backhouse
28	Darryl E Bacon
29	Paul Badcock
30	Debbie Maree Bahr
31	Carol Bailey
32	Margaret Baltatzidis
33	Bank Reform Now
34	Andrew Banks
35	Sharon Baragry
36	Richard Bardon
37	Graeme Barnes
38	Elisa Barwick
39	William Beatts-Rattray
40	James De Beaux
41	Jeremy Beck
42	Peter Beck
43	William Charles Best
44	Mark Best
45	Paul Best
46	Steven Bird
47	David Michael Blackwell
48	Milton Block
49	William Boeder

No.	Received from
50	Eldon John Bottcher
51	Carlos Boughton
52	David John Bowden
53	Malcolm Boxall
54	Janis Christine Boyd
55	John HC Boyd
56	Ian Leslie Brander
57	Nathan Bray
58	Michael Peter Brennan
59	Brenden Briese
60	Richard Gary Brown
61	Brad Brown
62	Leanne Bull
63	Shane Burgess
64	Nadia Burgess
65	Michael Patrick Burns
66	Noel Gregory Butland
67	Sandra Ann Campbell
68	Trudy Ann Campbell
69	Graham Cann
70	David De Carlo
71	Steven Carr
72	Denham Wilson Carter
73	Ann Cash
74	Martin Cash
75	Trenton Caust
76	Ronald Chandler
77	Graeme Harry Chapman
78	Shane Osmond Chellis

No.	Received from
79	Shane Chellis
80	Philip Chetcuti
81	CHOICE and Superannuation Consumers' Centre
82	Mrs Kay Christensen
83	Civil Liberties, Consumer Rights, No-Tolls Political Party
84	Rita St Clair
85	Klaus Gerhard Clapinski
86	Henry Layland Clarke
87	Thomas Clarke
88	Michael J Clayton
89	The Investment Collective
90	Adrian Collier
91	Colonial First State Investments Limited and Avanteos Investments Limited
92	Connecting Every Dot Pty Ltd
93	Connecting Every Dot Pty Ltd
94	Andrew Coogan
95	Peter Charles Cook
96	Peter Cooper
97	John Cosstick
98	Lane Cove Council
99	Janet Thomasina Cowden
100	Graham Crowther
101	Nicholas Culling
102	William Arthur Dagger
103	Brian Davies
104	Granada Day
105	Robert M Dealtry

No.	Received from
106	Debra
107	Jay Dellavanzo
108	Department of The Prime Minister and Cabinet (Commonwealth of Australia)
109	Sean Dewling
110	Victor Diduk
111	Craig Allan Dillon
112	Kiro Dimeski
113	Dr Scott Donald
114	David John Donkin
115	Terence Douglas
116	Robert Drake
117	Hugh Drum
118	Bernard Duffy
119	Paul Aubrey Dwyer
120	Peter Dyki
121	Neil Richard Eastway
122	Colin Edwards
123	Peter Eggers
124	John Allison Elliott
125	Energy Industries Superannuation Scheme Pool B Members
126	Vanessa Sally Errol
127	Clement Francis Fader
128	Family Financial Services Business
129	Finance Sector Union of Australia
130	Financial Planning Association of Australia
131	Financial Services Council

No.	Received from
132	Diane Marie Finlay
133	Rod Force
134	Valerie Frame
135	Terry Fraser
136	Saul Benedict Freedman
137	Richard French
138	Ray Gala
139	Paul Gallagher
140	Dominic Gannon
141	Ashish Garg
142	Elise Geritz
143	Garth John Gilbert
144	Ian Gill
145	Kylie Gillespie
146	Michael Gilligan
147	Dennis Peter Glynn
148	Brad Golding
149	Aileen Joyce Goldthorpe
150	Leigh Goodchild
151	Robert Gordon
152	Robert Gordon
153	Kenneth Gosney
154	Max Goulter
155	Larry Green
156	Peter Greening
157	Antonio Gullace
158	Bradley Halfacre
159	Simon Joseph Hall
160	Roger Hall

No.	Received from
161	Tony Halpin
162	Eli Everett Hammond
163	John Hanna
164	Sam Hansen
165	Nathan Hansford
166	Francis William Hardbottle
167	Ronald Hardie
168	Stephen Harding
169	Arie Hartland
170	David Hartley
171	Peter Harwood
172	James Frederick Haw
173	Paul Hayes
174	James Edward Hazzard
175	Anne Hern
176	Walter Hess
177	Jean-Francois Hirschy
178	Patrick Howard
179	Peter Albert Howells
180	Steve Hunter
181	Kenton Bruce Huxtable
182	William Robert Ifield
183	Industry Super Australia Pty Ltd
184	William Ingrey
185	Aaron Isherwood
186	Craig Isherwood
187	George Jacklyn
188	Bevan James

