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The Parliament of the Commonwealth of Australia

# **Review of the Australian Securities and Investments Commission Annual Report 2018**

House of Representatives  
Standing Committee on Economics

February 2020  
Canberra

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## Chair's foreword

On 16 October 2019, the committee scrutinised the Australian Securities and Investments Commission (ASIC) on its performance and regulatory responsibilities. This was the committee's first hearing with ASIC since the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) released its final report.

The Royal Commission found that Australia's financial sector suffered from a lack of moral leadership and a corporate culture motivated by greed. Evidence provided to the Royal Commission exposed shocking and widespread examples of misconduct and highlighted systemic failings throughout the banking and financial services sector. Revelations of further misconduct have continued to come to light following the conclusion of the Royal Commission.

The community expects the big banks and other financial institutions to be held to account and to fear their regulator. However, the Royal Commission found that ASIC had a 'deeply entrenched culture of negotiating outcomes rather than insisting upon public denunciation of, and punishment for, wrongdoing'. Commissioner Hayne emphasised that compliance with the law is not a matter of choice and that 'negotiation and persuasion, without enforcement, all too readily leads to the perception that compliance is voluntary'.

The Government has been working to implement the Royal Commission's recommendations and strengthen financial regulators to ensure a fair, strong, and efficient financial system for all Australians. In April 2019, the Government introduced a design and distribution obligations regime for financial firms as well as product intervention powers.

This will assist consumers to obtain appropriate financial products by requiring issuers and distributors of financial products to have a customer-centric approach to designing, marketing, and distributing financial products. It will also allow

ASIC to regulate, or if necessary, ban potentially harmful financial and credit products where there is a risk of significant consumer detriment.

In this report the committee scrutinises ASIC's progress implementing the changes recommended by the Royal Commission. It considers ASIC's program of change, including its new enforcement strategy, which focuses on increased and accelerated court-based outcomes and the use of new and tougher penalties; and its more intensive supervisory approach, which aims to improve the culture and behaviour of financial firms. The committee also scrutinises the advice ASIC is providing to the public for accuracy.

It is essential that we restore trust, eliminate conflicts of interest, and raise standards of professionalism in Australia's financial services industry. This will require not only the efforts of Government and regulators but the efforts and actions of leaders and individuals within the sector.

On behalf of the committee, I thank the Chair of ASIC, Mr James Shipton, and other ASIC representatives for appearing at the hearing.

**Tim Wilson MP**  
**Chair**



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## **Membership of the Committee**

**Chair** Mr Tim Wilson MP

**Deputy Chair** Hon Dr Andrew Leigh MP

**Members** Dr Anne Aly MP

Mrs Bridget Archer MP

Mr Adam Bandt MP

Mr Jason Falinski MP

Mr Craig Kelly MP

Mr Andrew Laming MP

Dr Daniel Mulino MP

Mr Ted O'Brien MP

## **Committee Secretariat**

**Secretary** Mr Stephen Boyd

**Inquiry Secretary** Ms Casey Mazzarella

**Administrative Officers** 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.





## List of abbreviations

ANZ	Australia and New Zealand Bank
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001 (Cth)</i>
ATO	Australian Tax Office
BEAR	Banking Executive Accountability Regime
BRC	Board Risk Committees
CBA	Commonwealth Bank of Australia
CCM	Close and Continuous Monitoring program
Corporations Act	<i>Corporations Act 2001 (Cth)</i>
DDO	Design and Distribution Obligations
NAB	National Australia Bank
National Credit Act	<i>National Consumer Credit Protection Act 2009 (Cth)</i>
OFR	Operating and Financial Review
RBA	Reserve Bank of Australia
ROA	Return on Assets
Royal Commission	Royal Commission into the Misconduct in the Banking, Superannuation and Financial Services Industry
SMSFs	Self-Managed Super Funds
TCFD	Task Force on Climate-related Financial Disclosures



## 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) 2018 Annual Report (annual report) stands referred to the committee in accordance with this schedule. The committee resolved at its meeting on 24 July 2019 that it would conduct an inquiry into the annual report.
- 1.3 ASIC is Australia's integrated corporate, markets, financial services, and consumer credit regulator. It is an independent Commonwealth statutory authority and administers the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the *Corporations Act 2001* (Corporations Act), as well as a range of additional legislation.<sup>1</sup>
- 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

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1 ASIC, 'Laws we administer', < <https://asic.gov.au/about-asic/what-we-do/laws-we-administer/> >, accessed 15 October 2019.

finance broking; and for supervising trading on Australian licensed equity, derivatives and futures markets.<sup>2</sup>

1.5 ASIC's vision is for 'a fair, strong and efficient financial system for all Australians'. To realise this vision, ASIC stated that it will use its regulatory tools to:

- change behaviours to drive good consumer and investor outcomes;
- act against misconduct to maintain trust and integrity in the financial system;
- promote strong and innovative development of the financial system;
- help Australians to be in control of their financial lives; and
- provide efficient and accessible business registers that make it easier to do business.<sup>3</sup>

## Areas of responsibility

1.6 As the corporate, markets, financial services, and consumer credit regulator, ASIC has a wide range of responsibilities. It is required by the ASIC Act to:

- maintain, facilitate, and improve the performance of the financial system and entities within it;
- promote confident and informed participation by investors and consumers in the financial system;
- administer the law effectively and with minimal procedural requirements;
- efficiently and quickly receive, process, and store information it receives;
- make information about companies and other bodies available to the public as soon as practicable; and
- take whatever action it can, and which is necessary, to enforce and give effect to the law.<sup>4</sup>

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2 ASIC, 'How we operate: History' <<https://asic.gov.au/about-asic/what-we-do/how-we-operate/history/>>, accessed 15 October 2019.

3 ASIC, 'Our role' <<https://asic.gov.au/about-asic/what-we-do/our-role/>>, accessed 15 October 2019.

4 ASIC, 'Our role' <<https://asic.gov.au/about-asic/what-we-do/our-role/>>, accessed 15 October 2019.

- 1.7 ASIC's service charter further describes its role in relation to corporate, market, and financial system regulation encompassing, among other activities:
- registering companies and managed investment schemes;
  - registering auditors and liquidators;
  - registering business names;
  - licensing financial services and consumer credit businesses; and
  - examining new market license proposals.<sup>5</sup>
- 1.8 ASIC maintains publically accessible registers of companies, and registered and licensed entities, as well as disqualified directors and people who are banned from the financial services industry.<sup>6</sup>
- 1.9 ASIC may also grant relief for companies or individuals from some sections of the Corporations Act and the *National Consumer Credit Protection Act 2009* (National Credit Act).<sup>7</sup>

## Enforcement outcomes

- 1.10 ASIC is responsible for pursuing companies or individuals that may have breached the laws it administers. The ASIC Act directs ASIC to 'take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it'.<sup>8</sup>
- 1.11 Following the Royal Commission's recommendation regarding ASIC's approach to enforcement, ASIC established an Office of Enforcement. The Office of Enforcement is responsible for carrying out ASIC's key enforcement activities and is functionally separate from ASIC's regulatory teams. It is comprised of ASIC's two specialist enforcement teams Markets Enforcement and Financial Services Enforcement, as well as the Enforcement Oversight Committee.<sup>9</sup>
- 1.12 ASIC advised that the Office of Enforcement will 'strengthen ASIC's enforcement culture and effectiveness' and will lead the application of

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5 ASIC, 'ASIC service charter', <<https://asic.gov.au/about-asic/what-we-do/how-we-operate/asic-service-charter/asic-service-charter/>>, accessed 15 October 2019.

