BRIEFING NOTE

FINANCIAL SERVICES ROYAL COMMISSION

Exposure Draft Legislation

6 February 2020

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CONTENTS

OVERVIEW

On 31 January 2020 the Government released draft legislation for consultation in relation to 22 recommendations and two additional commitments arising from the Financial Services Royal Commission (**FSRC**).

The draft legislation covers some of the key recommendations from the FSRC, and the Government's response to the Final Report, in the following areas:

- Breach reporting (including the introduction of breach reporting for credit licensees in relation to conduct by mortgage brokers) and investigation of misconduct;
- Reference checking and information sharing;
- Financial Advice;
- Superannuation;
- Insurance;
- Hawking of insurance and superannuation products;
- Making certain provisions of financial services industry codes 'enforceable code provisions' attracting civil penalties;
- Roles and responsibilities of ASIC and APRA in the superannuation industry;
- Granting ASIC a new "directions" power in relation to financial service and credit licensees; and
- Establishment of the Financial Regulator Assessment Authority, to independently review the effectiveness of APRA and ASIC.

The Government has requested that responses to the consultation be submitted by **28 February 2020**.

This Briefing Note provides a summary of some of the key aspects of the proposed reforms.

1 BREACH REPORTING AND INVESTIGATION OF MISCONDUCT

The draft legislation relates to the following FSRC recommendations relating to breach reporting:

- Recommendations 1.6 and 2.8 – AFSL and ACL holders to report serious compliance concerns about financial advisors and mortgage brokers;
- Recommendations 1.6 and 2.9 – Investigation of misconduct by financial advisers and mortgage brokers, and appropriate remediation of clients affected by the misconduct; and
- Recommendation 7.2 – Implement the ASIC Enforcement Review taskforce recommendations to:
  - clarify and strengthen the existing breach reporting regime for AFSL holders; and
  - introduce a comparable breach reporting regime for credit licensees.

Critically, breach reporting obligations will be extended to credit licensees, and the scope of reportable breaches will expand substantially, both in terms of the types of breaches that will be regarded as significant, and the fact that there are now objectively determinable criteria, which deem a breach to be significant.

The Government has also made an additional commitment in response to Recommendation 7.2, providing ASIC with a directions power. Further information in relation to this additional commitment is in section 9 of this briefing note below.

Significant changes will need to be made to breach reporting processes in light of these proposed changes, if they are enacted in their current form.

Recommendations 1.6 and 2.8 – AFSL and ACL holders to report serious compliance concerns about financial advisors and mortgage brokers

Recommendation 7.2 – Implement ASIC Enforcement Review taskforce recommendations

- The amendments:
  - introduce breach reporting for Credit Licensees;
  - significantly expand the obligations to breach report, compared to the existing regime; and
  - include prescriptive requirements including the form and timing of reports.

What needs to be reported

- Significant breaches and likely breaches. They are divided into core obligations and additional reportable situations. Additional reportable situations include if a licensee or its representative has:
  - engaged in conduct constituting gross negligence;
  - committed serious fraud.
- The test for when a breach or likely breach is significant now includes objective determinable criteria for core obligations. A breach or likely breach of a core obligation is taken to be significant if it:
  - constitutes a contravention of a civil penalty provision; or
  - is punishable by a penalty that may include imprisonment for a maximum period of 3 months or more (if it involves dishonesty) or 12 months or more; or
  - results or is likely to result in loss of damage to clients or members of the scheme;

- The current assessment criteria of significance do not apply to a breach of these core obligations.
- That means, for example, any breach of a civil penalty provision, irrespective of the number or the impact of the breach, will be reportable. This will significantly expand the scope of reportable breaches. The draft Explanatory Material gives the example of a failure to provide an individual client with an FSG and notes that this would be a reportable situation as it constitutes a contravention of a civil penalty provision.
- Investigations as to whether a licensee has breached a core obligation are reportable. There is also an obligation to report at the end of the investigation, both if the conclusion is there has been a breach **or** there are no reasonable grounds to believe a breach has occurred. This is to ensure ASIC has oversight over the progress of an investigation process.
- Licensees must report to ASIC if the licensee has reasonable grounds to suspect a reportable situation has arisen in respect of a:
    - mortgage broker; or
    - person providing personal advice to retail clients,

  operating under another license.
- The licensee the subject of the report must be provided with a copy of the report to ASIC. However there is no need to report to ASIC if the licensee has reasonable grounds to believe that ASIC is aware of the existence of the reportable situation and all information that would otherwise require to be in that report. The draft Explanatory Materials state that this is a high threshold.