No.	Received from
189	Mwrvyn James
190	Perry Jasper
191	Perry Jasper
192	Ron Jean
193	Peter John Johnston
194	William Paul Jones
195	Gail Jones
196	Darryl Joy
197	Kamal
198	Lidia Laura Kardos
199	Stephen Kardos
200	Brian Anthony Kehl
201	Keira
202	Mary Kellett
203	Glynn D Kelly
204	Keith Kerr
205	Peter Kirk
206	Scott Kirwan
207	Gary Knock
208	Noelene Knopke
209	Steve Kordatos
210	Kathleen Merle Koschel
211	Alexander Kozlow
212	Nigel Lacey
213	Samuel Lackey
214	Robert Samuel Laing
215	John Henry Lauridsen
216	Tom Lawler Transport Pty Limited

No.	Received from
217	Barbara Lawler
218	Barbara Lawler
219	Geoff Leach
220	Neil Bayden Lehmann
221	Cheryl Leijer
222	Rod Lewis
223	John Loiterton
224	Paul Loiterton
225	Cliff Longshaw
226	Rick Louder
227	Michael Lozo
228	Alan Lutherborough
229	Geoffrey Graeme Manifold
230	Anthony Mantella
231	Robert Marotta
232	Win Martin
233	& E Martino Super Fund
234	Sergio Mason
235	Vincent Maxwell
236	Bernadine McCullagh
237	Chris McDonald
238	Laura McDonough
239	Scott William McEwan
240	Patricia McInnes
241	Jocelyn Constance McKenzie
242	Gary McMahon
243	Glen Anthony McNamara
244	Cathleen Meggitt
245	Sandra Mel

No.	Received from
246	Heather Mildred
247	David Mills
248	Roy Moosa
249	John Mountney
250	Kirsten Muir
251	Teodora Nagy
252	National Australia Bank (NAB)
253	Elizabeth Needham
254	Thomas Joseph Nelson
255	James Graham Niccol
256	Richard Bruce Nicholls
257	Adam Richard Nichols
258	Doug Noble
259	Alfred Obrien
260	Rodney Bruce Ofarrell
261	Patrick Ohare
262	Deb Oliver
263	Michael James O'shannessy
264	Eddie Ozols
265	Colin Parkhurst
266	Samuel James Parr
267	Brian Parris
268	John Pathinathan
269	Reea Pawley
270	Benjamin Joel Pearce
271	Harry Rex Pearsall
272	Peter James Pendlebury
273	Ian Pendleton
274	Matthew Peos

No.	Received from
275	Francesco Pettinato
276	Airan Pevcic
277	Colin Horace Phillips
278	Jennifer Pickard
279	Leonia Picone
280	Emma Pimblett
281	Margaret Pinder
282	David Pinzone
283	Anna Piskunov
284	Platinum Investment Management Limited
285	Linda Polic
286	Linda Polic
287	Robert Poppi Poppi Superannuation Fund
288	Robert Poppi
289	Louis Poulter
290	Barry Powell
291	Peter Pronczak
292	Dennis Shane Pukallus
293	Alan Francis Quirk
294	Carol Ralston-Bryce
295	Carol Ralston-Bryce
296	David Ralston-Bryce
297	Jason Anthony Rapp
298	Dan Reinhold
299	Rice Warner Actuaries
300	Alan Francis Rider
301	Robert
302	Jean Helen Robinson

No.	Received from
303	Peter Robert Rolliston
304	Jorge Roshkov
305	Barbara Roy
306	Brett Sanders
307	Ron Sandilands
308	Reinhard Schemmann
309	Errol Schmetzer
310	Arthur Richard Schulz
311	Eric John Scroop
312	Graham Setterberg
313	Naveen Sharma
314	David Philip Sheedy
315	Annette Shields
316	Geoffrey Shields
317	Andrew Shine
318	Rachel Skelton
319	Garrick Small
320	Mark Smith
321	Nick Smith
322	Andrew Soulos
323	Karen Spencer
324	Andja Srzich
325	Andja Srzich
326	Charles Stanger
327	Dianne Stebbing
328	SteveH
329	Dr David Stevens
330	Shannon Stevens
331	Stockspot