6 ASIC, 'ASIC service charter', <<https://asic.gov.au/about-asic/what-we-do/how-we-operate/asic-service-charter/asic-service-charter/>>, accessed 15 October 2019.

7 ASIC, 'ASIC service charter', <<https://asic.gov.au/about-asic/what-we-do/how-we-operate/asic-service-charter/asic-service-charter/>>, accessed 15 October 2019.

8 *Australian Securities and Investments Commission Act 2001*, s. 1.

9 ASIC, *ASIC Enforcement Update: January to June 2019: Report 625*, August 2019, p. 3.

ASIC's 'Why not litigate?' operational discipline, including by developing enforcement policies.<sup>10</sup> ASIC explained that 'this approach does not mean that we take every matter to court but allows us to consider relevant factors to ensure we are doing what we should to punish past misconduct and to deter future misconduct'.<sup>11</sup>

- 1.13 In August 2019, ASIC advised that its new Office of Enforcement is now in place and that it is working to strengthen ASIC's enforcement effectiveness by accelerating court-based enforcement matters. Between July 2018 and June 2019 ASIC increased:
- the number of ASIC enforcement investigations by 20 per cent;
  - enforcement investigations involving the big six (or their officers or subsidiary companies) by 51 per cent; and
  - wealth management investigations by 216 per cent.<sup>12</sup>

## Scope and conduct of the review

- 1.14 ASIC appeared before the committee on 16 October 2019 in Canberra. This was ASIC's first appearance at a public hearing with the committee in the 46<sup>th</sup> Parliament. Details are provided at Appendix A.
- 1.15 The proceedings of the hearing were webcast 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.<sup>13</sup>
- 1.16 ASIC's responses to the committee's questions on notice and in writing are provided on the committee's website.<sup>14</sup>
- 1.17 This report focuses on matters raised at the public hearing.

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10 ASIC, *Royal Commission implementation update*, September 2019, p. 10.

11 ASIC, *ASIC Enforcement Update: January to June 2019: Report 625*, August 2019, p. 3.

12 ASIC, *ASIC Enforcement Update: January to June 2019: Report 625*, August 2019, p. 3.

13 House of Representatives Standing Committee on Economics, [https://www.aph.gov.au/Parliamentary\\_Business/Committees/House/Economics/ASICReview2018/Public\\_Hearings](https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/ASICReview2018/Public_Hearings).

14 House of Representatives Standing Committee on Economics, [https://www.aph.gov.au/Parliamentary\\_Business/Committees/House/Economics/ASICReview2018/Documents](https://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/ASICReview2018/Documents).

## **Current issues in financial systems regulation**

### **Overview**

- 2.1 The Australian Securities and Investments Commission (ASIC) appeared before the House of Representatives Standing Committee on Economics (the committee) on 16 October 2019 in Canberra for a public hearing as part of the committee's review of the ASIC Annual Report 2018.
- 2.2 Issues raised at the hearing included ASIC's new enforcement approach, consumer protections, and non-financial risk management. The committee scrutinised ASIC on its implementation of the recommendations of the Royal Commission into the Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission).
- 2.3 Other matters discussed included underperformance of superannuation funds, mortgages, audit inspection reviews, and the retail corporate bond market.

### **Financial Services Royal Commission**

- 2.4 The Royal Commission examined the conduct of financial services entities and found serious instances of misconduct and conduct falling below community expectations. The effectiveness of Australia's financial regulators, including ASIC, also came under scrutiny and were the subject of several of the Royal Commission's recommendations.
- 2.5 Commenting on ASIC's enforcement culture, Commissioner Hayne emphasised 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 neither be hidden nor ignored. Negotiation and persuasion, without enforcement, all too readily leads to the perception that compliance is voluntary. It is not.<sup>1</sup>

- 2.6 The Royal Commission's final report noted ASIC's 'deeply entrenched culture of negotiating outcomes rather than insisting upon public denunciation of, and punishment for, wrongdoing', and cautioned that, whilst remediation of consumers is important, it is 'not the only consideration relevant to the regulator'.<sup>2</sup>
- 2.7 Commissioner Hayne raised concerns 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'. Furthermore, it found 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'.<sup>3</sup>
- 2.8 The Government has 'committed to take action on all 76 of the Royal Commission's recommendations and, in a number of important areas, go further'. It has passed legislation that broadens and strengthens ASIC's powers as well as providing a range of tougher penalties for wrongdoers. Further legislation is expected to be introduced in 2020.<sup>4</sup>

## Implementation of the Royal Commission's recommendations

- 2.9 To date, ASIC has released two updates (in February and September 2019) on its progress implementing the changes recommended by the Royal Commission.<sup>5</sup> The committee scrutinised ASIC's implementation of the Royal Commission's recommendations.

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1 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, Volume 1, February 2019, pp. 424-425.

2 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, Volume 1, February 2019, pp. 424-425.

3 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report*, Volume 1, February 2019, pp. 424-425.

4 Australian Government, *Restoring trust in Australia's Financial System: Financial Services Royal Commission Roadmap*, August 2019.

5 ASIC, *Corporate Plan 2019-23: Focus 2019-20*, p. 2; ASIC, Update on implementation of Royal Commission recommendations, February 2019, <<https://download.asic.gov.au/media/5011933/asic-update-on-implementation-of-royal-commission-recommendations.pdf>>; ASIC, Royal Commission implementation update,



2.10 ASIC told the committee that it is continuing to build upon its program of change and has recently outlined its strategic priorities in its *Corporate Plan 2019-23* (Corporate Plan).<sup>6</sup> ASIC explained that:

One of the key points of departure from previous years in our corporate plan this year is that we are identifying problems that we want to solve for strategic issues in the financial services market that we believe need to be addressed... These problems are significant and they... will only be solved by applying different tools over different periods of time in different combinations ultimately to change behaviours inside the financial sector, and those behaviours need to lead ultimately to a better professional culture.<sup>7</sup>

2.11 The Corporate Plan states that over the next four years ASIC will continue to implement the change program it commenced in 2018, to bolster the effectiveness of its activities. These changes include:

- a new enforcement strategy, which focuses on increased and accelerated court-based outcomes overseen by a new Office of Enforcement and underpinned by the 'Why not litigate?' operational discipline and the use of new and tougher powers and penalties to achieve better outcomes;
- more intensive supervision to improve the culture and behaviour of financial firms, and to enhance governance practices (e.g. ASIC's Close and Continuous Monitoring (CCM) program, Corporate Governance Taskforce, and expanded oversight of financial markets);
- greater use of next-generation regulatory tools (e.g. artificial intelligence, data analytics and behavioural sciences); and
- a new internal governance framework to support effective decision- making.<sup>8</sup>

## New enforcement approach

2.12 ASIC advised the committee that it has 'significantly increased its focus on investigations and enforcement actions' following the Royal Commission and ASIC's program of change. It explained that, from February 2018, there has been a 24 per cent increase in the number of ASIC enforcement investigations and a 130 per cent increase in the number of enforcement

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September 2019, <<https://download.asic.gov.au/media/5268550/asic-royal-commission-implementation-update-published-12-september-2019.pdf>>.

