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Review of the Australian Securities and Investments Commission Annual Report 2017

House of Representatives
Standing Committee on Economics

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Canberra

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Chair's foreword

Trust is vital to a healthy financial services industry. However, trust in Australia's financial sector has been eroded by the development of a corporate culture in some institutions that places profit before customers and sales before service.

The reputation of Australia's banking and financial system has been damaged by shocking examples of misconduct, in particular by the four major banks and AMP. Evidence provided to the Royal Commission has exposed parts of the financial sector as having a corporate culture motivated by greed and lacking in moral leadership.

However, evidence of systemic failings also places the Australian Securities and Investments Commission (ASIC) in the spotlight because it is the regulator responsible for promoting investor and financial consumer trust and confidence, and ensuring fair, orderly and transparent markets.

ASIC needs to be tougher. Australians expect the big banks and others to fear their regulator. There have been too many examples where ASIC has not adequately penalised those it regulates. The heavy reliance on enforceable undertakings, for example, rather than seeking court-imposed penalties, has not met community expectations. Too many Australians believe that the banks have been let off 'scot-free' at the expense of banking customers, resulting in terrible financial losses and gross injustices.

The committee recognises that there is a new Chair and Deputy Chair of Enforcement of ASIC who are committed to taking a stronger stance on enforcement, supported by a range of tougher penalties recently introduced by the government.

On 22 June 2018 ASIC appeared before the committee, as part of the review of the regulator's 2017 Annual Report. The committee scrutinised ASIC on actions it is taking to restore trust, eliminate conflicts of interest and raise standards of professionalism in Australia's financial services industry, ASIC's surveillance and enforcement strategy, and new measures to strengthen ASIC.

The committee heard the government is undertaking significant reform of the banking and financial sector, including improving ASIC's ability to gather information, boosting its licensing and banning powers, and increasing criminal and civil penalties for corporate and financial misconduct. These reforms will ensure Australia's penalties are a credible deterrent to unacceptable behaviour.

The committee notes ASIC's call to restore trust, eliminate conflicts of interest and raise standards of professionalism in Australia's financial services industry and will continue to scrutinise ASIC's performance in promoting cultural change. Ultimately, it is up to the leaders and individuals in finance to treat their customers fairly, which is central to rebuilding trust in the services they offer.

Since the hearing, the government has announced a \$70.1 million package of new measures to further strengthen ASIC including \$26.2 million to help ASIC pursue the banks and other well-funded litigants in court for serious misconduct. ASIC will also receive \$8 million to embed dedicated staff within the big four banks and AMP to monitor governance and compliance activities.

The package also includes \$9.4 million to increase supervision of the superannuation sector, \$6.8 million to examine issues and pursue failings of corporate governance in large ASX companies, \$6.6 million to implement reforms to whistle-blower protection, and \$6 million to promote Australia as a world leader in regulatory technology solutions for the financial services industry. Ultimately, this will help rebuild trust in the financial system.

Funding has also been earmarked to improve consumer access to the Financial Advisers Register, to boost ASIC's enforcement work on the unfair contract term protections for small businesses, and for ensuring compliance by licensees and financial advisers with the Future of Financial Advice laws.

This commitment of new funding will enable ASIC to more closely supervise the big banks and better pursue and prosecute those who engage in misconduct in corporations and within the financial services industry.

The committee also took evidence on the poor response of one insurer, AAMI Insurance, to the 2015 Wye River bushfires in Victoria and heard that ASIC does not currently have regulatory oversight of the way consumers' claims are handled by their insurers because of an exemption in the Corporations Act. The committee does not accept that this excuses ASIC's lacklustre response and the inadequate penalty imposed on AAMI for making false or misleading statements in its advertising, after AAMI attempted to dramatically undercut insurance payouts to some policy holders who lost their homes in the bushfires.

On behalf of the committee, I thank the Chairman of ASIC, Mr James Shipton, and other representatives of ASIC for appearing at the hearing on 22 June 2018.

Sarah Henderson MP

Chair



Contents

Chair's foreword	iii
Membership of the Committee	vii
Terms of reference	viii
Abbreviations.....	ix

THE REPORT

1 Introduction	1
Background	1
Scope and conduct of the review	3
2 Current Issues in Financial Systems Regulation.....	5
Overview	5
Restoring trust in financial services	5
ASIC's performance and lessons learnt	6
Recent measures to strengthen ASIC.....	9
Conflicts of interest in the financial sector	11
Mortgage broker commissions	14
Grandfathered commissions	16
Professionalism and culture	16
Consumer redress.....	19

Surveillance and enforcement	20
Fees for no service.....	20
Other cases.....	22
Poor response of insurers to disaster events	23
ASIC funding	25
Payments to charities.....	27
Conclusion	28

APPENDIX

Appendix A – Hearing and witnesses	31
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LIST OF TABLES

Table 2.1 Summary of ASIC revenue, appropriations and expenses, 2016–17	26
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Membership of the Committee

Chair	Ms Sarah Henderson MP
Deputy Chair	The Hon Matt Thistlethwaite MP
Members	Mr Adam Bandt MP Ms Julia Banks MP Mr Scott Buchholz MP Mr Trevor Evans MP Mr Jason Falinski MP (from 20 June 2018) Mr Kevin Hogan MP (until 27 March 2018) Ms Ged Kearney MP (from 21 May 2018) Mr Craig Kelly MP Mr Matt Keogh MP Mr Josh Wilson MP (until 10 May 2018)

Committee Secretariat

Secretary	Mr Stephen Boyd
Inquiry Secretary	Dr John White
Office Manager	Ms Jazmine Rakic



Terms of reference

The House of Representatives Standing Committee on Economics is empowered to inquire into, and report on, the annual reports of government departments and authorities tabled in the House that stand referred to the committee for any inquiry the committee may wish to make. The reports stand referred in accordance with the schedule tabled by the Speaker to record the areas of responsibility of the committee.



Abbreviations

AFCA	Australian Financial Complaints Authority
ANZ	Australia and New Zealand Bank
ASIC	Australian Securities and Investments Commission
CBA	Commonwealth Bank of Australia
CIO	Credit and Investments Ombudsman
FASEA	Financial Adviser Standards and Ethics Authority
FOS	Financial Ombudsman Service
GFC	Global Financial Crisis
NAB	National Australia Bank
SCT	Superannuation Complaints Tribunal

Introduction

Background

- 1.1 The House of Representatives Standing Committee on Economics (the committee) is empowered to inquire into, and report on, the annual reports of government departments and authorities tabled in the House that stand referred to the committee in accordance with the Speaker's schedule.
- 1.2 The Australian Securities and Investments Commission (ASIC) 2017 Annual Report (annual report) stands referred to the committee in accordance with this schedule. The committee resolved at its meeting on 7 February 2018 that it would conduct an inquiry into the annual report.
- 1.3 ASIC is an independent Commonwealth statutory authority whose role is to administer the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the *Corporations Act 2001* (Corporations Act) and a range of additional legislation.¹
- 1.4 ASIC was established in 1991 as the Australian Securities Commission, replacing the National Companies and Securities Commission and the Corporate Affairs offices of the states and territories. It was renamed ASIC in 1998 when it was given responsibility for consumer protections in superannuation, insurance and deposit taking. ASIC's responsibilities were expanded in 2010 to regulate trustee companies, consumer credit and finance broking and for supervising trading on Australian licensed equity, derivatives and futures markets.²