No.	Received from	No.	Received from
332	Shaun Stoddart	358	Victims of Financial Fraud
333	Michael John Stone	359	Roula Vlassis
334	David Stow	360	April Waldron
335	Noel Stratford	361	Alexander Joseph Walsh
336	Frank Student	362	Ernst Van Walsum
337	Judith Sudholz	363	Trevor Ward
338	Wilson Sy	364	Sam Warne
339	Harry Tan	365	Shawna Warne
340	David Taylor	366	Clive Waterman
341	The Association of Superannuation Funds of Australia (ASFA)	367	Graeme Stewart Waugh
342	The Australian Banking Association	368	John Weber
343	David Thomas	369	Ray Weeks
344	Don Thomas	370	Michael Weigang
345	Margaret [Meg] Thornton	371	Westpac Banking Corporation
346	Lars Thystrup	372	Robert Whalley
347	Anton Tjioe	373	Bruce Whitehead
348	Anthony Tomlinson	374	Andrew Whyte
349	Treasury	375	Desmond Whyte
350	Stephen Tounson	376	David Williams
351	Rosemary Trudeau	377	Michael Wolf
352	Grahame Turner	378	Morgwn Wood
353	Anthony Tweedie.	379	Monty Woodbridge
354	TWU Nominees ATF Twusuper	380	David Woodhouse
355	Suzanne Vasanji	381	Loretta Woolston
356	Sonya Vering	382	Sleiman Yohanna
357	Victims of Financial Fraud	383	Alison Zerk

This includes all policy submissions in response to Round 5 (Superannuation) that have been published on the Royal Commission's website. The Commission reserved the right not to publish submissions where matters are subject to a non-publication order, or where there were privacy concerns about the information included. The Commission received 124 submissions in response to Round 5 (Superannuation) where the individual asked that their name be withheld.

Insurance

No.	Received from
1	AAI Limited
2	AMP
3	Daniel Archibald
4	ASFA
5	Anthony Asher
6	Association of Financial Advisers (AFA)
7	Australia and New Zealand Banking Group Limited
8	Australian Institute of Company Directors
9	Australian Institute of Superannuation Trustees
10	Australian Lawyers Alliance
11	Australian Prudential Regulation Authority (APRA)
12	Australian Securities and Investments Commission (ASIC)
13	Maurice Barry
14	Dennis Bass
15	Clifford Berenger
16	Berril & Watson Lawyers
17	Beyond Blue
18	Mark Glendon Bird
19	Margaret Blade
20	Paul Thomas Bourne
21	Deborah Brown
22	Dr Irfan Cakan
23	Charles Richard Campbell

No.	Received from
24	Charmaine Casey
25	Ronald George Cassar
26	Peter Chia
27	CHOICE and the Superannuation Consumers' Centre
28	ClearView
29	Commonwealth Bank of Australia
30	Consumer Action Law Centre
31	Consumer Credit Legal Service WA Inc
32	Tim Cull
33	Matthew Darragh
34	Department of Treasury
35	Serge Diklitch
36	Tony Di Donato
37	Timothy Dowling
38	Mohamed El-Ansary
39	Eric Insurance Limited
40	Phillip Everett
41	Prof Alan Fels AO and Prof David Cousins AM
42	Finance Sector Union of Australia
43	Financial Planning Association of Australia
44	Financial Rights Legal Centre
45	Financial Rights Legal Centre
46	Financial Services Council

No.	Received from
47	Grant James Forbes
48	Carolyn Forsberg
49	Russell Francis
50	Robert Franklin
51	Anthony Gliding
52	Dallas Graham
53	Innes Cowie Grant
54	GRC Institute
55	Andrew George Halliday
56	Christopher Nicholas Haslet
57	Health Professionals Australia Reform Association
58	Stephen Hitchcock
59	Bruce Holloway
60	Peter Horwath
61	Peter Horwath
62	Gary Roderick Howard
63	Industry Super Australia Pty Ltd
64	Insurance Council of Australia
65	David Johnson
66	Paul Jones
67	Holly Kelsall
68	Gillian Kirby
69	Selwyn Krepp
70	Terry Lai
71	Legal Aid NSW
72	Legal Aid Queensland
73	Wendy Lewthwaite
74	Local Government NSW
75	Peter Bowden Lockhart
76	Peter Lockhart
77	Steven Anthony Mark AM