6 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 2.

7 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 2.

8 ASIC, *Corporate Plan 2019-23: Focus 2019-20*, p. 2.

investigations involving the big six financial services firms or their subsidiary companies or offices.<sup>9</sup>

- 2.13 The committee asked ASIC about its higher-profile and more aggressive approach to enforcement and its performance regarding the pursuit of individuals rather than institutions. ASIC advised that it is pursuing a number of actions against directors and officers where there has been a failure to meet the standards that are required of them. ASIC explained that its approach is ‘two-pronged’:

...we need to enforce the law as regards to directors' and officers' duties. We need to make sure that there is denunciation of wrongdoing. We have to have a deterrence impact, but equally there are new tools coming our way that will have, I believe, an immediate behavioural change just because of the way they work by mapping out and articulating responsibilities and accountabilities.<sup>10</sup>

- 2.14 ASIC emphasised that ‘personal responsibility is absolutely key to the decisions being made inside financial services firms and absolutely key to the culture and the conduct and the fair deal that is required for consumers’. ASIC explained that regulatory structures in which individuals, and in particular individual leaders, are clearly aware of their responsibilities and their accountabilities will ‘go a long way’ to ensuring positive behavioural change.<sup>11</sup>

- 2.15 ASIC advised that the Government is currently working on a proposal to extend the Banking Executive Accountability Regime (BEAR) from a prudential sense through to a conduct sense. It told the committee that:

We believe that this extension of this accountability regime, so that leaders of financial institutions, particularly large ones – but as many financial institutions as possible – have a requirement under law to be responsible and accountable for the good conduct of their financial institutions, is absolutely key.<sup>12</sup>

- 2.16 In response to the committee’s question regarding optimal success rates for litigation, ASIC responded that it does not have a defined optimal success rate. It explained that ASIC ‘commences litigation when it is in the public interest to do [so] and when it considers it has reasonable basis for bringing that litigation’.<sup>13</sup>

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9 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 2.

10 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 3-4.

11 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 3-4.

12 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 3-4.

13 ASIC, *Response to question on notice*, QW8, p. 1.

- 2.17 ASIC advised that its enforcement litigation success rate has been above 90 per cent for the five years to 2018-2019. However, it noted that, given its new enforcement approach and changes to legislation, there is likely to be an increase in the complexity and uncertainty of ASIC litigation:

Success rate in any litigation is predicated on multiple factors, chief amongst them being strength of evidence accepted by the court... These changes are expected to mean more litigation against large and well-resourced institutions and in relation to new and existing laws that now carry penalties. This will mean an increase in the complexity and uncertainty of ASIC litigation. It can be expected as a consequence that ASIC's litigation risk, including the risk of not succeeding in its court actions, will increase.<sup>14</sup>

### Register of infringement notices

- 2.18 ASIC has various measures available as part of its enforcement proceedings. The committee asked whether fines that have been issued are disclosed on a public register. ASIC explained that it does not directly issue fines, which can only be levied in courts. However, ASIC can issue infringement notices in relation to alleged contraventions of some provisions, as an alternative to issuing judicial proceedings.<sup>15</sup>
- 2.19 ASIC advised the committee that it maintains a register of all infringement notices issued and paid on the ASIC website.<sup>16</sup>

### Enforcement work arising from the Royal Commission

- 2.20 ASIC stated that it has dedicated resources to Royal Commission referrals and related matters within its new Office of Enforcement. This dedicated enforcement program has an 'enhanced focus on contraventions of the financial services and credit laws by a range of financial institutions including ANZ, CBA, NAB, Westpac (the major banks), and AMP, superannuation trustees and insurers'.<sup>17</sup>
- 2.21 The Royal Commission made 13 referrals to ASIC, all of which are currently under investigation with one also in litigation. The Royal Commission also examined a number of case studies. ASIC advised that:
- 29 are currently under investigation;
  - four matters are before the court; and

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14 ASIC, *Response to question on notice*, QW8, p. 1.

15 ASIC, *Response to question on notice*, QON1, p. 3.

16 ASIC, 'Credit and ASIC Act infringement notices register', <<https://asic.gov.au/online-services/search-asics-registers/additional-searches/credit-and-asic-act-infringements-notices-register/>>, accessed 10 January 2020.

17 ASIC, *Royal Commission implementation update*, September 2019, p. 4.

- two are being considered by the Commonwealth Director of Public Prosecutions for potential criminal action.<sup>18</sup>
- 2.22 Furthermore, ASIC noted that, prior to and during the Royal Commission, a number of referrals and case studies were already under investigation. Currently, 17 case studies are under review to determine if investigations are warranted or enforcement action is available to ASIC.<sup>19</sup>
- 2.23 ASIC advised that, as at 31 July 2019, there were 88 enforcement investigations (of which 86 relate to the major banks and AMP) and 17 court actions underway within this dedicated enforcement program. In addition, 59 individuals are the subject of investigation and eight individuals were the subject of court action. A total of 82 outcomes had been achieved, including criminal, civil and administrative actions, and court enforceable undertakings.<sup>20</sup>

## **New supervisory approach**

- 2.24 ASIC highlighted its new Close and Continuous Monitoring (CCM) program, which commenced in October 2018.<sup>21</sup> It explained that CCM comprises ongoing onsite supervisory activities for financial institutions such as the big four banks and AMP. ASIC noted that, for 70 per cent of the period since CCM commenced, it has ‘actually been physically onsite interviewing and engaging with leaders, participants and employees of these financial institutions’.<sup>22</sup>
- 2.25 ASIC told the committee that CCM is a ‘very effective’ proactive regulatory tool, which creates a constructive feedback loop between ASIC, as the conduct regulator, and business leaders and market participants. It explained that:

This is the embedding process, which we have adopted following examples from overseas, particularly the United States, the United Kingdom, Hong Kong and elsewhere. What we are creating in this supervisory initiative is feedback loops to the chairs, the CEOs, the chief risk officers – the business leaders inside these financial institutions – whereby we are helping to identify issues before they become breaches of the law.<sup>23</sup>

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18 ASIC, *Royal Commission implementation update*, September 2019, p. 4.

19 ASIC, *Royal Commission implementation update*, September 2019, p. 4.

20 ASIC, *Royal Commission implementation update*, September 2019, p. 4.

21 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 2.

22 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 2.

23 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 2.

- 2.26 ASIC stated that, over the next four years, it plans to increase the number of large and complex financial services entities it monitors through the CCM program and to add additional areas of focus for its supervision.<sup>24</sup>

## Measuring performance and implementation of recommendations

- 2.27 The committee asked ASIC for its view on how best to hold financial institutions to account for their conduct against the implementation of the Royal Commission's recommendations. ASIC emphasised that it is important to consider how performance of the financial system and the financial institutions within that system is measured.<sup>25</sup>
- 2.28 ASIC advised the committee to scrutinise financial institutions on how they are measuring outcomes for consumers. It cautioned that only using a Net Promoter Score index, or metric, has 'proven not to be accurate as regards broader community understanding as to the performance of the financial system and financial institutions more broadly'.<sup>26</sup>
- 2.29 ASIC told the committee that leaders of financial institutions should explain how they are measuring their performance and ensuring fair outcomes for their customers and accountability within their institutions.<sup>27</sup>

## Consumer protections

### Disclosure

- 2.30 Financial services disclosure (disclosure) refers to the information that the law mandates must be provided to consumers by firms. It presents material information about the characteristics, fees, and/or risks of financial products and services. Disclosure is intended to inform consumers and assist them to make 'good' financial decisions.
- 2.31 In October 2019, ASIC published a report that found that disclosure and warnings for financial products can be less effective than expected, or even ineffective, in influencing consumer behaviour. Furthermore, it found that, in some instances, disclosure and warnings can backfire, contributing to consumer harm.<sup>28</sup>
- 2.32 The committee asked ASIC whether the problems regarding disclosure are the result of the complexity of the products, or the way in which

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24 ASIC, *Corporate Plan 2019-23: Focus 2019-20*, p. 6.