1 ASIC, *Laws we administer*, <<http://asic.gov.au/about-asic/what-we-do/laws-we-administer/>>, accessed 22 May 2018.

2 ASIC, *How we operate*, <<http://asic.gov.au/about-asic/what-we-do/how-we-operate/history/>>, accessed 22 May 2018.

- 1.5 ASIC's stated aims include promoting investor and financial consumer trust and confidence, ensuring fair, orderly and transparent markets and providing efficient and accessible registration for businesses and companies.³
- 1.6 Under the ASIC Act, the authority is responsible for:
- maintaining, facilitating and improving the performance of the financial system and entities in it (including the licensing of financial services providers);
 - promoting confident and informed participation by investors and consumers in the financial system (broadly through the delivery of financial literacy education);
 - administering the law effectively and with minimal procedural requirements;
 - enforcing and giving effect to the ASIC Act;
 - receiving, processing and storing, efficiently and quickly, the information given to ASIC; and
 - making information about companies and other bodies available to the public as soon as practicable.⁴
- 1.7 ASIC's service charter further describes its role in relation to corporate, market and financial system regulation as encompassing, among other activities:
- registering companies and managed investment schemes;
 - registering auditors and liquidators;
 - registering business names;
 - licensing financial services and consumer credit businesses;
 - examining new market licence proposals; and
 - maintaining publicly accessible registers of companies, and registered and licensed entities, as well as disqualified directors and people who are banned from the financial services industry.⁵

3 ASIC, *Our role*, <<http://asic.gov.au/about-asic/what-we-do/our-role/>>, accessed 22 May 2018.

4 ASIC, *Our role*, <<http://asic.gov.au/about-asic/what-we-do/our-role/>>, accessed 22 May 2018.

5 ASIC, *ASIC service charter results*, <<http://asic.gov.au/about-asic/what-we-do/how-we-operate/asic-service-charter-results>>, accessed 22 May 2018.

Scope and conduct of the review

- 1.8 ASIC appeared before the committee on 22 June 2018 in Canberra. This was ASIC's third appearance at a public hearing with the committee in the 45th Parliament. Details are provided in Appendix A.
- 1.9 ASIC's responses to the committee's questions on notice and in writing are provided on the committee's website.⁶
- 1.10 The proceedings of the hearing were webcast over the internet, through the Parliament's website, allowing interested parties to view or listen to the proceedings as they occurred. The transcript of the hearing is available on the committee's website.⁷ The hearing was well attended by members of the public and media.
- 1.11 This report focuses on matters raised at the public hearing.

6 House of Representatives Standing Committee on Economics, <https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/ASICAnnualReport2017/Documents>, accessed 02 August 2018.

7 House of Representatives Standing Committee on Economics, <https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/ASICAnnualReport2017/Public_Hearings>, accessed 27 June 2018.

Current Issues in Financial Systems Regulation

Overview

- 2.1 The Australian Securities and Investments Commission (ASIC) appeared before the committee at a public hearing on 22 June 2018 as part of the review of ASIC's 2017 Annual Report.
- 2.2 Key issues examined at the hearing included the need to restore trust, eliminate conflicts of interest and raise standards of professionalism in Australia's financial services industry, ASIC's surveillance and enforcement strategy, ASIC's role in rebuilding confidence in financial services, and new measures to strengthen ASIC.
- 2.3 The committee also took evidence about the poor response of insurers to the Wye River bushfires in Victoria.

Restoring trust in financial services

- 2.4 Trust is vital to a healthy financial services industry. However, trust in Australia's financial sector has been eroded by the development of a corporate culture that places profit before customers and sales before service.
- 2.5 Evidence provided to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission)¹ has been shocking and damning. The Royal Commission

1 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, <<https://financialservices.royalcommission.gov.au/Pages/default.aspx>>, viewed 26 June 2018.

has revealed systemic failings in the financial sector and, in particular, by Australia's four major banks and AMP.

- 2.6 The committee asked the Chairman of ASIC, Mr James Shipton, to comment on the seriousness of these failings. Mr Shipton stated:

The issues confronting the financial services industry right now are deep, they are significant and they are extremely confronting to me. What we are seeing by way of the royal commission is in many respects exactly what ASIC has been dealing with for many years and has been confronting for many years.²

- 2.7 The Chairman further commented:

I would also like to underline something..., which is that ultimately we at ASIC are here to ensure the confidence of the Australian public in the financial system, and it is fair to say that that confidence is in doubt. That confidence is under threat.³

ASIC's performance and lessons learnt

- 2.8 The committee questioned the Chairman about his reference to a 'trust deficit'⁴ in financial services, noting that it is ASIC's role to promote investor and financial consumer trust and confidence, and to ensure fair, orderly and transparent markets.⁵

- 2.9 In particular, the committee asked what responsibility ASIC took for the loss of consumer trust in Australia's financial system. The Chairman said he would not blame ASIC but accepted that there were lessons for the regulator to learn:

ASIC has been doing its extreme best under the circumstances over many years to... look after the best interests of consumers. Of course there are always lessons to be learned. Of course there are always ways of redeploying and redefining and reconfiguring the way that we do things. But I would not lay blame at ASIC. I would not put the burden on the shoulders of the fine men and women who I believe have been doing an excellent job over many years.⁶

2 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 2.

3 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 3.

4 See: Mr James Shipton, Chairman, ASIC, *The Trust Deficit and Corporate Australia*, Keynote address to Australian Council of Superannuation Investors Annual Conference, Sydney, Australia, 17 May 2018, <<https://asic.gov.au/about-asic/media-centre/speeches/the-trust-deficit-and-corporate-australia-acsi-conference-2018/>>, viewed 26 June 2018.

5 ASIC's strategic priorities also include providing efficient and accessible registration for businesses and companies. See: ASIC, *Our role*, <<http://asic.gov.au/about-asic/what-we-do/our-role/>>, viewed 25 June 2018.

6 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, pp. 3-4.

2.10 The Chairman outlined ASIC's strategy for rebuilding trust in Australia's financial services, noting that conflicts of interest and a lack of professionalism in the industry were key issues that needed to be addressed. The Chairman stated that ASIC will apply all its regulatory tools to deal with these issues:

That will include enforcement outcomes. That will include investigations. Right now we have over 1,000 regulatory interventions underway. We have around 800 surveillances and nearly 250 investigations. These are important exercises that we are embarking upon for the purpose of getting the industry to a position where they have earned the trust and the confidence of the Australian public.⁷

2.11 The committee asked the Chairman if a cultural shift at ASIC was required for it to adequately address systemic failings in the financial sector. The Chairman acknowledged that ASIC needed to lead by example in advocating for cultural reform, and was confident it could do so:

I have every confidence that ASIC will continue to be an example of fine professionalism. The men and women at this organisation are firmly committed to the challenges that we've been discussing, and which are confronting. I can give you my personal assurance that these fine people work as hard as they possibly can to address the issues. They feel the hurt that you feel. They are confronted as you are confronted.⁸

2.12 ASIC was asked if it had plans to move away from using enforceable undertakings towards seeking court-imposed penalties given the controversy over the effectiveness of enforceable undertakings. The Chairman stated:

My intention is to ensure that we are the most strategic, forceful and effective financial regulator that we can possibly be. That is my absolute intention, and I know that we have the commitment of the commissioners and of the fine men and women inside ASIC. We will utilise every single tool that we have available to us.⁹

2.13 The committee further questioned ASIC about its strategy and priorities in getting the best outcome for consumers with the available resources. The Chairman said this was the 'regulatory dilemma', stating 'any regulator in any agency in any industry anywhere in the world has limited resources

7 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 3.