No.	Received from
78	Ian McIntosh
79	Mental Health Australia
80	Robert Milne
81	Colin Minson
82	Leigh Selby Morgan
83	NAB
84	National Insurance Brokers Association
85	National Mental Health Commission
86	Lee Nicolle ta LDN Wholesale
87	Adrian Nixon
88	Patrick Joseph O'Connor
89	Diane Ohlmann
90	Anthony O'Leary
91	Shane Palmer
92	Joseph Panthradiil
93	David Pham
94	Gavin Polmans
95	Jeff Pope
96	Kylie Prince
97	Public Interest Advocacy Centre
98	Lea Pustetto
99	The QSuper Board
100	Marion Rae
101	Peter Razos
102	Rudolf Rensburg
103	Rest
104	Ian Rischmueller
105	Anthony Russell
106	Heather Ryan
107	Helen Kristina Ryan
108	Ian Satill

No.	Received from
109	Ben Saunders
110	Kathy Savvidis
111	Steven Sinfield
112	Slater and Gordon Lawyers
113	John Paul Sterndale
114	Terry Stokes
115	Michael John Stone
116	Dirk Swagerman
117	Penelope Tastula
118	Chris Thomas
119	Tom

No.	Received from
120	James Edward Troy
121	TWUSUPER
122	Gerasimos Nicholas Vallianos
123	Stuart Bruce Venn
124	Victorian Equal Opportunity and Human Rights Commission
125	Roula Vlassis
126	Rebecca Welsh
127	Westpac Banking Corporation
128	Christopher Sam Whitworth
129	Youi Pty Ltd

This includes all policy submissions in response to Round 6 (Insurance) that have been published on the Royal Commission's website. The Commission reserved the right not to publish submissions where matters are subject to a non-publication order, or where there were privacy concerns about the information included. The Commission received 43 submissions in response to Round 6 (Insurance) where the individual asked that their name be withheld.

Interim Report

No.	Received from
1	ACBF Group Holdings PTY LTD
2	Mario Andres Munoz Acosta
3	Thomas W Adams
4	Adaptive Cultures Pty Ltd
5	Ahmed Ahmetagic
6	Aidin
7	Patricia Ainsworth
8	Max Aleckson
9	Robert Alexander
10	Margaret Mary Alford
11	Anthony Allison
12	Amanda
13	Edwin Amery
14	AMP Limited
15	Amstelveen
16	Donna Anderson
17	Donna Anderson
18	Donna Anderson
19	Michael Anderson
20	Jacob Andrews
21	Lara Angell
22	Bundy Apostolou
23	ARCA
24	Daniel Archibald
25	Arenburg Consulting
26	Heather Armitage

No.	Received from
27	James Tom Anthony Arnold
28	Anthony Asher
29	Association of Financial Advisers Ltd
30	Association of Superannuation Funds of Australia (ASFA)
31	Stephen Atkin
32	Steve Atkin
33	Merrill Austin
34	Tony Austin
35	Australia and New Zealand Banking Group Limited (ANZ)
36	Australian Small Business and Family Enterprise Ombudsman
37	Australian Securities and Investments Commission (ASIC)
38	Australian Prudential Regulation Authority (APRA)
39	Australian Labor Party
40	Australian Institute of Company Directors
41	Australian Institute of Performance Sciences
42	Australian Institute of Superannuation Trustees
43	Australian Greens
44	Australian Financial Complaints Authority
45	Australian Finance Group Ltd
46	Australian Finance Industry Association

No.	Received from
47	Australian Banking Association
48	Michael Ayling
49	Christie Bader
50	Peter Baker
51	Henk Ballast
52	Bank of Queensland Limited
53	Banking Standards Board
54	Prof Elise Bant
55	Richard Bardon
56	Scotty Barr
57	Raylee Barrett
58	Dominic Barry
59	Ian Barry
60	Irene Barry
61	Michael Barry
62	Barry
63	Elisa Barwick
64	Benjamin Susan Bath
65	Gordon Batt
66	Dr Colin Beardsley
67	Kenneth Gerard Bebb
68	Jeremy Beck
69	Marjet Bedi
70	Theresa Beecroft
71	Adam Bell
72	Desmond Bell
73	Jennifer Bell
74	Bendigo and Adelaide Bank Limited

