



ASIC
Australian Securities &
Investments Commission

ASIC update on implementation of Royal Commission recommendations

February 2019

Further to its statement of 4 February, the Australian Securities and Investments Commission (ASIC) is today providing an update on its planned actions in relation to the recommendations of the Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission).

The Royal Commission's recommendations reinforce, and will inform the implementation of steps ASIC has been taking as part of a strategic program of change that commenced in 2018 to strengthen our governance and culture and to realign our enforcement and regulatory priorities. This update also provides a report of progress on those changes.

Royal Commission recommendations directed at ASIC

There are 12 recommendations that are directed at ASIC, or where the Government's response requires action now by ASIC, without the need for legislative change. ASIC is committed to fully implementing each of these. The attached table provides an outline of ASIC's planned actions.

ASIC extended remit and strengthened powers and penalties

Importantly, the Royal Commission in recommending the retention of the 'twin peaks' model of financial regulation, made many recommendations to strengthen and contemporise it. To this end, a further 34 recommendations that require legislative change will expand ASIC's remit, strengthen our powers and require more of the entities we regulate. Of those 34 recommendations, 11 will extend ASIC's remit and powers, whilst 23 recommendations will impose new requirements or restrictions on the entities we regulate. ASIC will supervise industry's implementation of those new requirements and take action where there is non-compliance.

Across the range of its jurisdiction, as a result of the recommendations and current reforms, there will be over 60 additional penalty provisions that ASIC will be able to action. These penalty provisions will be of greater deterrence value with the recent passage of the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018*. That Bill increases maximum prison penalties for the most serious offences to 15 years. It significantly increases civil penalties for companies, now to be capped at \$525 million, with maximum civil penalties for individuals increasing to \$1.05 million. Significantly, the Bill also introduces, for the first time, a civil penalty (capped at \$525 million) for breach of the primary obligation banks and other financial services and credit licensees owe to all of their customers, that is 'to do all things necessary to ensure the financial services covered by the licence are provided efficiently, honestly and fairly'.

Royal Commission referrals

In its final report the Royal Commission also made 11 specific referrals to ASIC in relation to eight entities. This was in addition to two referrals made during the course of the Commission's hearings. We have prioritised work on those matters. While

ASIC does not comment on actual or potential investigations, it will provide an update (when appropriate to do so publicly) on the handling of those matters – if proceedings are commenced, for example.

Royal Commission related enforcement work

In addition to the specific referrals, ASIC's enforcement teams are undertaking investigations into 12 matters that were case studies before the Royal Commission and have commenced proceedings in relation to two other case studies (Nulis and MLC, 18-259MR refers; and Dover Financial Advisers and Terry McMaster, 18-269MR refers). ASIC is assessing another 16 case studies to determine whether investigations should be commenced. Aside from the Royal Commission case studies, ASIC's enforcement teams are undertaking a large volume of work on a range of misconduct relating to major financial institutions and their representatives. ASIC expects these investigations to result in a number of referrals to the Commonwealth Director of Public Prosecutions for assessment for criminal prosecution. ASIC will continue to work closely with all relevant agencies, including the Australian Prudential Regulations Authority (APRA) and the Commonwealth Director of Public Prosecutions during the course of these investigations.

"Why not litigate?" posture and establishment of an Office of Enforcement

The Royal Commission identified ASIC's enforcement culture as the focus of the change needed at ASIC. The Royal Commission also identified that ASIC had acknowledged the need for that change and had already initiated action to do so. ASIC sought, and on 7 August 2018 obtained, additional funding from Government to accelerate its enforcement outcomes.

In October 2018, ASIC adopted a 'why not litigate?' enforcement stance and publicly committed to that posture going forward. ASIC initiated an Internal Enforcement Review (IER), led by Deputy Chair, Daniel Crennan QC, and assisted by Michael D Wyles QC, Professor Ian Ramsay of The University of Melbourne and Deputy Commissioner Leanne Close of the Australian Federal Police. ASIC put in place a series of interim measures to ensure a strong focus on court-based outcomes while that review took place.

The IER, completed in December 2018, includes a number of significant recommendations, foremost being the establishment of an Office of Enforcement within ASIC. The IER's report was provided to the Royal Commission in December 2018. The Royal Commission emphasised, as did the IER, the need to, as much as possible, separate enforcement staff from the ASIC's non-enforcement contact with regulated entities.