8 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 11.

9 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 25.

and they must do their level best to apply those resources in the most strategically efficient way'.¹⁰ The Chairman commented:

...we are looking at the way that we make these decisions, how we deal with the strategic dilemmas, at every level, so that when recommendations or choices have to be made at every level the officers, from the case officer all the way up to the commission, are aware of the potential options that are available and that we consider them. Often, when I'm asking a question, I say, 'What is the alternative option? What is the red team? What would the red team say in this particular exercise?' Ultimately it comes down to our very best professional regulatory judgement.¹¹

2.14 ASIC was asked whether its enforcement strategy included a focus on the larger, more complex cases, including investigations into the four major banks. In response, ASIC referred to the following enforcement outcomes from its Wealth Management Project as 'strategically important cases' in changing industry behaviour and improving consumer outcomes:

- civil penalty proceedings commenced against Westpac in 2016 alleging advice compliance failures including breaches of the 'best interests' duty in the course of telephone sales of superannuation products – the case was heard by the Federal Court in February 2018 and judgment is reserved;
- court enforceable undertakings accepted from CBA and ANZ in July 2018, to ensure their distribution of superannuation products complies with financial advice laws;
- court enforceable undertakings accepted in April 2018 from CBA subsidiaries and ANZ, requiring improved compliance systems and processes to avoid 'fees for no service' conduct (in addition to substantial remediation programs already implemented for customers affected by this conduct in the past);
- ongoing investigations of 'fees for no service' conduct by other entities;
- civil penalty proceedings commenced against Westpac and against AMP in June 2018 alleging liability as licensee for breaches of the 'best interests' duty by their advisers.¹²

10 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 15.

11 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 15.

12 ASIC, Question on Notice, 2QoN, <https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/ASICAnnualReport2017/Documents>, viewed 2 August 2018.

Recent measures to strengthen ASIC

- 2.15 The Government is taking action to strengthen ASIC, including improving ASIC's ability to gather information, boosting its licensing and banning powers, and increasing criminal and civil penalties for corporate and financial misconduct.¹³ These reforms are long overdue and will ensure Australia's penalties are a credible deterrent to unacceptable behaviour.
- 2.16 In particular, the Government has announced it will increase and harmonise penalties for the most serious criminal offences under the *Corporations Act 2001* (Cth) (Corporations Act) to a maximum of:
- i. the greater of \$1.05 million (for individuals, from \$200,000) and \$10.5 million (for corporations, from \$1 million); or
 - ii. three times the benefit gained or loss avoided; or
 - iii. 10% of the annual turnover (for corporations).¹⁴
- 2.17 ASIC's powers will also be increased by:
- expanding their ability to ban individuals from performing any role in a financial services company where they are found to be unfit, improper, or incompetent;
 - strengthening their power to refuse, revoke or cancel financial services and credit licences where the licensee is not fit or proper; and
 - boosting ASIC's tools to investigate and prosecute serious offences by harmonising their search warrant powers to provide them with greater flexibility to use seized materials, and granting ASIC access to telecommunications intercept material.¹⁵
- 2.18 The Government has also announced powers that will allow ASIC to strip wrongdoers of profits, and a product intervention power to protect consumers. The product intervention power would allow ASIC to temporarily ban financial products that are likely to give rise to poor consumer outcomes because of the way they are sold.¹⁶

13 The Hon. Scott Morrison MP, Treasurer and The Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Boosting penalties to protect Australian consumers from corporate and financial misconduct', *Joint Media Release*, 20 April 2018.

14 The Hon. Scott Morrison MP, Treasurer and The Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Boosting penalties to protect Australian consumers from corporate and financial misconduct', *Joint Media Release*, 20 April 2018.

15 The Hon. Scott Morrison MP, Treasurer and The Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Boosting penalties to protect Australian consumers from corporate and financial misconduct', *Joint Media Release*, 20 April 2018.

16 The Hon. Scott Morrison MP, Treasurer and The Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Boosting penalties to protect Australian consumers from corporate and financial misconduct', *Joint Media Release*, 20 April 2018.

- 2.19 The Government has already provided \$127 million in additional funding to ASIC to strengthen its investigative and surveillance capabilities, introduced an industry funding model for ASIC to give it secure funding, and announced a new second Deputy Commissioner with an enforcement focus. The Government has also established a new standards setting body for financial advisers, the Financial Adviser Standards and Ethics Authority (FASEA).¹⁷
- 2.20 The committee asked what strengths a second Deputy Commissioner will bring to ASIC. The Chairman responded that the Deputy Commissioner, Mr Daniel Crennan QC, will 'bring significant experience from the bar and also from the corporate world and we believe that he will be able to enhance our strategic approach with regard to the deployment of our enforcement tools.'¹⁸
- 2.21 The committee asked ASIC if there was an imbalance between the incentives and penalties in the financial system, and whether the proposed new powers for ASIC will correct this. The Chairman responded:
- Yes. We are very much looking forward to the passing of these increased powers, these increased penalties. They will position us to be, I think, more forward-looking in addressing the imbalance that you highlight.¹⁹
- 2.22 The committee asked ASIC if it was confident it now had the tools to be an appropriately tough and feared regulator, given the evidence of widespread and systemic misconduct in its sectors of responsibility. The Chairman said he would use the full force of ASIC's powers to rebuild trust in Australia's financial sector:
- We will use every inch of our enforcement powers to achieve this goal. I want the message to go out to the financial services industry that they need to be proactive in responding to these challenges themselves, because we have a very forward-deployment mind set right now as regards the utilisation of all of our tools: enforcement, surveillance, supervision.²⁰
- 2.23 Since the hearing, the government has announced a \$70.1 million package of new measures to strengthen ASIC including \$26.2 million to help ASIC pursue the banks and other well-funded litigants in court for serious misconduct. ASIC will also receive \$8 million to embed dedicated staff
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17 The Hon. Scott Morrison MP, Treasurer and The Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Boosting penalties to protect Australian consumers from corporate and financial misconduct', *Joint Media Release*, 20 April 2018.

18 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 24.

19 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 19.

20 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 4.

within the big four banks and AMP to monitor governance and compliance activities.²¹

- 2.24 The package also includes \$9.4 million to increase supervision of the superannuation sector, \$6.8 million to examine issues and pursue failings of corporate governance in large ASX companies, \$6.6 million to implement reforms to whistleblower protection, and \$6 million to promote Australia as a world leader in regulatory technology solutions for the financial services industry.²²
- 2.25 Funding has also been earmarked to improve consumer access to the Financial Advisers Register, to boost ASIC's enforcement work on the unfair contract term protections for small businesses, and for ensuring compliance by licensees and financial advisers with the Future of Financial Advice laws.²³
- 2.26 This commitment of new funding will enable ASIC to more closely supervise the big banks and better pursue and prosecute those who engage in misconduct in corporations and within the financial services industry.