25 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 16.

26 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 16.

27 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 16.

28 ASIC and AFM, *Disclosure: Why it shouldn't be the default*, October 2019.

disclosures are presented to consumers. The committee questioned whether complexity is sometimes unnecessary and intentional, seeking to make disclosure less useful for consumers.

2.33 ASIC explained that, more often than not, disclosure, especially long-form disclosure is not an effective consumer protection. Furthermore, it confirmed that it found examples 'where firms are, perhaps without good intent, working around disclosure or misusing it to the disadvantage of consumers'.<sup>29</sup>

2.34 ASIC told the committee that behavioural economics research shows that once a product has more than two or three features it is very difficult for consumers to make an objective and informed decision. It noted that even ubiquitous products, such as credit cards, will often have a large number of features attached. Many of these features are not of value of the consumer but make it very difficult to compare products.<sup>30</sup>

2.35 ASIC also raised concerns about 'sludge', a term in behavioural economics that refers to firms actively taking advantage of behaviourally-informed strategies to profit from the lack of scrutiny that consumers apply.<sup>31</sup> ASIC explained that:

Sludge is where there are unnecessary frictions in the market that make it very difficult for a consumer. It's easy for them to get into a product; it's very difficult for them to get out of a product. But also, for example, it's very difficult for a consumer to lodge a complaint...sludge gets in the way, ultimately, of the accountable person within that firm, let alone the directors, knowing that complaints are being lodged, and thus we've got products that are actually a form of toxic revenues and not a form of good revenues, which is what we saw play out in the royal commission.<sup>32</sup>

2.36 ASIC advised that it is conducting thematic reviews of particular product markets to consider consumer outcomes and will 'call out' unnecessary complexity and sludge. It noted that it has recently 'called out' sludge regarding consumer credit insurance and internal dispute resolution. ASIC explained that 'we used what we found from that sludge – the unnecessary frictions for consumers – to inform the guidance that we've provided to firms around what we expect with better internal dispute resolution arrangements going forward'.<sup>33</sup>

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29 Ms Karen Chester, Deputy Chair, ASIC, *Transcript*, 16 October 2019, p. 14.

30 Ms Karen Chester, Deputy Chair, ASIC, *Transcript*, 16 October 2019, pp. 14-15.

31 Richard H. Thaler, 'From Cashews to Nudges: The Evolution of Behavioural Economics', *American Economic Review*, 2018, 108(6), p. 1285.

32 Ms Karen Chester, Deputy Chair, ASIC, *Transcript*, 16 October 2019, p. 15.

33 Ms Karen Chester, Deputy Chair, ASIC, *Transcript*, 16 October 2019, p. 18.

2.37 ASIC advised the committee that the design and distribution obligations, which are scheduled to come into effect in April 2021, should address the shortfalls of disclosure and combat sludge:

We'd like to think that, if firms do what they're obliged to do by those requirements, the case studies that we saw in the royal commission are less likely to be seen. The one common thread across all of the royal commission case studies is that if firms had met their design and distribution obligations and not just relied on disclosure then we wouldn't have had those case studies.<sup>34</sup>

### **Design and distribution obligations and product intervention powers**

2.38 In April 2019, the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* introduced a design and distribution obligations regime for financial services firms as well as a product intervention power.

2.39 The design and distribution obligations (DDO), which are scheduled to come into effect in April 2021, aim to assist consumers to obtain appropriate financial products by requiring issuers and distributors of financial products to have a customer-centric approach to designing, marketing, and distributing financial products. Criminal and civil penalties apply for breaching the obligations.<sup>35</sup>

2.40 The product intervention powers, which are currently in effect, allows ASIC to regulate, or if necessary, ban potentially harmful financial and credit products where there is a risk of significant consumer detriment. The power is intended to enable ASIC to take action before harm, or further harm, is done to consumers. Criminal and civil penalties apply to contraventions of the new arrangements.<sup>36</sup>

2.41 ASIC described the design and distribution obligations and product intervention powers as 'bookends'. It explained that products that meet the design and distribution obligations should, as a result, avoid creating significant consumer detriment in the market and therefore will not require the use of the product intervention powers.<sup>37</sup>

2.42 ASIC told the committee that this is a 'new frontier in regulation' in which regulation is proactive rather than just reactive.<sup>38</sup> It described the new

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34 Ms Karen Chester, Deputy Chair, ASIC, *Transcript*, 16 October 2019, p. 15.

35 Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019, *Revised Explanatory Memorandum*, pp. 5-6.

36 Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019, *Revised Explanatory Memorandum*, pp. 43-44.

37 Ms Karen Chester, Deputy Chair, ASIC, *Transcript*, 16 October 2019, p. 16.

38 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 17.

product intervention powers as a 'game-changer for rebalancing the onus away from the consumer and to the firm in terms of doing the right thing'<sup>39</sup>:

It is about the performance of the product...going forward, instead of it being a long-form document around an insurance product, which is still required, it's asking firms to look at things about how are you going to measure the performance of that product in terms of how it affects the consumer? So good issues that we would look at when we're doing thematic reviews on looking at the performance...are claims outcomes, loss ratios, and complaints through internal dispute resolution and external dispute resolution. These are the sort of things that we, ASIC, will be looking at as the regulator when we are looking at the effectiveness of competition and the performance of firms in markets, consumer outcome measures, but it is also what we're expecting firms to do in meeting those obligations going forward.<sup>40</sup>

## Superannuation

- 2.43 The committee noted that superannuation is a very complex multidimensional product and asked ASIC how regulation should be considered in this context. ASIC explained that superannuation is particularly challenging as it is complex; people are compelled through the superannuation guarantee to have it; and it has cognitive biases, especially for young people, as people tend to only focus on it as they approach retirement.<sup>41</sup>
- 2.44 ASIC told the committee that its recent report on disclosure highlighted issues regarding overreliance on short form disclosure, such as superannuation dashboards, and consumers misjudging the quality of advice they receive regarding their retirement. ASIC explained that 81 per cent of consumers thought that the retirement advice they had received was of very good quality, but an expert panel that was formed by ASIC and reviewed the advices found that only three per cent were of good quality.<sup>42</sup>

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39 Ms Karen Chester, Deputy Chair, ASIC, *Transcript*, 16 October 2019, p. 14.