No.	Received from
75	David Alexandria Bennett
76	Peter Bennett
77	Ernest Frank Berlic
78	Mark Best
79	Paul Best
80	Neil Bidder
81	Farhad B Billimoria
82	Steven Maxwell In Bird
83	Anthony Barry Blackman
84	Kelvin Blair
85	Roger Blakeway
86	Leigh John Boileau
87	Bob Bone
88	Bernie Bourke
89	Rory Bowler
90	Rory Bowler
91	Martin Andrew Boyd
92	Nolene Bradshaw
93	Ian Leslie Brander
94	Ivan Brbot
95	Bredan Brieze
96	Brisbane Residents United Inc
97	Henry Neil Gribble Broadbent
98	Steven Henderson Brown
99	Adrian Bryant
100	Mr B A Bucktin
101	Roger Bugg
102	Margo Bunt
103	Allan Burke

No.	Received from
104	Gerald Burns
105	Burrell Stockbroking & Superannuation
106	Jessica Buxton
107	Brian Byrne
108	Wendy Cain
109	Joshua Lawrence Camm
110	Joshua Camm
111	Tony Cammarano
112	Meredith Melinda Campbell
113	Professor Liz Campbell
114	Meredith Campbell
115	Trudy Campbell
116	Thomas Canning
117	Martin Carey
118	Leslie J Carnegie
119	Steven Carr
120	Genevieve Carrier
121	Brett Robert Cash
122	Troy Michael Cash
123	John Sommers Casley
124	Caux Round Table
125	William John Cebula
126	Centre for Future Work at the Australia Institute
127	Centre for Law Markets and Regulation, UNSW
128	Centre for Research in Religion and Social Policy, University of Divinity
129	Andrew Jack Chalkley

No.	Received from
130	Ronald Chandler
131	Chartered Accountants Australia and New Zealand
132	Lorena Chater
133	Neil Chater
134	Chai Yee Cheng
135	CHOICE
136	Mrs Kay Christensen
137	Citizens Electoral Council of Australia
138	Fanita Clark
139	Nathan Clark
140	Peter Clark
141	Martin Claxton
142	Peter Clements
143	JOST & Co
144	Julian Cochran
145	David Collett
146	Adrian Collier
147	Combined Pensioners and Superannuants Association (CPSA)
148	Combined Industry Forum
149	Dr Vicky Comino
150	Commercial & Asset Finance Brokers Association of Australia
151	Commonwealth Bank of Australia and its associated entities
152	Community and Public Sector Union (PSU Group)
153	Brian Concannon

No.	Received from
154	Barry Conde
155	Connective Broker Services Pty Ltd
156	Thomas Moore Connelly
157	Maxwell John Connor
158	Constituents of the Burdekin Electorate (Queensland)
159	Consumer Credit Law Centre SA
160	Consumer Credit Legal Service WA Inc
161	Consumer Action Law Centre
162	Consumer Policy Research Centre
163	Nick Contarino
164	Colin Evan Cook
165	Geoffrey Cornell
166	Lindsay D Cosgrove
167	John Cosstick
168	Robert Couper
169	Mark Coutts
170	Janet Thomasina Cowden
171	Stephen Cox
172	CPA Australia
173	Timothy Cragg
174	Caulfield Craig
175	Glenn Crichton
176	David John Cridland
177	Anne Crocker
178	Mr Rik Crockford
179	Phillip Randall Cross
180	Tina Gayle Crossley

No.	Received from
181	John Crothers
182	Geoffrey Crowther
183	Graham Crowther
184	Graham Crowther
185	Ngaire Crowther
186	Nicholas Culling
187	John Charles Culverwell
188	Stephen Donald Currie
189	Customer Owned Banking Association
190	Mark Dalrymple
191	Andrew Dalton
192	Victor Damos
193	Andrew Lloyd Davey
194	George Davies
195	Peter James Davis
196	Ian Davis
197	Anne Marie Dawborn
198	Timothy J de Beaux
199	Robert Melvyn Dealtry
200	Geoffrey Youle Dean
201	Department of the Prime Minister and Cabinet
202	DFS Group
203	Stephen Dobson
204	Rodney Doel
205	John Douglass
206	Mr Ronald J Doyle
207	Joshua Anthony Doyle
208	Peter Doyle