Following the release of the Royal Commission's Final Report and Government response, and informed by these and the IER, ASIC has determined to establish a separate Office of Enforcement within ASIC. A document summarising the framework and principles the Commission has determined for its implementation is attached (page 12). ASIC is establishing a taskforce to put the Office of Enforcement in place. This will be completed in 2019.

While these changes will be implemented, due to the long pipeline involved in fully investigating and successfully prosecuting misconduct, the impact of these changes will only become fully visible over time. However, as an early indication of change, since 1 February 2018 there has been a 15% increase in the number of ASIC enforcement investigations on foot and a 50% increase in the number of ASIC enforcement investigations of misconduct by large financial institutions (or their employees or subsidiary companies).

ASIC's broader strategic change program

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

The Royal Commission acknowledged ASIC's use of CCM in its final report. Our use of new regulatory and supervisory approaches is aimed at driving meaningful change in industry directly, and at supporting our strong enforcement stance. In the first two months of operation commencing at the end of October 2018, our CCM onsite reviews have seen ASIC staff on site at major financial institutions for 40 out of 45 working days and involved in more than 100 onsite interviews of banking staff at all levels. These reviews enable early identification of specific issues in institutions to minimise future harmful impact, including through the frank disclosure of our findings to the CEOs, business leaders, and boards of the institutions.

The strengthened "twin peaks" model will also require closer coordination and cooperation with APRA. ASIC and APRA already have joint work underway to enhance our cooperation arrangements in order to improve outcomes across the financial system, increase efficiency of regulation and promote a whole-of-system oversight.

ASIC welcomes the call for greater regulator accountability with the planned establishment of a new oversight body. We will be proactive in working with the new oversight body to develop regulatory performance measurement frameworks that provide a public mechanism for monitoring our effectiveness, with particular focus on the level of impact ASIC's work has on the overall fairness, strength and efficiency of the Australian financial system.

Beyond the formal recommendations, the Royal Commission's final report contained a number of findings and observations about ASIC and its work. Those findings and observations will inform our actions going forward – how we implement the Royal Commission recommendations and our change agenda.

Reforms advocated by ASIC

Many of the recommendations made by the Royal Commission involve reforms ASIC advocated for in its earlier submissions to the Royal Commission and, in some cases, in earlier reviews and inquiries. These include:

- an expanded role for ASIC to become the primary conduct regulator in superannuation;
- the extension of Banking Executive Accountability Regime (BEAR)- like accountability obligations to firms regulated by ASIC, with their focus being on conduct;
- the end of grandfathering of Future of Financial Advice (FOFA) commissions;
- the extension of the proposed product intervention powers and design and distribution obligations to a broader range of financial products and services;
- the extension of ASIC's role to cover insurance claims handling and the application of unfair contract terms laws to insurance;
- reforms to breach reporting; and
- ASIC being provided with a directions power.

These changes will build on the existing reform agenda and, in particular, on the important changes introduced by the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018*, which implements changes that were also sought by ASIC.

Conclusion

ASIC acknowledges the statement made by the Government in its response to the Royal Commission that the findings, recommendations and referrals of the Royal Commission 'will require the regulators to take on new responsibilities and, in many cases, simply do more'. ASIC will work with the Government as it seeks to ensure that regulators remain appropriately resourced and as it considers what additional funding is required in the 2019–20 budget context.

The proposed new powers, penalties, legislative reform and funding are crucial to ASIC meeting the expectations of the community, Parliament and the Government. Taken collectively they significantly strengthen ASIC's regulatory and enforcement powers and the deterrence value of those powers to stem future misconduct.

ASIC stands ready to work with the Parliament, the Government, and APRA to implement the reform agenda. Beyond that, ASIC looks forward to working with enhanced powers and resourcing, its strengthened enforcement culture and the full range of other regulatory tools available to it, to strive for a fair, strong and efficient financial system for all Australians.