40 Ms Karen Chester, Deputy Chair, ASIC, *Transcript*, 16 October 2019, p. 18.

41 Ms Karen Chester, Deputy Chair, ASIC, *Transcript*, 16 October 2019, p. 18.

42 Ms Karen Chester, Deputy Chair, ASIC, *Transcript*, 16 October 2019, p. 18.



- 2.45 ASIC noted that research conducted by Professor Hazel Bateman and colleagues about superannuation dashboards found that:
- the choices of more than 35 per cent of participants were not significantly impacted by any of the prescribed information items;
  - even simplified risk information was irrelevant to the decisions of approximately three quarters of participants;
  - only 5 per cent of participants used all or almost all of the prescribed information and, at times, these participants used the information in unexpected ways; and
  - consumer choice could easily be manipulated through the ‘dashboard’ form – for example, by relabelling or reweighting asset allocation information used in the pie chart.<sup>43</sup>
- 2.46 ASIC told the committee that there is a lot of information about superannuation available to consumers in various formats. It plans to conduct consumer testing around and consumer development to determine what information is available, what information is useful, and how best to assist consumers in this space.<sup>44</sup>
- 2.47 ASIC acknowledged that ‘it is very clear from the government and also from the royal commission that we need to take a lead role as the conduct regulator in superannuation’. It advised that ASIC is also focusing ‘very intently’ on trustee duties. ASIC told the committee that it currently has 21 cases of investigation underway ‘in relation to the superannuation space’.<sup>45</sup>

## Surveillance of underperforming funds

- 2.48 The committee noted that the Productivity Commission’s report, *Superannuation: Assessing Efficiency and Competitiveness*, identified a significant number of underperforming superannuation funds, including some with excessive fees. The committee asked whether ASIC’s program of targeted surveillance of superannuation funds would address this issue.
- 2.49 ASIC advised that it is carrying out a surveillance project focused on persistently underperforming funds in FY2019-20. The project ‘seeks to identify if the underperformance arises from actionable misconduct, such as contraventions of laws concerning conflicts of interest, failure to act in members’ best interests, or lack of diligence by trustees’.<sup>46</sup>

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43 ASIC, *Response to question on notice*, QW6, p. 1.

44 Ms Danielle Press, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 18.

45 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 3.

46 ASIC, *Response to question on notice*, QW5, p. 1.

- 2.50 ASIC told the committee that its intent is to change the behaviour of superannuation trustees through ‘identification and punishment of historical and present misconduct that may give rise to fund persistent underperformance’. It explained that ‘by focusing attention on misconduct by trustees that is associated with persistent underperformance, this stream of work should deter particular behaviours of trustees that are likely to cause persistent underperformance’.<sup>47</sup>

## Self-Managed Super Funds

- 2.51 The committee noted that concerns have been raised in the media<sup>48</sup> regarding advice<sup>49</sup> that ASIC issued about Self-Managed Super Funds (SMSFs). The committee asked whether ASIC considered its advice to be accurate and balanced. In particular, the committee questioned ASIC’s advice that:
- generally, balances under \$500,000 have lower returns after expenses and tax compared to industry and retail super funds;
  - it takes over 100 hours a year to run a SMSF; and
  - the average cost of running a SMSF is \$13,900 per year.
- 2.52 ASIC told the committee that it believes that its data is accurate and drawn from reputable sources, predominantly the Australian Tax Office (ATO) and Productivity Commission. ASIC assured the committee that its advice is not intended to scare people out of using SMSFs, rather it is intended to raise issues that consumers should be considering when going into a SMSF:
- For some people, SMSFs are absolutely the right outcome and the right option. For others, they're not. We think that the benefits are well articulated but the risks are not as well articulated. We think that consumers deserve to have those red flags highlighted to them before they make a decision that is very difficult to unwind.<sup>50</sup>
- 2.53 The committee asked whether ASIC’s advice was implying that consumers with balances less than \$500,000 should not have a SMSF. ASIC responded that research from the Productivity Commission found that for balances lower than \$500,000, a SMSF will, on average, underperform an APRA regulated fund. ASIC explained that:

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47 ASIC, *Response to question on notice*, QW5, p. 1.

48 James Kirby, ‘Swashbuckling ASIC butchers SMSF advice’, *The Australian*, 15 October 2019.

49 ASIC, *Self-managed super funds: Are they for you?*, <<https://download.asic.gov.au/media/5301438/self-managed-superannuation-funds-are-they-for-you.pdf>>, accessed 29 October 2019.

50 Ms Danielle Press, Commissioner, ASIC, *Transcript*, 16 October 2019, pp. 4-5.

The bigger issue is [for consumers with funds that] are less than \$500,000 with no way of increasing to that number. So it's really about a question to the adviser, 'Is this right for me?' It's not a limit on saying, 'If you don't have \$500,000 you should never have an SMSF.' It is a question of asking the adviser, 'Why is this the right answer for me?'<sup>51</sup>

- 2.54 When asked about the average returns for low-balance SMSFs, ASIC advised that, for the period 2016-17 (and the preceding two financial years), SMSFs with a balance of less than \$200,000 had a negative return on assets (ROA) when compared to SMSFs with a balance of more than \$200,000.<sup>52</sup>
- 2.55 ASIC explained that, in 2016-17, the ROA for SMSFs with a balance of more than \$100,000 but less than \$200,000 was -0.48 per cent, whereas the ROA for SMSFs with a balance of more than \$200,000, but less than \$500,000 was 4.65 per cent (see Table 2.1).<sup>53</sup>

**Table 2.1 SMSF average ROA by fund size, 2012-13 to 2016-17**

Fund size	2012-13	2013-14	2014-15	2015-16	2016-17
\$1 - \$50k	-17.29%	-12.57%	-17.43%	-17.27%	-14.67%
>\$50k - \$100k	-5.22%	-2.86%	-6.78%	-7.27%	-5.39%
>\$100k - \$200k	0.82%	1.50%	-1.05%	-3.41%	-0.48%
>\$200k - \$500k	6.34%	5.88%	2.42%	0.04%	4.65%
>\$500k - \$1m	9.29%	8.32%	4.59%	1.50%	7.01%
>\$1m - \$2m	10.64%	9.58%	5.70%	2.33%	8.37%
>\$2m	11.61%	11.30%	7.54%	4.66%	12.89%

Source ASIC, *Response to question on notice, QON2, p. 1.*

## Mortgages

### Responsible lending case

- 2.56 In March 2017, ASIC commenced Federal Court proceedings alleging that, during the period between December 2011 and March 2015, Westpac failed to properly assess whether borrowers could meet their repayment obligations before entering into home loan contracts.<sup>54</sup>
- 2.57 In August 2019, Perram J ruled that Westpac had not breached the responsible lending provisions of the *National Consumer Credit Protection*

51 Ms Danielle Press, Commissioner, ASIC, *Transcript*, 16 October 2019, pp. 4-5.

52 ASIC, *Response to question on notice, QON2, p. 1.*

53 ASIC, *Response to question on notice, QON2, p. 1.*

54 ASIC, 'ASIC commences civil penalty proceedings against Westpac for breaching home-loan responsible lending laws', *Media Release 17-048MR*, 1 March 2017.