Timing and form of reports

- Licensees must report matters to ASIC within 30 calendar days after the licensee reasonably knows the matter has arisen. However, outcomes of investigations need to be reported within 10 calendar days after the licensee first reasonably knows the outcome of the investigation.

ASIC to publish information

- Reports must be in the form prescribed or approved by ASIC.
- ASIC must publish information about reports lodged during a financial year. ASIC has discretion as to the content and form of publication. However the draft Explanatory Materials states that it is expected it will include:
    - the name of the licensee;
    - number of reported breaches;
    - breakdown of breach reports by corporate group;
    - the number of breaches compared to the size, activity and volume of business associated with an entity.
- However, it will not include information about reports regarding investigations or reports about other licensees.
- All information will be published on ASIC's website within 4 months after the end of each financial year.

Penalties

- Failure to lodge a report in the prescribed form or on time is an offence including with a maximum of 2 years' imprisonment. It is also a civil penalty provision (**CPP**), meaning that the maximum

financial penalty for a contravention of a civil penalty provision will apply. For body corporates, this is the greater of:

- 50,000 penalty units ($10.5 million);
- if the court can determine – the benefit derived or detriment avoided by the body corporate because of the contravention, multiplied by 3; or
- 10% of the annual turnover of the body corporate but to a maximum monetary value of 2.5 million penalty units ($525 million).

- In addition, infringement notices could also be issued.

Transition provisions for Breach Reporting

- The new reporting obligations will apply to all reportable situations arising on or after 1 April 2021.
- The existing breach reporting provisions in section 912(D) of the Corporations Act 2001 (Cth) will continue to apply in relation to breaches or likely breaches that occur before 1 April 2021, even if the licensee becomes aware of the breach or likely breach after that date.

Recommendations 1.6 and 2.9 – Investigation of misconduct by financial advisers and mortgage brokers, and appropriate remediation of clients affected by the misconduct

- The Corporations Act and the National Consumer Credit Protection Act (**Credit Act**) impose a number of general obligations including the obligations on licensees, amongst other things, to do all things necessary to ensure that financial services are provided efficiently, honestly and fairly. Additionally, licensees must have adequate arrangements in place for compensating retail clients for loss or damage suffered because of breaches of the legislative provisions. ASIC Guidance is also provided in relation to this requirement.
- The FSRC found that upon the detection of misconduct, licensees did not always consider the steps they should take to investigate whether an adviser may have acted inappropriately, resulting in delayed detection of adviser misconduct.
- Commissioner Hayne recommended that licensees should be required as a condition of their licence to take a number of steps when they detect the occurrence of misconduct. These steps would require the need to investigate misconduct, notify affected clients and remediate where required.

  The Exposure Draft Bill proposes amendments to the Corporations Act and Credit Act to implement these recommendations.

Notification and Investigation

- Licensees (or their representatives) must take reasonable steps to notify an affected client of a reportable situation (as defined by the new breach reporting obligations of section 912D Corporations Act and section 50A Credit Act) if they provide or have provided personal advice to a retail client in relation to a relevant financial product, or credit assistance to a consumer in relation to a credit contract secured by a mortgage over residential property and the licensee or representative is a mortgage broker.
- A reportable situation includes a significant breach or likely significant breach of a core obligation (as defined by the new breach reporting obligations) or conduct amounting to gross negligence or serious fraud. There must be reasonable grounds (as referred to by common law principles) for the licensee to believe that the situation amounts to conduct which encompasses a reportable situation.

- There must be reasonable grounds for the AFSL and credit licensee to suspect a person has suffered or will suffer loss or damage as a result of the situation and that the person has a legally enforceable right to recover loss against the licensee (or its representative).
- The notice must be in writing and contain sufficient information to give the affected client an understanding of the nature of the reportable situation and the basis for suspicion the client may have suffered or will suffer loss or damage. If a form has been approved by ASIC, clients must be notified in that form.
- A licensee must also conduct an investigation into circumstances that require an affected client to be notified (as described above). The investigation must identify the conduct and quantify the loss or damage suffered by the client. A contravention of the obligation to investigate misconduct is a civil penalty and an offence.
- Notice must be given to an affected client and an investigation must commence within 30 days after the licensee first reasonably knows that the misconduct detected has potentially resulted in loss or damage that the client has a legally enforceable right to recover. The investigation must be completed as soon as practicable after it has commenced. The affected client must be notified of the outcome of the investigation within 10 days after its completion and inform of the nature and full extent of the misconduct. The failure of a licensee to notify an affected client of the outcome of an investigation incurs a civil penalty and is also an offence.