FSRC recommendation	Government response	ASIC update
<p>Recommendation 1.13 — Charging default interest</p> <p>The ABA should amend the Banking Code to provide that, while a declaration remains in force, banks will not charge default interest on loans secured by agricultural land in an area declared to be affected by drought or other natural disaster.</p>	<p>The Government supports the ABA acting on this recommendation.</p>	
<p>Recommendation 1.16 — 2019 Banking Code</p> <p>In respect of the Banking Code that ASIC approved in 2018, the ABA and ASIC should take all necessary steps to have the provisions that govern the terms of the contract made or to be made between the bank and the customer or guarantor designated as ‘enforceable code provisions’.</p> <p>Recommendation 4.9 — Enforceable code provisions</p> <p>As referred to in Recommendation 1.15, the law should be amended to provide for enforceable provisions of industry codes and for the establishment and imposition of mandatory industry codes.</p> <p>In respect of the Life Insurance Code of Practice, the Insurance in Superannuation Voluntary Code and the General Insurance Code of Practice, the Financial Services Council, the Insurance Council of Australia and ASIC should take all necessary steps, by 30 June 2021, to have the provisions of those codes that govern the terms of the contract made or to be made between the insurer and the policyholder designated as ‘enforceable code provisions’.</p>	<p>The Government supports ASIC and the ABA acting on this recommendation following the implementation of Recommendation 1.15.</p> <p>The Government supports the Financial Services Council, the Insurance Council of Australia and ASIC acting on this recommendation, following the implementation of the Government response to Recommendation 1.15 about ASIC’s powers to approve codes with enforceable provisions.</p> <p>This responds to the Productivity Commission’s report <i>Superannuation: Assessing Efficiency and Competitiveness</i> which recommended a binding and enforceable superannuation insurance code of conduct, which would thereafter become a condition of holding an RSE licence.</p>	<p>ASIC will work with industry in anticipation of the Parliament legislating reforms in relation to codes and ASIC’s powers to provide for ‘enforceable code provisions’. This work will include a focus on which code provisions need to be made ‘enforceable code provisions’ on the basis they govern the terms of the contract made or to be made between the financial services provider and the consumer. ASIC will also continue to work within the existing law to improve the quality of codes and code compliance.</p>

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<p>Recommendation 2.4 — Grandfathered commissions</p> <p>Grandfathering provisions for conflicted remuneration should be repealed as soon as is reasonably practicable.</p>	<p>The Government agrees to end grandfathering of conflicted remuneration effective from 1 January 2021.</p> <p>Grandfathered conflicted remuneration can entrench clients in older products even when newer, better and more affordable products are available on the market. Grandfathering has now been in place for over five years, providing industry with sufficient time to transition to the new arrangements. It is therefore now appropriate for grandfathering to end.</p> <p>The Government is also committed to ensuring that the benefits of removing grandfathering flow to clients. From 1 January 2021, payments of any previously grandfathered conflicted remuneration still in contracts will instead be required to be rebated to applicable clients where the applicable client can reasonably be identified.</p> <p>Where it is not practicable to rebate the benefit to an individual client because, for example, the grandfathered conflicted remuneration is volume-based so it is not able to be attributed to any individual client, the Government expects industry to pass these benefits through to clients indirectly (for example, by lowering product fees).</p> <p>To ensure that the benefits of industry renegotiating current arrangements to remove grandfathered conflicted remuneration ahead of 1 January 2021 flow through to clients, the Government will commission ASIC to monitor and report on the extent to which product issuers are acting to end the grandfathering of conflicted remuneration for the period 1 July 2019 to 1 January 2021 and are</p>	<p>Consistent with the Government's response to this recommendation, ASIC will monitor and report on the extent to which product issuers are acting to end the grandfathering of conflicted remuneration for the period 1 July 2019 to 1 January 2021. This will include consideration of the passing through of benefits to clients, whether through direct rebates or otherwise.</p>