*Act 2009* (National Credit Act).<sup>55</sup> He found that ‘a credit provider may do what it wants in the assessment process’.<sup>56</sup> Perram J explained that the National Credit Act:

...requires a credit provider to ask itself only whether ‘the consumer will be unable to comply with the consumer’s financial obligations under the contract’ or, alternatively, whether the consumer ‘could only comply with substantial hardship’...the Act is silent on how the credit provider answers these questions’.<sup>57</sup>

2.58 In September 2019, ASIC filed an appeal with the Full Federal Court of Australia. ASIC explained that ‘ASIC considers that the Federal Court’s decision creates uncertainty as to what is required for a lender to comply with its assessment obligation, nor does ASIC regard the decision as consistent with the legislative intention of the responsible lending regime’.<sup>58</sup>

2.59 The committee asked what ASIC had learned from this case. ASIC explained that it is currently developing additional guidance regarding responsible lending. However, it noted that its guidance does not have the force of law. When asked whether this was a deficit, ASIC disagreed. It stated that ‘at the end of the day, we can provide our interpretation of what the obligations are and it’s up to the individual licensees and entities to determine for themselves whether they agree or not with our interpretation’.<sup>59</sup>

## Tracker mortgages

2.60 A tracker mortgage is a type of variable rate mortgage with the interest rate fixed at a set percentage point above a benchmark rate. In some jurisdictions around the world, this is the common or only type of variable rate mortgage. Variable rate mortgages that are not tied to an underlying benchmark, which are common in Australia, are less common in other jurisdictions.<sup>60</sup>

55 *National Consumer Credit Protection Act 2009*, s. 131(2)(a).

56 *Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial)* [2019] FCA 1244 (13 August 2019) [82].

57 *Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial)* [2019] FCA 1244 (13 August 2019) [3-5].

58 ASIC, ‘ASIC to appeal Westpac responsible lending Federal Court decision’, *Media Release 19-246MR*, 10 September 2019.

59 Mr Sean Hughes, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 16.

60 ASIC, ‘Briefing on Competition and Tracker Mortgages’, *Tabled Document No. 2*, received from Mr Greg Medcraft, Chair, ASIC, 19 October 2016, Senate Economics Legislative Committee, p. 3.

- 2.61 The committee noted that, in 2016, ASIC encouraged lenders to offer tracker mortgages, as it would 'bring a number of benefits to consumers and overcome some perceived issues in variable rate home loans currently on offer'.<sup>61</sup> The committee asked whether ASIC still held this view.
- 2.62 ASIC responded that it is now 'agnostic' regarding tracker rate mortgages. It advised that 'it is a matter for the market to determine what products they wish to offer to consumers'. ASIC pointed to the ACCC's recently launched inquiry into home loan pricing, noting that it 'would be the appropriate vehicle to look at those sorts of products'.<sup>62</sup>
- 2.63 ASIC explained that, since 2016, several large financial institutions had considered the economics of offering tracker mortgages. However, it was found that the changes in rates had an added degree of risk for the financial institution, and, because of this, the interest rate offerings were not able to be competitive in the current environment.<sup>63</sup>

## Audit inspection reviews

- 2.64 The committee raised the findings of ASIC's 2017-18 audit inspection report, noting that it found 50 per cent of audit reviews had identified significant deficiencies. Table 2.2 lists the percentage of the key audit areas that ASIC reviewed on a risk basis where it found that auditors did not obtain reasonable assurance that the financial report as a whole was free of material misstatement.<sup>64</sup>

**Table 2.2 ASIC findings by number and size of firms inspected**

Type of firm	18 months to 30 June 2018	18 months to 31 December 2016
Largest six firms	20 per cent	23 per cent
Other national and network firms	29 per cent	31 per cent
All firms	24 per cent	25 per cent

Source ASIC, *Report 607: Audit inspection program report for 2017-18, January 2019*, pp. 9-10.

- 2.65 The committee noted that ASIC publishes aggregated statistics about audit quality, but not the individual concerns that have been raised. It also

61 ASIC, 'Briefing on Competition and Tracker Mortgages', *Tabled Document No. 2*, received from Mr Greg Medcraft, Chair, ASIC, 19 October 2016, Senate Economics Legislative Committee, p. 3.

62 Mr Sean Hughes, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 6.

63 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 6.

64 ASIC, *Report 607: Audit inspection program report for 2017-18, January 2019*, pp. 9-10.

noted that ASIC did not name the auditor or state whether the problem is due to the company, the auditor, or both. The committee questioned whether the release of firm-by-firm data would improve transparency and encourage firms to avoid 'cosy' audit relationships.

- 2.66 ASIC explained that Section 127 of the *Australian Securities and Investments Commission Act 2001* (ASIC Act) prevents it from releasing information obtained using its compulsory powers without the consent of the parties involved. However, it advised that it will be publishing ongoing firm-by-firm data for the four largest audit firms, as these firms have already consented and released their individual firm data relating to findings from ASIC's audit surveillance program.<sup>65</sup>
- 2.67 ASIC noted that the identity of the auditor of a company that has made material changes to net assets and profit following ASIC enquiries can already be ascertained from the relevant financial report of the company, which is public information. It explained that 'whether or not any change is due to failings of an individual within the company or the company auditor is a serious matter raising legal issues around the adequacy of evidence to support such a statement, natural justice and possibly defamation'.<sup>66</sup>
- 2.68 ASIC told the committee that it 'would not suggest the lack of care of an auditor of a company has led to material changes to financial reports if [it had] not comprehensively investigated the role of that auditor, formed a view that the evidence clearly establishes those facts to the standard required at law, and taken action against them'.<sup>67</sup>
- 2.69 ASIC cautioned that it is important to remember that, while the audit is an important independent checking process of the financial results, 'just because there's a problem in that checking process does not mean there's a problem in the financial results'.<sup>68</sup>

## Non-financial risk management

- 2.70 In October 2019, ASIC published a report on director and officer oversight of non-financial risk. The report highlighted important shortcomings in corporate governance practices in large listed entities. Focusing primarily

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65 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 8.

66 ASIC, *Response to question on notice*, QW4, p. 1.

67 ASIC, *Response to question on notice*, QW4, p. 1.

68 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 8.

on the oversight and management of compliance risk, ASIC's review found that:

- All too often, management was operating outside of board-approved risk appetites for non-financial risks, particularly compliance risk. Boards need to actively hold management accountable for operating within stated risk appetites.
- Monitoring of risk against appetite often did not enable effective communication of the company's risk position. Boards need to take ownership of the form and content of information they are receiving to better inform themselves of the management of material risks.
- Material information about non-financial risk was often buried in dense, voluminous board packs. It was difficult to identify key non-financial risk issues in information presented to the board. Boards should require reporting from management that has a clear hierarchy and prioritisation of non-financial risks.
- Companies generally sought to use board risk committees (BRCs) to achieve desired outcomes, but their effectiveness could be improved. BRCs should meet more regularly, devote enough time and be actively engaged to oversee material risks in a timely and effective manner.<sup>69</sup>

- 2.71 ASIC noted that there is no 'one size fits all' solution to these findings. It encouraged boards to proactively identify and assess their own characteristics and processes as well as promoting the oversight of non-financial risk.<sup>70</sup>
- 2.72 The committee asked whether ASIC intends to continue to monitor the way boards are considering and managing non-financial risk to provide further guidance or further actions. The committee also questioned whether ASIC's work is overlapping with APRA's work, such as its qualitative examinations of culture changes in financial organisations.
- 2.73 ASIC told the committee that this review was an extension of the self-assessments which were required by APRA from large financial institutions. ASIC explained that, from a macro perspective, the report was written in a 'principled fashion so that there can be lessons learned by most, if not all directors – particularly those of listed companies'. ASIC told the committee that it would like all companies to read the report and

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69 ASIC, *Corporate Governance Taskforce: Director and officer oversight of non-financial risk*, October 2019, pp. 2-3.