Conflicts of interest in the financial sector

- 2.27 The Chairman called the ten years that followed the Global Financial Crisis (GFC) a 'lost decade' in which Australian banks and other financial institutions failed to learn from the international response to the GFC:

I believe that there has been a lost opportunity, almost a lost decade, of awareness by the financial sector to learn from the mistakes and the lessons that we saw in the rest of the world, where the whole financial system moved to recognise inherent conflicts of interest, non-financial risks as well as financial risks, and deal with them, remediate them and to put in place structures and responses within the system itself that would enable an industry-promoted response.²⁴

21 The Hon. Scott Morrison MP, Treasurer and The Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Turnbull Government Expands ASIC's Armoury', *Joint Media Release*, 7 August 2018.

22 The Hon. Scott Morrison MP, Treasurer and The Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Turnbull Government Expands ASIC's Armoury', *Joint Media Release*, 7 August 2018.

23 The Hon. Scott Morrison MP, Treasurer and The Hon. Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Turnbull Government Expands ASIC's Armoury', *Joint Media Release*, 7 August 2018.

24 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 3.

2.28 The Chairman called for an industry-wide response in Australia, highlighting the need for the financial sector to seek out and eliminate conflicts of interest where they exist:

The task before us is paramount and fundamental, and we now call on the financial services sector not to wait for any recommendation of the royal commission and not to wait for our enforcement or intervention powers and actions but to lean into the issues and highlight...the inherent conflicts of interest that exist right now in finance and deal with them. They have a responsibility also. We take our responsibility incredibly seriously and you will see us execute on that responsibility, but it really behoves the financial sector itself to recognise, now and immediately, the challenge and the task at hand.²⁵

2.29 The committee scrutinised ASIC about its review of how the financial advice arms of Australia's largest financial institutions manage conflicts of interest in providing financial advice. The following firms were included in ASIC's review:

- AMP: AMP Financial Planning Pty Limited and Charter Financial Planning Limited
- ANZ: Millennium 3 Financial Planning Pty Ltd and ANZ Financial Planning
- CBA: Count Financial Limited and Commonwealth Financial Planning Limited
- NAB: GWM Adviser Services Limited and NAB Financial Planning, and
- Westpac: Securitor Financial Group Ltd and Westpac Financial Planning.²⁶

2.30 During its review, ASIC examined a sample of files to test whether advice to switch to in-house products satisfied the best interests duty and related obligations under the Corporations Act. In January 2018, ASIC reported that, in 75 per cent of the advice files reviewed, the advisers did not demonstrate compliance with the duty to act in the best interests of their clients. Furthermore, in 10 per cent of the files reviewed, ASIC 'had significant concerns about the potential impact of the non-compliant advice on the customer's financial situation.'²⁷

25 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 3.

26 ASIC, *Report 562: Financial advice: Vertically integrated institutions and conflicts of interest*, January 2018, pp. 20-1.

27 ASIC, *Report 562: Financial advice: Vertically integrated institutions and conflicts of interest*, January 2018, p. 35.

- 2.31 Given the large scale of non-compliance, and the seriousness of some of the cases uncovered in its review, the committee asked ASIC to clarify whether these compliance failures were breaches of section 961B of the Corporations Act. ASIC confirmed that the institutions concerned 'didn't demonstrate, on their files, that they had met that obligation'.²⁸
- 2.32 The committee asked ASIC what action it is taking in relation to the failings outlined in its report. ASIC responded:
- We have engaged with each of those licensees around not only remediation across the board for clients who may have been affected but putting in place proper compliance procedures. We've also made it very clear to the industry that what we have seen in relation to these institutions is not unique to those institutions.²⁹
- 2.33 ASIC stated it is conducting follow-up work on the fees for no service investigation, including working with the industry to raise standards and ensure that customers are being remediated. ASIC also noted that it has banned a record number of poor advisors in the past year.³⁰
- 2.34 The committee asked ASIC how it thought vertically integrated³¹ institutions like the major banks should manage the conflict of interest that exists between advising clients to switch to in-house products and the duty to act in the best interests of those clients. ASIC responded:
- Our focus is on the conflict, not so much the structure. What we do, of course, is identify and diagnose the structural elements, trying to better understand why these conflicts of interest exist. We have highlighted in reports the consequences of vertical integration and how that has a conflict of interest outcome. Our focus is on trying to eradicate the conflict and the poor consumer outcome. The structure is another conversation at a policy and a legislative level. Our focus is on, as I said, the manifestation of that conflict and the mitigation and, potentially, the eradication of that conflict.³²

28 Ms Louise Macaulay, Senior Executive Leader, Financial Advisers, ASIC, *Transcript*, 22 June 2018, p. 9.

29 Ms Louise Macaulay, Senior Executive Leader, Financial Advisers, ASIC, *Transcript*, 22 June 2018, p. 9.

30 Mr Peter Kell, Deputy Chair, ASIC, *Transcript*, 22 June 2018, p. 9.

31 Vertical integration refers to the business model of combining activities at two or more different stages of production.

32 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 22.

- 2.35 The committee notes recent decisions by NAB³³ and CBA³⁴ to sell their wealth management arms, while ANZ announced its intention to sell its wealth business in 2016.³⁵ The Royal Commission heard evidence ANZ's decision was driven by widespread compliance failures by its financial planners.³⁶ Westpac, however, has stated publically that it has no plans to exit wealth management.³⁷

Mortgage broker commissions

- 2.36 ASIC was questioned about the importance of disclosure of commissions and other types of remuneration for mortgage brokers. Noting the 2017 report³⁸ of its review of mortgage broker remuneration, in which it examined the effect of remuneration structures on the quality of consumer outcomes, ASIC stated:

We think it's important for consumers to know which lenders a broker is actively recommending. There's often a suggestion that brokers have a choice of 20 or 30 lenders to recommend. What we found, in practice, occurs is that they will typically recommend around four lenders to most of their customers. We think disclosure of that is important. We also think disclosure of ownership structures is important to customers because there are several large mortgage-broking businesses that are owned by

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- 33 T Boyd, 'NAB's sale of MLC follows three core strategic failures', *Australian Financial Review*, 3 May 2018, <<https://www.afr.com/brand/chanticleer/nabs-sale-of-mlc-follows-three-core-strategic-failures-20180503-h0zpk5>>, viewed 25 June 2018.
- 34 T Boyd, 'CBA's demerger of CFS group will be welcomed by investors', *Australian Financial Review*, 25 June 2018, <<https://www.afr.com/brand/chanticleer/cbas-demerger-of-cfs-group-will-be-welcomed-by-investors-20180624-h11t6n>>, viewed 25 June 2018.
- 35 J Eyers, 'ANZ looking to sell wealth business in Australia, reports \$5.9b profit', *Australian Financial Review*, 3 November 2016, <<https://www.afr.com/business/banking-and-finance/financial-services/anz-looking-to-sell-wealth-business-in-australia-reports-59b-profit-20161102-gsgfq0>>, viewed 25 June 2018.
- 36 J Frost, 'ANZ's wealth sale driven by compliance breaches', *Australian Financial Review*, 23 April 2018, <<https://www.afr.com/business/banking-and-finance/financial-services/anzs-wealth-sale-driven-by-compliance-breaches-20180422-h0z3is>>, viewed 25 June 2018.
- 37 A Uribe, 'Westpac sticks by BT Financial Group, as other banks exit wealth', *Australian Financial Review*, 6 November 2017, <<https://www.afr.com/business/banking-and-finance/financial-services/westpac-sticks-by-bt-financial-group-as-other-banks-exit-wealth-20171106-gzfp1v>>, viewed 25 June 2018.
- 38 ASIC, *Report 516: Review of mortgage broker remuneration*, 16 March 2017, <<https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-516-review-of-mortgage-broker-remuneration/>>, viewed 29 June 2018.