Remediation

- A licensee must take reasonable steps to pay an affected client within 30 days of an investigation into a reportable situation having been completed if there are reasonable grounds to believe that the affected client has suffered loss or damage and the client has a legally enforceable right to recover the loss or damage from licensee. The amount will be equal to the loss or damage suffered as a result of the reportable situation. The obligation to remediate an affected client within 30 days is both a CPP and an offence.

Penalties

- Breaches of these provisions of the Corporations Act and Credit Act incur civil and criminal penalties.
- A breach of a civil penalty provision can lead to a maximum penalty of:
  - $525 million (Corporations Act); or
  - $1,050.000 (Credit Act)
- A breach of an offence provision under both the Corporations Act and Credit Act can lead to a maximum penalty of 2 years imprisonment.

Transition provisions for breach reporting

- The new reporting obligations will apply to all reportable situations arising on or after 1 April 2021.
- The existing breach reporting provisions in section 912(D) of the Corporations Act will continue to apply in relation to breaches or likely breaches that occur before 1 April 2021, even if the licensee becomes aware of the breach or likely breach after that date.

2 REFERENCE CHECKS AND INFORMATION SHARING

The draft legislation relates to Recommendation 1.6 and 2.7 – Reference checks and information sharing for prospective financial advisers and mortgage brokers.

Recommendations 1.6 and 2.7 – Reference checks and information sharing for prospective financial advisers and mortgage brokers

- The Exposure Draft Bill amends the Corporations Act and the Credit Act to:
  - oblige an AFSL or Australian credit licensee holders to comply with a reference checking and information sharing protocol;
  - empower ASIC to create legislative instruments that set out the detail of the reference checking and information sharing obligations;
  - create a civil penalty for non-compliance with the obligations, incurring a maximum penalty of $525 million; and
  - implement a defence of qualified privilege for persons who give information about a representative in the course of complying with their obligations under the protocol.
- The reference checking and information sharing protocol applies to individuals if there are reasonable grounds to suspect that if the individual is successful in obtaining the job they have sought, they will provide:
  - personal advice to retail clients about financial products; or
  - will provide credit assistance in relation to credit contracts secured by mortgages over residential property and be a mortgage broker or a director, employee or agent of the mortgage broker.
- The protocol must not require:
  - information to be provided in relation to conduct that occurred more than 5 years before the information is shared;
  - personal information to be shared other than with the consent of the individual to whom the information relates.

3 FINANCIAL ADVICE

The draft legislation proposes some key changes to the regulation of the financial advice industry, addressing the following FSRC recommendations:

- Recommendation 2.1 – Enhancements to the existing ongoing fee arrangement provisions; and
- Recommendation 2.2 – Disclosure of lack of independence.

Further information in relation to these changes is provided in the table below.

Additional changes relating to the financial advice industry have also been proposed in the context of breach reporting and misconduct, in response to the following FSRC recommendations:

- Recommendation 2.7 – Reference checks and information sharing for prospective financial advisers; and
- Recommendation 2.9 – Investigation of misconduct by financial advisers and appropriate remediation of clients affected by the misconduct.

Further information on these changes can be located at section 1 of this note above.

Ongoing fee arrangements
Recommendation 2.1 – to enhance the existing ongoing fee arrangement provisions