70 ASIC, *Corporate Governance Taskforce: Director and officer oversight of non-financial risk*, October 2019, p. 3.

consider how the findings apply to their management and consideration of non-financial risk.<sup>71</sup>

- 2.74 ASIC advised that, from a micro perspective, the review is also creating a supervisory feed-back loop by also providing specific observations to participating entities. Each of the entities that were part of the non-financial risk exercise (AMP, ANZ, CBA, the Insurance Group, IOOF, NAB, and Westpac) were provided direct feedback about how they can better process, manage, identify, and deal with non-financial risk in their company-specific situation.<sup>72</sup>
- 2.75 ASIC also addressed commentators' criticisms that the report is asking directors to become managers:
- It is not asking directors to fill the shoes of officers or managers. What it is asking directors to do is to be aware, be inquisitive, look at the structures and the processes around information flows and the identification of non-financial risks so that the boards and board risk committees can be armed with information so that they can exercise their important obligations of diligence and responsibility in order to help management best manage non-financial risks and, for that matter, risks more broadly.<sup>73</sup>
- 2.76 The committee asked ASIC whether its review of oversight of non-financial risk only looked at whether the board had or had not considered the risk – 'a tick box' – or if it had examined the substance of the consideration and decision regarding the risk.
- 2.77 ASIC emphasised that the responsibilities placed on directors are 'profound' and that directors have 'tremendous responsibilities to act with care and to act diligently and responsibly'. It explained that directors have a 'responsibility in the particular circumstances of their company and of their industry and of the environment...in which they operate to then determine the factors and considerations they need to act on by way of disclosure of risk statements or development of business plans or strategy'.<sup>74</sup>
- 2.78 The committee noted that there appeared to be a lack of clarity regarding how ASIC and the courts may determine whether a board had or had not appropriately considered non-financial risk – falling somewhere in between a tick box and examining the substance of the consideration and decision.

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71 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, pp. 19-20.

72 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, pp. 19-20.

73 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 20.

74 Mr James Shipton, Chair, ASIC, *Transcript*, 16 October 2019, p. 20.



2.79 ASIC advised the committee that the Australian Institute of Company Directors has issued a forward governance agenda, which covers many aspects of non-financial risk. In addition, the Governance Institute of Australia, together with the Australian Institute of Company Directors, have retained counsel to provide best practice recommendations around minute-taking within companies.<sup>75</sup>

## Disclosure of climate change related risks and opportunities

2.80 In August 2019, ASIC updated its guidance regarding the disclosure of climate change related risks and opportunities.<sup>76</sup> This was in response to the Government response to recommendations of the Senate Economics Committee's report on Carbon Risk<sup>77</sup>, which encouraged ASIC to 'review its guidance material to ensure that it continues to provide appropriate principles and high level guidance that stakeholders can apply in meeting their disclosure obligations'.<sup>78</sup>

2.81 In September 2018, ASIC conducted a review of climate risk disclosures. It made a number of recommendations for listed companies, including that companies should:

- consider climate risk – directors and officers of listed companies should adopt a probative and proactive approach to emerging risks, including climate risk;
- comply with the law – s. 299A(1)(c) of the *Corporations Act 2001* (Corporations Act) requires disclosure of material business risks affecting future prospects in an operating and financial review (OFR); and
- disclose useful information to investors – specific disclosure is more useful than general disclosure.<sup>79</sup>

2.82 ASIC advised the committee that, under s. 180 of the Corporations Act, directors are required to act with 'due care and diligence' and that this applies to dealing with risk to the business.<sup>80</sup> ASIC pointed to the Hutley legal opinion, which asserts that 'company directors that fail to consider climate risks now could be found liable of breaching their duty of care and

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75 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 20.

76 ASIC, 'ASIC updates guidance on climate change related disclosure', *Media Release 19-208MR*, 12 August 2019.

77 Senate Economics References Committee, *Carbon Risk: a burning issue*, April 2017.

78 Government response to *Carbon Risk: a burning issue*, March 2018, <[https://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Carbonriskdisclosure45/Government\\_Response](https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Carbonriskdisclosure45/Government_Response)>.

79 ASIC, *Report 593: Climate risk disclosure by Australia's listed companies*, September 2018, p. 4.

80 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 10.

diligence in the future...a negligence allegation against a director who had ignored climate risk was likely to be only a matter of time'.<sup>81</sup>

- 2.83 In response to the committee's question regarding how climate risk is calculated, ASIC explained that risk includes consideration of changes in climate and more extreme weather events as well as transition risks. It advised that risk is assessed based on the guidance and frameworks for climate-related financial disclosures released by the Taskforce on Climate-Related Financial Disclosures.<sup>82 83</sup>

### Calculating transition risk

- 2.84 The Reserve Bank of Australia (RBA) Financial Stability Review noted that Australian financial institutions that have exposure to carbon-intensive industries will be exposed to transition risk. It explained that 'sudden or unexpected regulatory change could quickly lower the value of such assets or businesses, some of which may become economically unviable'. Furthermore, the RBA noted that 'such regulatory changes could either be domestic or come from abroad, given the carbon intensity of Australia's exports'.<sup>84</sup>

- 2.85 The committee noted the Governor of the Bank of England, Mark Carney's, recent comments that some of the most sophisticated institutions are 'degree-rating' their portfolios, when considering climate change, and currently estimate that their portfolios are consistent with more than two degrees of warming above pre-industrial levels. Dr Carney told the Commons Treasury Committee that:

...the Japan pension fund...estimates that its portfolio is consistent with 3.7° warming. That is not a point-in-time estimate, but it is looking at the strategies of the companies and countries that it holds assets of and at where they are headed, where temperatures would stabilise. That is a pension fund that actively manages down that degree warming as one of its objectives. Major insurance companies also do this – AXA and Allianz are two examples that are somewhere in the same area. It indicates that if you price the capital markets, all the assets are probably – I am not giving you a precise figure – north of 4° for the capital markets as

81 Noel Hutley SC and Sebastian Hartford Davis, *Climate Change and Directors' Duties: Supplementary Memorandum of Opinion*, Centre for Policy Development, March 2019, p. 2.

82 The Taskforce's 31 members were chosen by the Financial Stability Board (an international body that monitors and makes recommendations about the global financial system) to include both users and preparers of disclosures from across the G20's constituency covering a broad range of economic sectors and financial markets.

83 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 9.