banks, and we think disclosure of that information is also important.³⁹

- 2.37 When asked whether there is currently an obligation for a mortgage broker to disclose verbally to a client that they are receiving both an up-front commission and a trailing commission from a lender. ASIC responded that there was not, and commented:

The obligation to disclose commissions arises once the credit contract has been provided to the customer. So, the home loan documentation will contain information about the commissions that are paid to the broker by the lender.⁴⁰

- 2.38 ASIC noted that improvements in disclosure can have limitations and even paradoxical effects:

We've seen, in other contexts, that disclosure doesn't really assist consumers to make good decisions. And, in some situations, we've seen that disclosing your conflict of interest actually results in the consumer having more confidence in you because you're seen to be trustworthy.⁴¹

- 2.39 ASIC was asked if a 'best interests' duty should apply to mortgage brokers like it does to financial advisors. ASIC responded:

That is a matter for the government to decide on. We have publicly said that we think that, in relation to the standard that exists at the moment for brokers, which is that they need to provide a service which ensures that the loan is not unsuitable, there's scope for raising that standard. Whether that should be a 'best interest' standard, I think, is something that is worth considering, but we don't have a firm view on whether best interest is the right standard or whether a more tailored obligation should apply to brokers, given that they are recommending different types of products to financial advisers.⁴²

- 2.40 ASIC confirmed that, as a consequence of its recommendations, the industry is now moving away from bonuses and volume-based

39 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 10.

40 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 10.

41 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 10.

42 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 10.

commissions.⁴³ ASIC said it has also called for the removal of soft dollar payments.⁴⁴

Grandfathered commissions

- 2.41 In 2013, the Future of Financial Advice reforms banned conflicted remuneration for financial advisors, such as commissions and volume-based payments.⁴⁵ However, a provision remains that allows financial advisers to collect 'grandfathered' commissions that existed before 2013. This means that the old laws continue on contracts that were entered into before the new laws came into effect.
- 2.42 Evidence provided to the Royal Commission suggests that Australia's largest financial services companies, in particular AMP, continue to derive significant revenue from trailing commissions. In April 2018, the Royal Commission heard that the majority of revenue being paid to AMP financial planners came from grandfathered commissions.⁴⁶
- 2.43 The committee asked ASIC when the provision that allows grandfathered commissions will be removed. ASIC noted that the Royal Commission is examining evidence relating to the grandfathering of commissions, and stated that the provision would be removed 'as soon as practicable'.⁴⁷

Professionalism and culture

- 2.44 In addition to the financial sector's failure to address conflicts of interest, the Chairman attributed the current trust deficit in financial services to a loss of focus on professionalism and customer service:

They [the men and women in finance] need to be proud in the execution of a very valuable purpose that finance serves for the community and society. That purpose has been lost. That purpose has been lost, in my mind, because there's been a focus on revenue targets and profitability as opposed to serving communities, society and a broader economy.⁴⁸

43 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 10.

44 Mr Peter Kell, Deputy Chair, ASIC, *Transcript*, 22 June 2018, p. 10.

45 ASIC, Future of Financial Advice, *FOFA Background and implementation*, October 2014, <<https://asic.gov.au/regulatory-resources/financial-services/future-of-financial-advice-reforms/fofa-background-and-implementation/>>, viewed 29 June 2018.

46 J Frost, 'Banking royal commission: AMP under attack', *Australian Financial Review*, 16 April 2018, <<https://www.afr.com/business/banking-and-finance/financial-services/banking-royal-commission-amp-under-attack-20180416-h0ytth>>, viewed 29 June 2018.

47 Mr Peter Kell, Deputy Chair, ASIC, *Transcript*, 22 June 2018, p. 8.

48 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 3.

- 2.45 The committee asked ASIC what work it is doing to raise professional standards in financial services. ASIC responded that it is currently consulting on its approval and oversight of compliance schemes for financial advisers,⁴⁹ and will need to adjust its Financial Advisers Register as a consequence.⁵⁰
- 2.46 ASIC also noted the FASEA is currently consulting⁵¹ on a Code of Ethics and proposed guidance on degree equivalence and educational pathways for financial advisers.⁵²
- 2.47 ASIC was asked if there had been any recent improvements in the culture of the organisations it regulates, particularly the banks. ASIC noted that the industry has moved to implement the changes recommended by the Retail Banking Remuneration Review Report (Sedgwick Review). These changes mean that retail bank staff and managers no longer receive incentives based directly or solely on sales performance.⁵³ ASIC commented:
- We continue to see cases where poor behaviour has been caused not by large financial incentives but by the way that staff performance is measured and assessed by the organisation. I think it's a case where it won't be enough to just remove the financial incentives; it will be about the cultural change that's required to reinforce the behaviours that you're looking for. There remains a risk that, even without the sales incentives, certain behaviours will continue because of the way that staff are measured and assessed in their performance.⁵⁴
- 2.48 The committee asked ASIC if it was concerned about the welfare of the employees who have often borne the brunt of consumers' mistrust and anger towards their banks. The Chairman noted that ASIC has been

49 ASIC, Consultations, *CP 300 Approval and oversight of compliance schemes for financial advisers*, 15 May 2018, <<https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-300-approval-and-oversight-of-compliance-schemes-for-financial-advisers/>>, viewed 25 June 2018.

50 Ms Louise Macaulay, Senior Executive Leader, Financial Advisers, ASIC, *Transcript*, 22 June 2018, p. 9.

51 Financial Adviser Standards and Ethics Authority, Announcements, *FASEA releases draft Code of Ethics and proposed guidance on degree equivalence and educational pathways*, 19 March 2018, <<https://www.fasea.gov.au/fasea-releases-draft-code-of-ethics-and-proposed-guidance-on-degree-equivalence-and-educational-pathways/>>, viewed 25 June 2018.

52 Ms Louise Macaulay, Senior Executive Leader, Financial Advisers, ASIC, *Transcript*, 22 June 2018, p. 9.

53 S Sedgwick, *Retail Banking Remuneration Review Report*, 19 April 2017, <https://www.betterbanking.net.au/wp-content/uploads/2018/01/FINAL_Rem-Review-Report.pdf>, viewed 29 June 2018.

54 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 18.

informed that incidents of concerning behaviour inside branches has increased recently, stating that he has given the following message to the leaders of the financial institutions:

...this increases the urgency of a response. We need solutions to be done and applied very quickly because, in addition to trust and confidence, it's affecting real people and affecting people who are, in effect, innocent.⁵⁵

- 2.49 ASIC was asked whether bonuses paid to executives and others in the financial sector had a negative effect on culture and consumer outcomes. The Chairman agreed and stated:

I have put to the industry that they need to look very carefully not just at their remuneration structures but also their MIS [Management Information System] structures in and around measurements of performance. I've put to them that the next generation that they as a business should evolve to is targeting and measuring behaviours that they want to proactively promote – particularly, as you rightly point out, behaviours that increase the experience of the consumers and the customer outcome. I have put that to them as one of the challenges of the new frontier. It's not just remunerating performance in a quantitative metric; it is rewarding, highlighting and identifying cultural and human behaviours that we believe will help that financial institution and the sector more broadly get to a point where the system itself is fairer, stronger and more efficient.⁵⁶

- 2.50 One indication of the culture of a bank is the respect it gives to the laws and regulations under which it operates. ASIC was questioned about the major banks' resistance to ASIC's supervision, noting evidence provided to the Royal Commission that Westpac was the least responsive.