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	<p>passing the benefits to clients, whether through direct rebates or otherwise.</p> <p>This also responds to the Productivity Commission's report <i>Superannuation: Assessing Efficiency and Competitiveness</i> which also recommended ending grandfathered trailing commissions.</p>	
<p>Recommendation 2.5 — Life risk insurance commissions</p> <p>When ASIC conducts its review of conflicted remuneration relating to life risk insurance products and the operation of the ASIC Corporations (Life Insurance Commissions) Instrument 2017/510, ASIC should consider further reducing the cap on commissions in respect of life risk insurance products. Unless there is a clear justification for retaining those commissions, the cap should ultimately be reduced to zero.</p>	<p>In 2017, the Government enacted reforms to life insurance remuneration that capped the commissions a financial adviser would receive for providing advice in relation to the purchase of a life insurance product. As part of these reforms, the Government announced that ASIC would conduct a review in 2021 to consider whether the reforms have better aligned the interests of advisers and consumers. If the review does not identify significant improvement in the quality of advice, the Government stated it would move to mandate level commissions, as was recommended by the Financial System Inquiry.</p> <p>The Government supports ASIC conducting this review and considering the factors identified by the Royal Commission when undertaking this review.</p>	<p>ASIC will implement this recommendation. ASIC will consider this recommendation and factors identified by the Royal Commission in undertaking its post implementation review of the impact of the ASIC Corporations Life Insurance Commissions Instrument 2017/510, which set commission caps and clawback amounts, and which commenced on 1 January 2018 (ASIC media release 17-168 MR refers). As noted by the Royal Commission, and consistent with the Government's timetable, ASIC's review will take place in 2021.</p>
<p>Recommendation 4.4 — Cap on commissions</p> <p>ASIC should impose a cap on the amount of commission that may be paid to vehicle dealers in relation to the sale of add-on insurance products.</p>	<p>The Government agrees to provide ASIC with the ability to cap commissions that may be paid to vehicle dealers in relation to the sale of add-on insurance products.</p> <p>The value of the commissions paid in relation to add-on insurance products sold through vehicle dealers has significantly exceeded the amounts paid out to consumers through claims. High</p>	<p>Pending the Parliament legislating to provide ASIC with the ability to place a cap on such commissions, ASIC will continue to work to address problems in relation to the sale of add-on insurance products in the context of motor vehicle sales.</p>

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	<p>levels of commissions have contributed to poor consumer outcomes.</p> <p>Providing ASIC with the ability to cap commissions will ensure an appropriate cap is set and varied if required in response to any future concerns.</p>	
<p>Recommendation 6.2 — ASIC’s approach to enforcement</p> <p>ASIC should adopt an approach to enforcement that:</p> <ul style="list-style-type: none"> • takes, as its starting point, the question of whether a court should determine the consequences of a contravention; • recognises that infringement notices should principally be used in respect of administrative failings by entities, will rarely be appropriate for provisions that require an evaluative judgment and, beyond purely administrative failings, will rarely be an appropriate enforcement tool where the infringing party is a large corporation; • recognises the relevance and importance of general and specific deterrence in deciding whether to accept an enforceable undertaking and the utility in obtaining admissions in enforceable undertakings; and • separates, as much as possible, enforcement staff from non-enforcement related contact with regulated entities. 	<p>The Government supports ASIC acting on this recommendation.</p> <p>The adoption of the Royal Commission’s recommendation will build on changes already underway within ASIC, both with its recent shift to a ‘why not litigate’ stance, and recommended changes to its policies, processes and procedures put forward by its recent internal review of enforcement.</p>	<p>ASIC’s actions are underway. ASIC will continue to implement this commitment, which is consistent with the strategic direction it has adopted for its approach to enforcement. In particular, ASIC has adopted a ‘<i>Why not litigate?</i>’ enforcement stance and initiated an internal enforcement review (IER). ASIC’s Commission has determined to create a separate Office of Enforcement within ASIC and this will be implemented in 2019. ASIC will take the IER report and the Royal Commission’s comments on it into account, as it makes its final changes to its enforcement policies, procedures and decision-making structures to deliver on its ‘<i>Why not litigate?</i>’ enforcement stance.</p>
<p>Recommendation 6.10 — Co-operation memorandum</p>	<p>The Government supports ASIC and APRA continuing to work together to update their existing memorandum of understanding to ensure that it clearly sets out how they will</p>	<p>ASIC will, working with APRA, implement this recommendation, including in relation to any statutory obligation to cooperate, share information and notify APRA of breaches or suspected breaches, that the Government puts in</p>

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<p>ASIC and APRA should prepare and maintain a joint memorandum setting out how they intend to comply with their statutory obligation to co-operate.</p> <p>The memorandum should be reviewed biennially and each of ASIC and APRA should report each year on the operation of and steps taken under it in its annual report.</p>	<p>comply with their statutory obligation to co-operate.</p>	<p>place as part of its response to Recommendation 6.9</p> <p>ASIC and APRA are currently working together to enhance cooperation arrangements including by revising the existing Memorandum of Understanding. The aim is to improve outcomes across the financial sector, increase efficiency of regulation and promote a whole of system view. This work will be completed in 2019.</p>
<p>Recommendation 6.12 — Application of the BEAR to regulators</p> <p>In a manner agreed with the external oversight body (the establishment of which is the subject of Recommendation 6.14 below) each of APRA and ASIC should internally formulate and apply to its own management accountability principles of the kind established by the BEAR.</p>	<p>The Government agrees that APRA and ASIC should be subject to accountability principles consistent with the BEAR.</p> <p>The Government notes that the Financial Conduct Authority in the UK has adopted a similar regime to enhance its own internal accountability.</p>	<p>ASIC agrees to implement this recommendation. In anticipation of the Government's establishment of the external oversight body, ASIC will commence work on developing accountability maps consistent with the BEAR. ASIC will consider the approach of the Financial Conduct Authority in implementing this recommendation.</p> <p>ASIC will develop and publish accountability statements before the end of 2019.</p>

Appendix - Establishing ASIC's Office of Enforcement.