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209	Philip Edward Drew
210	Robert Dring
211	Peter Drury
212	Magdalene DSilva
213	Christine Dudley
214	Martin Duffield
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217	Alexander Duncan
218	Andrew Dunlop
219	Paul Durling
220	John Dwyer
221	William Edgar
222	Rosemarie Edler
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224	Robertus van Egdom
225	Dr Liz Elliott
226	Dr Elizabeth Elliott
227	Shane Ellis
228	Tooraj Enayati
229	Clive Ettia
230	Mikayla Lee Evans
231	Christopher Evers-Swindell
232	Elmore Family
233	David Farmer
234	Thomas Michael Farrell
235	Charles Faulkner
236	Sergii Fedotov
237	Linda Fencaros

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238	Simon Fenton
239	James Ferguson
240	Andrew Fernbach
241	Finance Sector Union of Australia
242	Finance Brokers Association of Australia Limited
243	Financial Services Council
244	Financial Services Institute of Australasia (FINSIA)
245	Financial Rights Legal Centre
246	Financial Planning Association of Australia
247	Financial Counselling Australia
248	Financial Counselling Australia
249	Financial Counselling Australia
250	Andre Fink
251	Diane Marie Finlay
252	First Impressions Image Training
253	Jared Fletcher
254	Rhonda Fletcher
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261	Finley Francois
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271	John Garrick
272	Tim Gaspar
273	Dennis Gentilin
274	Kylie Gillespie
275	Steve Gillham
276	Associate Professor George Gilligan
277	Gary Glancy
278	Brad Golding
279	Donald George Goldsmith
280	William Edward Gollan
281	Lewis Bramley Goodridge
282	Jen Goods
283	Richard Gorman
284	Michael John Gough
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288	Rosamund Clare Grady
289	Natasha GraebnerBraun
290	Anthoy Irving Graham

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291	Laurie Gransden
292	Karin Grant
293	GRC Institute
294	Mary Green
295	Gregory
296	Mark Greville
297	Kenneth Walter Grundy
298	Guerdon Associates Pty Limited
299	Anthony Gunn
300	Peter Hagen
301	Mark P Haikonen
302	Roger Hall
303	Elizabeth Handley
304	Brian Hankinson
305	Keith Harper
306	Douglas Harrison
307	Douglas Harrison
308	Ian Harrison
309	Edward Hartman
310	Carol Harvey
311	Simon Haselgrove
312	Mike Haydon
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322	Dean Herron
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326	Brendan Holland
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328	Paul Homolka
329	Peter Horwitz
330	Stuart Howe
331	Ray Huang
332	Carole Hubbard
333	Anthony Joseph Hudson
334	Steven Hughes
335	Douglas Humphries
336	Johanna Hunneman
337	Warwick William Alfred Hunt
338	Gordon Hunter
339	Steve Hunter
340	Kenton Huxtable
341	Liudmyla Iakovets
342	Kingsley Iddon
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344	William Ifield
345	Industry Super Australia Pty Ltd
346	Graeme Inglis

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347	William Robert Ingrey
348	Institute of Managed Account Professionals
349	Insurance Council of Australia
350	Noelene Isherwood
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352	Ronald Ernest Jean
353	Heike Jindra
354	John
355	M. Johnston, A. Lofts, I. Peel, B. Cobb, N. Watson, M. Newman, W. McDonald
356	Evan Jones
357	William Jones
358	Thomas James Jordan
359	Simon Joseph Hall
360	Kathleen
361	Mr John Kearney
362	David Kecek
363	Cynthia Kardell
364	Leslie Thomas Kelly
365	Keith Derek Kerr
366	Michelle Kiamil
367	Don Kim
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369	Phillip King
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371	Joerg Steven Kiss
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373	Marcel Knuffel

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375	John Kohl
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377	Tully Kops
378	Laurence Krass
379	Selwyn Krepp
380	John Krylyszyn
381	Hans Kuehn
382	Carl Kuen
383	Nigel Lacey
384	Anton Lagerway
385	Alan Lane
386	Kieren Lane
387	Larry
388	Law Council of Australia
389	Ann Lawler
390	Anthony Lawless
391	Michael Lawrance
392	Christopher Lee
393	Peter Lee
394	Legal Aid NSW
395	Legal Aid Queensland
396	Christopher John Lewis
397	Nerida Lewis
398	Rod Lewis
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400	Geoffrey Links
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402	Adrian Lobo

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403	Louise Locke
404	Warren Loone
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408	Macquarie Group Limited
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412	Irene Maher
413	Peter Mair
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415	Nakisa Malakooti
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417	John Mandalios
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419	John Henry Mann
420	Anthony Mantella
421	Robert Marotta
422	John D Marsh
423	James Keith Marshall
424	Martin North Digital Finance Analytics
425	Colin W Martin
426	Kenneth Arthur Martin FCPA
427	Cv & E Martino Super Fund
428	Thomas Marwick
429	Rainer Mora Mathews
430	Richard Matthews