- 2.51 In particular, the committee was concerned by revelations that Westpac took two years to notify ASIC that it was issuing credit card limit increases that could cause financial hardship, and only then after ASIC had threatened legal action.⁵⁷ The Chairman responded:

Those vignettes, those case studies that you mentioned, are very good ones for the industry more broadly to reflect upon. I have said publicly, and I will say again today, that there is far too a

55 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 18.

56 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 17.

57 S Danckert, 'Westpac "only tell us about issues when they think we are likely to find out"', *Australian Financial Review*, 23 March 2018, <<https://www.smh.com.au/business/banking-and-finance/westpac-only-tell-us-about-issues-when-they-think-we-are-likely-to-find-out-20180323-p4z5vy.html>>, viewed 27 June 2018.

legalistic approach by many organisations, and many people inside those financial organisations, when it comes to responding to issues and to questions. Yes, of course, legal processes are important. We take those legal processes very seriously as well but there is a need for a more professional, a more human minded and a more community oriented response by financial institutions. There is much work to be done.⁵⁸

Consumer redress

2.52 In addition to the measures already outlined, the Government has established the Australian Financial Complaints Authority (AFCA), which will commence operation on 1 November 2018. AFCA will replace the Financial Ombudsman Service (FOS), Credit & Investments Ombudsman (CIO) and Superannuation Complaints Tribunal (SCT).

2.53 ASIC was asked about the transition arrangements and where consumers should be taking their disputes. The Chairman responded:

I would advise Australians that they should firstly be raising complaints directly with the financial institutions, the internal mechanisms. If they feel minded, I understand that the royal commission has invited submissions and representations. Then...there are external complaints platforms that are in existence at the moment, transitioning to AFCA in the future. Of course we also receive complaints.⁵⁹

2.54 According to FOS, consumers can still lodge their disputes with FOS, CIO and SCT until 1 November 2018. All current disputes at FOS and disputes that are open when AFCA begins will be handled under the existing FOS Terms of Reference.⁶⁰

2.55 ASIC was questioned whether people who had been unhappy with the resolution of their disputes through FOS would be able to try again with AFCA. ASIC responded 'if that matter's been adjudicated by FOS, and a decision has been issued by FOS, most likely there's nothing further.'⁶¹ ASIC added:

I think the advice to people in those circumstances is: if those cases have been looked at and if a change of law comes out of the royal

58 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 12.

59 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 20.

60 Financial Ombudsman Service, *AFCA Information for Consumers*, <<https://www.fos.org.au/consumers/afca-information-for-consumers/>>, viewed 29 June 2018.

61 Mr Warren Day, Senior Executive Leader, Assessment and Intelligence, ASIC, *Transcript*, 22 June 2018, p. 21.

commission, or other changes come out of the royal commission, it is cold comfort to them, but their circumstance likely is not to be assisted because of those findings.⁶²

- 2.56 When asked if consumers who were unhappy with resolutions reached through the external dispute resolution bodies should complain to ASIC, ASIC responded:

If you still think that there is misconduct there, if you want to let us know that's fine but, as our chair emphasised, we are not necessarily a complaints resolution body. Yes, we receive what we might call complaints from the public, but we look at it from a point of view of saying: 'Are there systemic issues? Are there other issues of misconduct that we think are serious enough that we need to take action?'⁶³

- 2.57 ASIC drew the committee's attention to a new requirement for all financial services providers to report their complaints and disputes statistics, stating that it will 'put some sunlight' on where problems exist.⁶⁴

- 2.58 ASIC also noted that Australia has developed a 'vibrant class action regime' that provides redress through the court system.⁶⁵

- 2.59 The committee asked ASIC what action is being taken to better protect small business from misconduct. ASIC commented that AFCA will have significant jurisdiction of small business matters:

For small business it will include small business lending of loans of up to \$5 million in dispute, and they'll be able to award amounts of \$1 million, and \$2 million in the case of rural lending. That's a very significant increase.⁶⁶

Surveillance and enforcement

Fees for no service

- 2.60 The committee questioned ASIC about its investigations into the charging of fees for no service by Australia's largest financial institutions, including the advice arms of AMP, ANZ, CBA, NAB and Westpac groups. ASIC said
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62 Mr Warren Day, Senior Executive Leader, Assessment and Intelligence, ASIC, *Transcript*, 22 June 2018, p. 21.

63 Mr Warren Day, Senior Executive Leader, Assessment and Intelligence, ASIC, *Transcript*, 22 June 2018, p. 21.

64 Mr Peter Kell, Deputy Chair, ASIC, *Transcript*, 22 June 2018, p. 20.

65 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 22 June 2018, p. 19.

66 Mr Peter Kell, Deputy Chair, ASIC, *Transcript*, 22 June 2018, p. 20.

that 'AMP and others moved to a model where they were charging fees on a regular basis but not providing services, and this turned out to be systemic across these institutions.'⁶⁷ ASIC commented:

We're up to around \$250 million across the largest five firms in the industry by way of compensation, with likely more to come, and AMP is part of that. And in addition, in the AMP case, you have the nature of their response to ASIC's investigation into fees for no service, which is the subject of our current work. We are taking that very, very seriously. It is one of the largest financial firms in the country. We need to ensure that that firm is operating fairly and efficiently for all Australians that are its customers.⁶⁸

- 2.61 When asked why it did not announce its investigation into AMP to the public, ASIC responded that it did not comment on active investigations. ASIC stated:

We are subject to confidentiality, but we also are acutely aware that the mere announcement of an investigation – I'm talking about the 280-odd that we've got on at the moment. A number of those will find that there are in fact no breaches of the law. But, if we announce that publicly at the beginning, it can have fairly detrimental effects on entities or people.⁶⁹

- 2.62 ASIC was questioned about evidence provided to the Royal Commission that the AMP board reviewed 25 drafts of an expert report it commissioned from law firm Clayton Utz into AMP's charging of fees for no service. The report was provided to ASIC on the basis it was independent. In particular, ASIC was asked when it became aware of the report. ASIC commented:

We were generally aware of the circumstances surrounding that investigation by Clayton Utz and the subsequent report from May of last year... We were provided with that report in October or November.⁷⁰

- 2.63 The committee asked ASIC why the AMP board members were allowed to remain on the board despite the fact ASIC was aware that they were potentially breaking the law. ASIC responded:

67 Mr Peter Kell, Deputy Chair, ASIC, *Transcript*, 22 June 2018, p. 8.

68 Mr Peter Kell, Deputy Chair, ASIC, *Transcript*, 22 June 2018, p. 6.

69 Mr Tim Mullaly, Senior Executive Leader, Financial Services Enforcement, ASIC, *Transcript*, 22 June 2018, p. 7.

70 Mr Tim Mullaly, Senior Executive Leader, Financial Services Enforcement, ASIC, *Transcript*, 22 June 2018, p. 7.

...we have a substantive investigation into the underlying issues, and those underlying issues are deliberate conduct around fees for no service and misleading ASIC. Those are the significant matters. When I say 'misleading ASIC', that's in relation to the 20-odd situations where they provided information and we have concerns, and it's under investigation, so nothing's been proved. We have concerns around that conduct. The provision of the Clayton Utz report and the characterisation of it as being independent haven't been a significant part of our investigation.⁷¹

- 2.64 Following further questioning about the investigation into AMP, ASIC told the committee that it had been consulting with the Commonwealth Director of Public Prosecutions on the investigation, which is expected to be completed in late 2018. ASIC also said it had a team of 'a bit over half-a-dozen, and we've got external counsel' working on the investigation.⁷²

Other cases

- 2.65 The committee questioned ASIC about the status of its investigation into matters concerning the collapse of Queensland Nickel. ASIC responded that no charges have been laid in respect of the investigation, but that the investigation is well progressed. ASIC commented:

Our investigation concerns suspected breaches of provisions on directors' duties and provisions dealing with lodgement of misleading documents. Broadly speaking, it relates to the use of company funds to fund the Palmer United Party, the transfer of assets without payment of due consideration and how those transactions were accounted for, the disclosure of information to company auditors and to the regulator, and the extent of related party transactions. As these inquiries are ongoing there is some difficulty in getting into more detail.⁷³

- 2.66 The committee asked ASIC about its investigation into Cash Converters' poor debt collection practices. ASIC's found that Cash Converters 'systematically failed to meet regulatory guidelines on debt collection practices, including by too frequently contacting consumers.'⁷⁴ When

71 Mr Tim Mullaly, Senior Executive Leader, Financial Services Enforcement, ASIC, *Transcript*, 22 June 2018, p. 7.

72 Mr Tim Mullaly, Senior Executive Leader, Financial Services Enforcement, ASIC, *Transcript*, 22 June 2018, p. 7.

73 Mr John Price, Commissioner, ASIC, *Transcript*, 22 June 2018, p. 17.

74 ASIC, 'Cash Converters pays \$650,000 due to poor debt collection practices', *Media Release 18-149*, 24 May 2018.

asked if this frequent contact qualified as harassment and coercion, ASIC confirmed it did:

Yes. There is a prohibition in the ASIC Act against harassment and coercion. Jointly with the ACCC, we published guidelines which explain to the industry how we will apply that prohibition when it comes to debt collection practice. Those guidelines provide quite a lot of detail around the conduct that we expect, but the key prohibition is the prohibition on harassment and coercion in the ASIC Act.⁷⁵

2.67 ASIC also outlined additional action it has taken against Cash Converters around responsible lending, noting the payday lender has paid a \$1.35 million penalty and refunded close to \$11 million to consumers. ASIC commented:

...we've had a series of actions, and they've entered into a very substantial review of their business practices. So it's not just this one matter; we've had a real focus on this sector and they are a significant player in this sector. We've got penalties, remediation and changes to the way they go about their business.⁷⁶

2.68 ASIC also confirmed that Cash Converters would not be able to resume conducting its own debt collection activities without ASIC's permission.⁷⁷

2.69 When asked what redress has been made in respect of Cash Converters reporting incorrect information to Equifax, ASIC commented:

Those incorrect listings have all been corrected. To the extent that consumers had negative information placed on their credit files with Equifax, Cash Converters has corrected that.⁷⁸

Poor response of insurers to disaster events

2.70 On Christmas Day in 2015, a bushfire burned through the small Victorian coastal township of Wye River and destroyed more than 100 homes. A number of policyholders held complete replacement cover insurance policies, however their insurer, AAMI, offered significantly less money

75 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 23.

76 Mr Peter Kell, Deputy Chair, ASIC, *Transcript*, 22 June 2018, p. 23.

77 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 23.

78 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 23.

- than it cost to rebuild their homes, with shortfalls in some cases of up to half a million dollars.
- 2.71 Following an ASIC investigation, AAMI paid \$43 200 in penalties for making false or misleading statements on its website and in radio advertisements about its Home Building Insurance 'Complete Replacement Cover' policy. AAMI promoted the policy on the basis that it would repair or rebuild the insured house, no matter the cost to AAMI.⁷⁹
- 2.72 The committee noted community concerns about ASIC's investigation being a whitewash, including that ASIC could have taken action earlier and more forcefully to address AAMI's misleading conduct with respect to its insurance product.
- 2.73 The committee asked ASIC why it did not take a tougher stance on the insurer, given the flaws in the policy and the way it was sold. ASIC responded that the tragic circumstances surrounding the Wye River fire 'highlights the problem that exists in Australia with underinsurance and home-building coverage when there is a total loss', noting that the flaws in the policy were not unique to the AAMI policy.⁸⁰ ASIC remarked that there 'are many other types of home insurance policies where we do hear cases of insurers underquoting or providing responses to claims that fall short of what the consumer believes is an appropriate amount to settle that claim.'⁸¹
- 2.74 ASIC added that it has been advocating for complete replacement cover policies to be more widely available in Australia since the Canberra bushfires in 2004.⁸²
- 2.75 ASIC also said that 'there were serious deficiencies' with how AAMI handled the claims of bushfire victims.⁸³ When asked if it had addressed these deficiencies, ASIC said that it is currently powerless to act due to an exemption in the Corporations Act.⁸⁴
- 2.76 Under the Corporations Act, ASIC is responsible for ensuring that financial service providers, including insurers, fulfil the requirements of

79 ASIC, 'AAMI pays \$43,200 for misleading advertising', *Media Release 17-398*, 22 November 2017.

80 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 5.

81 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 6.

82 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 5.

83 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 5.

84 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 5.

holding an Australian Financial Service licence. This means they must provide services efficiently, honestly and fairly. However, claims handling is exempt from the definition of a financial service, which means that ASIC does not have regulatory oversight of the way consumers' claims are handled by their insurers.

2.77 ASIC noted that it has recommended this exemption be removed, most recently in its review of life insurance claims handling.⁸⁵ ASIC commented:

There is an explicit exemption; it's not an oversight. It's an explicit exemption in the settings that Parliament has put in place under the Corporations Act to exempt claims handling from, in effect, the consumer protection provisions of the Corporations Act. The parliamentary joint committee, in its recent report on life insurance, recommended that this exemption be removed. We would also like to see it removed, not just for life insurance but also for general insurance claims, and we are very pleased that the minister has committed to doing that. We also think that unfair contract terms should be extended to insurance products as well.⁸⁶

2.78 ASIC noted that the Government is proposing to remove the exemption but is awaiting the outcome of the Royal Commission.⁸⁷

ASIC funding

2.79 ASIC is currently shifting to an industry funding model, where ASIC's costs of regulation are borne by the companies it regulates, rather than the taxpayer. ASIC's regulatory costs will now be allocated across 48 industry subsectors based on the actual costs of ASIC's regulation of each subsector in the previous financial year.⁸⁸ ASIC is working with its stakeholders to implement the model in 2018 and will issue the first invoices in early 2019.⁸⁹

85 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 5. See: ASIC, *Report 498 Life insurance claims: An industry review*, 12 October 2016.