- The Corporations Act currently provides, among other things, specific disclosure obligations for ongoing fee arrangements. The current regime obliges a fee recipient to provide a fee disclosure document which details the services provided to a client, any services a client was entitled to receive and the fees payable during the previous 12 month period.
- The Corporations Act also currently governs the renewal of an ongoing fee arrangement, providing, amongst other things, ASIC with the power to exempt a person from compliance with the requirement to provide a renewal notice if they are subject to an approved code of conduct.
- Commissioner Hayne identified a number of cases of clients being charged fees for ongoing financial advice services that were not provided. He recommended that a client should be required to opt in to an ongoing service arrangement annually and recommended that clients should be given a forward-looking summary of services and fees provided in an upcoming period.
- The Exposure Draft Bill proposes that from 1 July 2020, the following will be required in relation to ongoing fee arrangements:
    - Annual reviews: Fee recipients will be required to seek a renewal of ongoing fee arrangements from clients annually. The amendments also remove the statutory exemptions on certain persons to give a renewal notice.
    - Prospective fee disclosure statements: Fee recipients will be required to provide clients with an annual fee disclosure statement that details the services clients are entitled to receive and lists the amounts of each ongoing and additional fees payable in the upcoming 12 month period. A contravention of this provision will be a CPP under the Corporations Act, requiring the court to make a mandatory declaration that there has been a contravention of a CPP (see below for details of the penalty to be imposed for breaching a CPP).
    - Written consent: Fee recipients must obtain express written consent from clients to deduct and accept a payment of fees under an ongoing fee arrangement. The provisions make it a condition that an ongoing fee arrangement terminates if written consent is not obtained. A contravention of this amendment is a CPP under the Corporations Act.

- Record-keeping: Fee recipients will be required to keep appropriate and detailed records to demonstrate compliance with the Corporations Act. Records must be kept for five years and a failure to do so will be a criminal offence.

- The breach of a CPP can result in a penalty being the greatest of:
  - 50,000 penalty units ($10.5 million);
  - if the court can determine – three times the benefit derived from (or detriment avoided by) the contravention; or
  - 10% of annual turnover, up to a maximum value of 2.5 million penalty units ($525 million).

Disclosure re independence
Recommendation 2.2: Disclosure of lack of independence

- The current state of section 923A of the Corporations Act generally restricts entities that provide financial advice from using certain words or expressions such as "independent", "impartial" or "unbiased" unless it is truly the case (eg. they do not receive direct or indirect benefits such as gifts or commissions for suggesting a financial product).
- The current disclosure requirements also requires the entity to provide clients with a Financial Services Guide before giving financial advice.
- Commissioner Hayne recommended that disclosures of conflicts of interest should be more express. He noted that there is no requirement for non-independent financial advisers to explain to a client that he or she is not independent.
- The Exposure Draft Bill amends, amongst others, sections 923A and 942C of the Corporations Act to:
  - require entities to provide clients with an express written disclosure of their lack of independence if that is the case; and
  - provide ASIC with the power to legislate a prescribed form to be used for the purposes of the above disclosure.

4 SUPERANNUATION

The draft legislation relates to the following recommendations involving the superannuation industry:

- Recommendation 3.1 – No other role or office;
- Recommendation 3.2 – No deducting advice fees from MySuper accounts; and
- Recommendation 3.3 – Limitations on deducting advice fees from choice accounts.

Given Commissioner Hayne's comments that the superannuation industry is rife with conflicts of interest between the obligations that trustees of registrable superannuation entities (**RSEs**) have to their members and their duties to other parties, many of the areas for reform which are specific to superannuation deal with resolving such conflicts. The table below summarises the manner in which such reform will impact the operation of RSEs and the relationship between the trustee of an RSE and their members.

In addition to the above, there are broader reforms arising from Commissioner Hayne's recommendations, including reforms to breach reporting (section 1 above) and the role of APRA and ASIC (section 8 below), which are likely to have a significant impact on the operation of an RSE and the manner in which the trustee of an RSE carries out its duties.

The Government has also responded to the Commissioner's Recommendation 3.4, relating to the hawking of superannuation products. Further detail in relation to this can be located in the Hawking section of this briefing note (section 6 below).

Recommendation 3.1 – No other role or office
▶ A number of covenants currently contained in section 52 of the Superannuation Industry (Supervision) Act 1993 (the **SIS Act**) contemplate that, in carrying out its duties as the trustee of a RSE, the trustee may have a conflict between its duties to and interests of beneficiaries and the duties to and interests of other persons. ▶ The current conflicts management requirements require trustees of RSEs to develop an appropriate conflicts management framework that give priority to the interests of beneficiaries. ▶ After consideration of various conflicts management frameworks developed by trustees to comply with the above requirements, Commissioner Hayne concluded that these frameworks and related policies were often ineffective, as trustees rarely sought to avoid conflicts of interests and duties. Further, Commissioner Hayne considered that trustees of RSEs should avoid roles which require them to "wear two hats" (which is particularly relevant to dual regulated entities). ▶ The Exposure Draft Bill creates an additional condition on RSE licences which prohibits RSE licensees from having a duty to act in the interests of another person, subject to exceptions that enable trustees to undertake their ordinary functions as the trustee of an RSE or providing personal advice. ▶ The new licence condition would not prohibit an RSE licensee from having a duty that does not involve acting in the interests of another person. Further, only legally enforceable duties to act in the interests of another are captured by the new licence condition. This may for example allow RSE licensees to provide trustee administration services to other entities in exchange for fees as this would likely involve a contractual duty to provide a service to the entity, rather than a duty to act in the interests of the entity.
Recommendation 3.2 – No deducting advice fees from MySuper accounts
▶ MySuper products are simple products with basic features and one investment option. These products are designed as "default" options for members.