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439	McGing Advisory & Actuarial
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441	Patricia McInnes
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452	Dan Meiers
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460	Jon Minney
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463	Michael Molesworth
464	Lindsay Morris
465	Wayne Morrison
466	Mortgage Choice
467	Mortgage & Finance Association of Australia (MFAA)
468	Jackie Morton
469	Kirsten Muir
470	Kerryn Lee Munday
471	Tony Murphy
472	Eric Michael Murray
473	Mike Musgrave
474	Di Myers
475	Teodora Nagy
476	Max Najar
477	National Australia Bank (NAB)
478	National Association of Community Legal Centres and Financial Counselling Australia
479	Sandra Elizabeth Neal
480	Roland Nelson
481	George Neofitou
482	Assoc Prof Ben Neville and Prof Dirk Matton
483	Khoa Nguyen
484	Carl Nickson
485	Don Nicol

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486	Jennifer Oakley
487	Kevin Edward OBrien
488	Paul O'Carrigan
489	Michael Offe
490	Danny O'Mahony
491	Michael Ooms
492	Mark Opie
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494	Stephen John O'Rourke
495	Andreas Ortmann
496	Peter Ousby
497	John Howan Owens
498	Eerik Owerhall
499	Cris Parker
500	Cris Parker
501	Jeremy Parker
502	Graham Paterson
503	Robert Paterson
504	Julie Suzanne Hamblin Patullo
505	Nichalus Thomas Payne
506	Gregory Payne
507	Benjamin Pearce
508	Graeme Pearce
509	Daniel Pearson
510	Stuart Penhall
511	Paul Gregory Penny
512	Nicholas Perna
513	Peter
514	John Geoffrey Philp

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515	Jennifer Pickard
516	Howard Pierce
517	A Lois Pinnell
518	Platinum Investment Manahement Limited
519	Greg Poett
520	Jennifer Poett
521	Rodney John Polkinghorne
522	Diane Poppi
523	Robert Poppi
524	Robert Poppi
525	Adrian Power
526	Bruce Preston
527	Claire Priestley
528	Marie Pringalle
529	Property Council of Australia
530	Janet E Pukallus
531	Dennis Pukallus
532	Qld Whistleblowers Action Group
533	Queensland Whistleblowers Action Group
534	Alan Quirk
535	Adviser Ratings
536	Kim Rees
537	Regional Banks – AMP Bank, Bendigo and Adelaide Bank, Bank of Queensland, ME
538	Dennis Reincastle
539	Shane Reynolds
540	John P Richards

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541	John Richardson
542	Alan Francis Rider
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544	Maria Marcia Rigoni
545	Benjamin Glyn Roberts
546	Anthony James Robey
547	Jane Robinson
548	Jean Robinson
549	William Stewart Roddick
550	Graham Rodwell
551	Brendan Rolfe
552	Paul Ross
553	Ronald Rowlands
554	Barbara Roy
555	Ross Russell
556	Mario Russo
557	Joshua Saik
558	Daniel Francis Salisbuy
559	Marcus Oliver Saltmarsh
560	Michael Sanderson
561	Ron Sandilands
562	Reg Sandy
563	Heidi van Schaik
564	Reinhard Schemmann
565	Errol Schmetzer
566	Errol Schmetzer
567	Frank Scott
568	Keallie Scott
569	Mark Sell

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570	Gregory Semfel
571	Dennis Sgarretta
572	Geoff Shannon
573	Geoff Shannon
574	Kevin John Sharp
575	Dr Kym Sheehan
576	Dr Kym Sheehan and Professor David Kinley
577	Graham Shepherd
578	Nathan John Shoesmith
579	Leeann Short
580	Sr MaryJane Singleton OPI
581	Michael Sita
582	Alan George Skyring, BE MIE Aust.
583	Smartline Home Loans Pty Ltd (trading as Smartline Personal Mortgage Advisers)
584	Colin Smartt
585	Jim Smith
586	Michelle Smith
587	Veronica Smith
588	SMSF Association
589	Mark Sneddon
590	Edward Raymond Snyder
591	Joan Sohl
592	Ray Somlai
593	Christopher Sorbello
594	Christopher Soren Shann Turnbull
595	Andreas Soulos