84 Reserve Bank of Australia, *Financial Stability Report*, October 2019, p. 58.

a whole. AXA prices US Treasuries at 5.4%, to give you an example.<sup>85</sup>

- 2.86 The committee asked ASIC whether companies are required to take Australia's international commitments, such as the Paris Agreement's commitment to limit global warming to 1.5 degrees above pre-industrial levels, as well as the pathways necessary to reach those commitments into account when calculating and disclosing transition risk.
- 2.87 ASIC responded that there are a wide range of factors that directors need to take into account when making assessments about risk but there is a degree of flexibility in what weighting is applied to those particular factors. It noted that, while this has not yet been tested in court, 'courts are unlikely to come back saying "We require disclosure against a mandated, specific scenario in terms of temperature"'.<sup>86</sup>
- 2.88 The committee asked whether ASIC believed that Australian companies are adequately planning for a two-degree world and the transition to a two-degree world. ASIC, noting that it had yet to start the second round of surveillance, advised that, based on the work it did last year, 17 per cent of listed companies in its sample identified climate risk as a material risk. ASIC explained that:
- The majority of larger companies, and I'm talking here about ASX 100 companies, had considered climate risk to some extent as part of the company's business. That goes back to my earlier point around companies needing to have a probative sort of system to think about these risks. But outside larger entities, particularly the smaller end of the listed market, there was a way to go.<sup>87</sup>
- 2.89 When the committee asked whether Task Force on Climate-related Financial Disclosures (TCFD) standards should be mandatory, ASIC noted that it is a policy matter for government. However, ASIC advised that 'the TCFD standard is fast becoming the *de facto* standard that companies are adopting'.<sup>88</sup>

## Surveillance

- 2.90 ASIC confirmed that it will be conducting surveillance of climate change related disclosure practices in the coming year, noting that this will be its

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85 Dr Mark Carney, Governor, Bank of England, House of Commons Treasury Committee, *Oral Evidence: Bank of England Financial Stability Reports*, HC 681, 15 October 2019, p. [17].

86 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 12.

87 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 13.

88 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 14.

second round of surveillance. ASIC explained that its surveillance considers two important disclosure obligations:

- prospectuses when raising funds, which have very stringent legal obligations as to the level of disclosure that is required; and
- OFRs, an annual disclosure document that listed entities are required to publish outlining 'challenges there might be to a company's strategy, future risks and prospects going forward'.<sup>89</sup>

- 2.91 ASIC advised that it scrutinises the public disclosures that relevant companies have made and weighs the disclosures against the legal requirements. If ASIC has questions regarding the disclosures, it will raise its concerns with the company.<sup>90</sup>
- 2.92 ASIC emphasised that its focus is primarily on the 'process of the disclosure and looking at how the disclosure has been made'. However, ASIC noted that if there is concern that a disclosure statement may be misleading or deceptive it 'clearly enlivens our jurisdiction'.<sup>91</sup>

## Retail corporate bond market

- 2.93 The committee noted that the 2014 Financial System Inquiry found that the Australian retail corporate bond market has faced a range of constraints that have limited the market's development.<sup>92</sup> The committee asked ASIC if greater transparency could facilitate a more liquid bond market.
- 2.94 ASIC explained that it is difficult to pinpoint exactly what is affecting the liquidity of the domestic bond market. It noted that there are questions regarding whether there is sufficient liquidity to have a significant, viable market. ASIC advised that the Government is currently consulting on further reforms to develop and encourage the market.<sup>93</sup>

## Beneficial ownership register

- 2.95 The committee asked ASIC for its view regarding the establishment of a beneficial ownership register to make clear who really owns shares, rather than allowing shell companies to hide the true owners of firms. ASIC advised that beneficial ownership requirements were in place in the past

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89 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 9.

90 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 9.

91 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, pp. 10-11.

92 Australian Government, *Financial System Inquiry, Final Report*, December 2014, p. 263.

93 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 16 October 2019, pp. 6-7.

- but were removed. However, it noted that Treasury had recently conducted consultations on some beneficial ownership requirements being reinserted into the law to assist in combating financial crimes.<sup>94</sup>
- 2.96 ASIC told the committee that there are practical challenges to beneficial ownership reforms, such as the difficulty of enforcing the provisions for international shareholders as well as the difficulty of gathering information about ownership structures from overseas jurisdictions.<sup>95</sup>
- 2.97 ASIC explained that companies can seek to trace the ownership of certain shareholdings using ownership tracing provisions in the Corporations Act. Furthermore, if satisfactory answers about ownership cannot be found, companies can approach ASIC, which has powers to trace share ownership.<sup>96</sup>
- 2.98 ASIC advised that the issue of beneficial owners is 'effectively' addressed by the current substantial shareholder regime.<sup>97</sup> The Corporations Act requires a person to make a substantial holding disclosure once a person (together with their associates) has relevant interests in voting shares or interests carrying five per cent or more of total votes.<sup>98</sup>
- 2.99 ASIC acknowledged that a beneficial ownership register may provide benefits to regulators but questioned whether it would benefit consumers:
- There are obviously benefits to regulators like us who surveil the markets. The more information we get is very useful. But whether there's any benefit for a consumer to know that Fred Smith or somebody else has got three per cent or two per cent of a company I think is a really interesting question.<sup>99</sup>
- 2.100 However, ASIC noted that there is mixed feedback from business regarding whether beneficial ownership provisions would be useful for the operation of business more broadly.<sup>100</sup>

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94 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 7.

95 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 7.

96 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 7.

97 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 7.

98 *Corporations Act 2001*, s. 671B.

99 Ms Cathie Armour, Commissioner, ASIC, *Transcript*, 16 October 2019, p. 7.

100 Mr John Price, Commissioner, ASIC, *Transcript*, 16 October 2019, pp. 7-8.

## Conclusion

- 2.101 The Royal Commission found that Australia's financial sector suffered from a lack of moral leadership and a corporate culture motivated by greed. Evidence provided to the Royal Commission exposed shocking and widespread examples of misconduct and highlighted systemic failings throughout the banking and financial services sector. Revelations of further misconduct have continued to come to light, following the conclusion of the Royal Commission.
- 2.102 The community expects the big banks and other financial institutions to be held to account and to fear their regulator. However, the Royal Commission found that ASIC had a 'deeply entrenched culture of negotiating outcomes rather than insisting upon public denunciation of, and punishment for, wrongdoing'. Commissioner Hayne emphasised that compliance with the law is not a matter of choice and that 'negotiation and persuasion, without enforcement, all too readily leads to the perception that compliance is voluntary'.
- 2.103 The committee notes that the Government has been working to quickly implement the Royal Commission's recommendations and strengthen financial regulators. In particular, the introduction of the design and distributions obligations and product intervention powers. This will assist consumers to obtain appropriate financial products and enable ASIC to take action before harm, or further harm, is done to consumers.
- 2.104 The committee notes ASIC's progress regarding the implementation of the Royal Commission's recommendations, in particular ASIC's new enforcement strategy, which focuses on increased and accelerated court-based outcomes and the use of new and tougher penalties; and its more intensive supervisory approach, which aims to improve the culture and behaviour of financial firms. It also notes the significant increase in the number of ASIC enforcement investigations.
- 2.105 It is essential that we restore trust, eliminate conflicts of interest, and raise standards of professionalism in Australia's financial services industry. This will require not only the efforts of Government and regulators but the efforts and actions of leaders and individuals within the sector.
- 2.106 The committee will continue to scrutinise ASIC's performance, particularly ASIC's ongoing implementation of the Royal Commission's recommendations and the strengthening of ASIC's enforcement culture.

**Mr Tim Wilson MP**  
**Chair**  
**5 February 2020**







## **Appendix A – Hearing and witnesses**

### **Public hearing**

**Wednesday, 16 October 2019 – Canberra**

*Australian Securities and Investments Commission*

Mr James Shipton, Chairman

Mr Daniel Crennan, Deputy Chair

Ms Karen Chester, Deputy Chair

Ms Cathie Armour, Commissioner

Ms Danielle Press, Commissioner

Mr John Price, Commissioner

Mr Sean Hughes, Commissioner