86 Mr Peter Kell, Deputy Chair, ASIC, *Transcript*, 22 June 2018, p. 6.

87 Mr Michael Saadat, Senior Executive Leader, Deposit takers, Credit and Insurers, ASIC, *Transcript*, 22 June 2018, p. 5.

88 ASIC, *ASIC Industry Funding*, June 2018, < <https://asic.gov.au/about-asic/what-we-do/how-we-operate/asic-industry-funding/>>, viewed 29 June 2018.

89 ASIC, *Annual Report 2016-17*, p. 6.

Table 2.1 Summary of ASIC revenue, appropriations and expenses, 2016–17

	2016-17 \$'000	2015-16 \$'000	Change \$'000	%
Revenues from Government (incl. ESA)	341,641	311,427	30,214	10%
Own-source revenue	7,261	5,200	2,061	40%
Total revenue	348,902	316,627	32,275	10%
Total expenses (including depreciation and amortisation)	392,460	371,223	(21,237)	(6%)
Surplus/(deficit)	(43,558)	(54,596)	11,038	20%

Source ASIC, *Annual Report 2016-17*, p. 26.

- 2.80 The committee asked ASIC how much of the industry funding it will get to retain. ASIC responded that 'it doesn't get to keep any of that money. That is money that goes to the Government – effectively reimbursement for the appropriation to ASIC.'⁹⁰ ASIC added that 'if there are recoveries of court costs or some of our investigation costs, if they relate to matters in our enforcements special account, we do retain that.'⁹¹
- 2.81 ASIC's Annual Report states that in 2016-17 it received about \$342 million from Government, including \$27 million from the Enforcement Special Account (ESA).⁹²
- 2.82 When asked what proportion of its revenue was currently industry funded, ASIC responded that it was roughly \$240 million out of \$350 million (total revenue).⁹³ ASIC confirmed that the intention was for it to be 100 per cent industry funded once the new arrangements were fully implemented.⁹⁴
- 2.83 The committee questioned ASIC on why its projected expenses were declining over the next four years. ASIC responded that it was a budgeting decision taken by the Government, but noted that the declining expenses were contributed to by a number of projects coming to an end. ASIC said it was working with the Government on several New Policy

90 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 22 June 2018, p. 12.

91 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 22 June 2018, p. 12.

92 ASIC, *Annual Report 2016-17*, p. 26.

93 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 22 June 2018, p. 12.

94 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 22 June 2018, p. 12.

Projects, including a plan to embed ASIC staff in the major banks and other firms.⁹⁵

- 2.84 ASIC was asked about its proposal to embed its staff in the major banks. The Chairman stated the approach would provide for:

...regulatory and supervisory teams that are more knowledgeable and understanding of particular institutions, have a better, more real-time, on-the-ground assessment of their risks, both financial and non-financial, and are better able to speak the same language back to the financial institution that they use so as to get effective change.⁹⁶

- 2.85 The Chairman added that the approach would help to improve the culture of the firms hosting the ASIC teams, stating 'it helps with cultural change and cultural reform inside financial institutions, which, again, is one of our key goals.'⁹⁷

Payments to charities

- 2.86 Noting that several enforceable undertakings that ASIC has entered into have required payments to be made to charities, largely by the major banks around financial literacy, the committee asked ASIC how it enforced those payments. ASIC responded that it has a process in place where it engages with the charities to confirm the money has been received and how it is being spent.⁹⁸

- 2.87 When questioned on its arrangements for monitoring Enforceable Undertakings, ASIC informed the committee that there is no single group responsible. Rather, ASIC said responsibility sits 'with the group that is responsible for, if you like, the underlying problem', providing the following example:

...the court enforceable undertakings that we took from the larger institutions in relation to the wholesale foreign exchange businesses sit with the group that's responsible for managing conduct in the wholesale foreign exchange business.⁹⁹

- 2.88 ASIC added it receives a regular report on the progress against all of the enforceable undertakings across the organisation.¹⁰⁰

95 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 22 June 2018, p. 13.

96 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 16.

97 Mr James Shipton, Chairman, ASIC, *Transcript*, 22 June 2018, p. 16.

98 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 22 June 2018, p. 14.

99 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 22 June 2018, p. 14.

100 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 22 June 2018, p. 14.

2.89 When asked who selects the charity that benefits from the Enforceable Undertaking, ASIC replied that the other party proposes the charity. ASIC stated:

We're very concerned to ensure that this is a true community benefit payment. Not only do we consider the tax status but we ask the organisations who are making the payments to confirm that they will not claim a tax deduction for that payment.¹⁰¹

Conclusion

- 2.90 The reputation of Australia's banking and financial system has been damaged by shocking examples of misconduct, in particular by the four major banks and AMP. Evidence provided to the Royal Commission has exposed the financial sector as having a corporate culture motivated by greed and lacking in moral leadership.
- 2.91 However, evidence of systemic failings has also placed ASIC in the spotlight because it is the regulator responsible for promoting investor and financial consumer trust and confidence, and ensuring fair, orderly and transparent markets. ASIC needs to be tougher. The community expects the big banks and others to fear their regulator.
- 2.92 The committee notes that the Government is undertaking significant reform of the banking and financial sector, including providing ASIC with a range of new surveillance and enforcement powers.
- 2.93 The committee also took evidence on the poor response of insurers to the Wye River bushfires in Victoria and heard that ASIC does not currently have regulatory oversight of the way consumers' claims are handled by their insurers because of an exemption in the Corporations Act. The committee notes the Government is proposing to remove the exemption but is awaiting the outcome of the Royal Commission.
- 2.94 The committee notes that ASIC imposed \$43 200 in penalties on AAMI for making false or misleading statements in its advertising. Given there has been some commentary that ASIC in the past has not been the tough and feared regulator it should be, the committee is of the view ASIC should have acted sooner and that the penalties imposed on AAMI more severe.
- 2.95 The committee supports ASIC's call to restore trust, eliminate conflicts of interest and raise standards of professionalism in Australia's financial services industry and will continue to monitor ASIC's performance in promoting cultural change. Ultimately, it is up to the leaders and
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101 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 22 June 2018, p. 14.

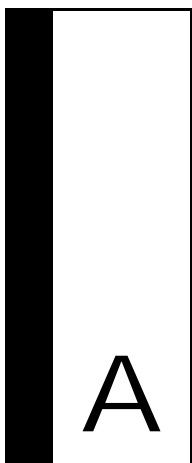
individuals in finance to treat their customers fairly, which is central to rebuilding trust in the services they offer.

- 2.96 The committee will continue to scrutinise ASIC's performance, particularly in relation to the Government's new banking and financial services regulations and initiatives.

Ms Sarah Henderson MP

Chair

22 August 2018



Appendix A – Hearing and witnesses

Public hearing

Friday, 22 June 2018 – Canberra

Australian Securities and Investments Commission

Mr James Shipton, Chairman

Mr Peter Kell, Deputy Chair

Ms Cathie Armour, Commissioner

Mr John Price, Commissioner

Warren Day, Senior Executive Leader (SEL), Assessment & Intelligence

Jane Eccleston, SEL, Investment Managers and Superannuation

Greg Kirk, SEL, Strategy Group

Louise Macaulay, SEL, Financial Advisors

Tim Mullaly, SEL, Financial Services Enforcement

Michael Saadat, SEL, Deposit takers, Credit and Insurers