ASIC is committed to increasing consumer trust and confidence in the financial system and combating misconduct. ASIC will take action against misconduct and the resulting harms to consumers and markets. ASIC's enforcement culture requires investigations to be conducted with a clear view of the regulatory outcomes to be achieved and with a focus on the question, "why not litigate?".

Following the Final Report of the Royal Commission, the Government's Response and ASIC's Internal Enforcement Review, the Commission has resolved to establish an Office of Enforcement within ASIC. The Office of Enforcement will be responsible to the Commission for investigation and enforcement of contraventions of the laws that ASIC administers. The decision to establish a separate Office of Enforcement is founded on the principles that:

- It is preferable to centralise decision-making processes to ensure determination of whether or not it is in the public interest to commence enforcement action and (if so) utilising the most appropriate and effective responses available to ASIC;
- Such decision-making should be informed by cogent and well-reasoned recommendations from experienced enforcement senior executives and managers with defined and dedicated accountabilities for delivery of ASIC's enforcement strategies and objectives;
- Teams operating within the Office of Enforcement will be separate, as much as possible, from non-enforcement related contact with regulated entities.

The Commission will continue to determine the governance arrangements, strategic settings, guiding principles and operational guidelines that will be observed by the Office of Enforcement and ASIC generally. In particular, the Commission will retain decision-making responsibility for significant enforcement matters.

Commission decisions:

1. The Commission approves and will implement an Office of Enforcement within ASIC to be responsible and accountable to the Commission for investigation and enforcement of contraventions of the legislation administered by ASIC.
2. The Royal Commission's Final Report, insofar as it relates to ASIC's enforcement activities, will be integral to Commission's consideration of guiding principles and operational guidelines for the Office of Enforcement and ASIC generally.

3. The guiding principles and operational guidelines approved by the Commission for the Office of Enforcement and ASIC generally will have as their predicate a focus on deterrence, public denunciation and punishment of wrongdoing by way of litigation.
4. The Office of Enforcement will adopt and monitor the observation of clear and transparent overarching principles set by the Commission to give effect to the objects set out in ss1(2)(a), (b), (d) and (g) and ss12A(2) and (3) of the ASIC Act.
5. The following principles will guide ASIC's work including the approach of the Office of Enforcement:

Principle One: Where a possible breach of the law is known to ASIC, ASIC will undertake an assessment and, if appropriate, conduct an investigation by reference to the facts and law. Once ASIC is satisfied that breaches of law are more likely than not, it will ask itself: why not litigate?

Principle Two: Any public interest in pursuing a (non-court) negotiated outcome is weighed against the clear benefits of a judgment and imposition of a prison sentence, civil penalty or other court-based outcome with a negotiated outcome pursued only where objective assessment weighs in favour of the negotiated outcome (reflecting paragraph 3 above).

Principle Three: There is a focus on both corporate accountability and individual accountability particularly at executive and board level for breaches of the legislation administered by ASIC.

Principle Four: Emerging technologies are employed to enhance ASIC's enforcement capabilities and these technologies are monitored so ASIC keeps pace with advances in these technologies.

Principle Five: There is careful monitoring of, and an endeavour to pre-empt, budgeting and resourcing requirements.

6. The Office of Enforcement will have an overarching and effective communication strategy to ensure the deterrent impact of ASIC's enforcement actions are maximised.

7. ASIC will provide ASIC staff, including the staff of the Office of Enforcement, with regular education and training including in the skills of investigation and enforcement.
8. The Commission will formulate and adopt Key Performance Indicators for the Office of Enforcement which should report against those KPIs annually.
9. The Office of Enforcement will prepare and provide the Commission with comprehensive data and analysis on (at least) an annual basis which evaluates the performance of the Office of Enforcement both quantitatively and qualitatively.