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596	Ursula Frances Soulsby
597	Paul Spajic
598	Karen Spencer
599	SR Group
600	Jeanette A Staehr
601	Geoffrey Stafford
602	Stand Fast Finance
603	John A Stanford
604	Charles Frederick Stanger
605	Mile Stankovic
606	Adam Steen
607	Bruce L Stephens
608	Nigel Stevenson
609	John Leslie Stewart
610	Andrew James Stewart
611	Tim Stewart
612	Pauline Joy Stow
613	David Stow
614	David Stubberfield
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616	Bruce Styles
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618	Suncorp Group Limited
619	Michael Swain
620	Wilson Sy
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622	Colin Tabell
623	Murad Talukdar
624	Sherryn Tanti

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625	Tasmanian Small Business Council
626	John Terenzini
627	The QSuper Board
628	The Ethics Centre
629	The Australia Institute
630	Andrew Thompson
631	Carolyn Thomson
632	Margaret Thornton
633	Lars Thystrup
634	Bronwyn Tillman
635	Bronwyn Tillman
636	Stavroula Tirekidis
637	Anthony Tomlinson
638	William Tonge
639	Ruth Lorraine Tonsbeek
640	Johan Tonsbeek
641	Norm Townsend
642	Janette Townshend
643	Treasury
644	Stephen Trounson
645	Neal Beirne Tully
646	Neal Beirne Tully
647	TWU Nominees att TWU Superannuation ("TWUSUPER")
648	Brian Tyler
649	Urban Development Institute of Australia
650	Gerrit Frederick van der Tang
651	Joshua Van Der Neut

No.	Received from	No.	Received from
652	Sandra van der Laan	674	Desmond Whyte
653	George Vella	675	Leslie Robert Williams
654	Stuart Bruce Venn	676	Chris Williams
655	Jacob Vermeulen	677	J Wilmott
656	Victims of Financial Fraud	678	Brett Wilson
657	Petrus Vlaar	679	Simo Wilson
658	Peter Wakeman	680	Kenneth Graham Winton
659	Russell Wallace	681	David Wishart
660	Alexander Joseph Walsh	682	Harold Ashley Witham
661	Sir John Walsh of Brannagh	683	Wayne Wood
662	Robyn Wanicek	684	Montague Woodbridge
663	Vivienne Ward	685	Monty Woodbridge
664	Patricia Warren	686	Monty Woodbridge
665	Brian Lloyd Weekes	687	Linda Delores Woodward
666	Ray Weeks	688	Lenard Rhys Yarrow
667	Stephen Weller	689	Carlos Yohanna
668	Eric Wells	690	Sleiman Yohanna
669	David Wenk	691	Zainah Yohanna
670	Reginald Trevor Went	692	Michael Frank Zabel
671	Westpac Banking Corporation	693	Anthony Zarro
672	Barbara Whatham	694	Mr Anton Zwickl
673	Rodney Langford Kay Wheeler		

This includes all policy submissions in response to the *Interim Report* that have been published on the Royal Commission's website. The Commission reserved the right not to publish submissions where matters are subject to a non-publication order, or where there were privacy concerns about the information included. The Commission received 196 submissions in response to the *Interim Report* where the individual asked that their name be withheld.

Appendix 7: Background Papers and Research Paper

Appendix 7 includes copies of the Background Papers and Research Paper, as listed in the following table.

Each of these Background Papers and Research Paper can be found on the [Publications page of the Commission's website](#).

Title of Background Paper	Date of publication
Background Paper 14: General Insurance	12-Jun-2018
Background Paper 15: Catastrophes and Natural Disasters Insurance	12-Jun-2018
Background Paper 20: Natural Disaster Insurance	21-Jun-2018
Background Paper 22: Superannuation	24-Jul-2018
Background Paper 23: Overview of Key Regulatory Reforms in Superannuation	24-Jul-2018
Background Paper 25: Legal Framework Governing Aspects of the Australian Superannuation System	26-Jul-2018
Background Paper 26: Some Features of the General and Life Insurance Industries	28-Aug-2018
Background Paper 27: Reforms to General and Life Insurance	28-Aug-2018
Background Paper 28: Group Life Insurance	28-Aug-2018
Background Paper 29: Life Insurance	28-Aug-2018
Background Paper 30: Information about Selected Aspects of Foreign Financial Services Regulation	14-Nov-2018
Research Paper: Conflicts of Interest and Disclosure	07-Nov-2018