- Under the current MySuper fee rules, fees can only be charged to a MySuper product if they fall within one of seven categories and comply with applicable "charging rules" (see sections 29V and 29VA of the SIS Act). One such category includes advice fees.
- To address the concern with the "invisibility" of advice fees (particularly where those fees are ongoing), Commissioner Hayne recommended prohibiting the deduction of any advice fees from a MySuper product, and emphasised that advice fees should only be paid for the actual provision of a service. If a MySuper member sought financial advice about their superannuation, Commissioner Hayne's view was that these members should pay for that advice directly. It was also noted that such a prohibition is consistent with the status of MySuper as a simple product with basic features.
- To give effect to the recommendation, the Exposure Draft Bill amends Part 2C of the SIS Act to remove a trustee's ability to charge advice fees in relation to MySuper products.
- Trustees are still permitted to charge fees in relation to intra-fund advice as administration fees (which must be collectively charged in accordance with the applicable charging rules in s 29VA of the SIS Act). Further, section 99F of the SIS Act (which prohibits a trustee from passing the costs of particular types of financial product advice incurred by a member on to any other member) continues to apply.

Recommendation 3.3 – Limitations on deducting advice fees from choice accounts

- Consistent with the reasoning above, Commissioner Hayne recommended that the deduction of any advice fee (other than for intra-fund advice) from superannuation accounts other than MySuper accounts should be prohibited unless the requirements about annual renewal, prior written identification of service and provision of the client's express written authority set out in Recommendation 2.1 in connection with ongoing fee arrangements are met.
- The Exposure Bill introduces a new section 99FA which will prohibit a trustee from charging a member fees for advice provided to that member (other than collectively charged advice, such as intra-fund advice) unless:
  - the fee is charged in accordance with an arrangement that the member has entered into;
  - the member has consented to being charged the fee in accordance with the arrangement. The requirements for obtaining of such consent are also prescribed (with a distinction being made between "ongoing fee arrangements" and those arrangements which fall outside of this definition); and
  - the trustee has the consent or a copy of the consent.
- Section 99F of the SIS Act continues to apply to fees for advice charged to other members.

5 INSURANCE

The draft legislation relates to the following insurance-related FSRC recommendations:

- Recommendation 4.3 – Establish an industry-wide deferred sales model for the sale of add-on insurance products;
- Recommendation 4.4 – Provide ASIC with the power to impose a cap on commissions for add-on insurance products and insurance-like products;
- Recommendation 4.5 – Implement a duty to take reasonable care to not make a misrepresentation to an insurer for consumer insurance contracts; and
- Recommendation 4.6 – Add an extra condition for life insurers to show they would not have entered into a contract on any terms if they had known about the unintentional misrepresentation or non-disclosure.

The Government has also included a further commitment in response to recommendation 4.2 (which related to funeral expenses insurance), to restrict the use of the terms "insurer" and "insurance" if the product or service is not insurance, in circumstances where it is likely that the product or service could mistakenly be believed to be insurance.

Lastly, the Government has also responded to the Commissioner's Recommendation 4.1, relating to the hawking of insurance products. Further detail in relation to this can be located in the Hawking section of this briefing note (section 6 below).

Add-on insurance
Recommendation 4.3 – Establish an industry-wide deferred sales model for the sale of add-on insurance products

- Prior to the FSRC, ASIC and the Productivity Commission both released reports that revealed widespread issues within the add-on insurance market. Similarly, in his Final Report following the FSRC, Commissioner Hayne found that:
  - add-on insurance products denoted poor value for consumers;
  - insurers often paid more in commissions than in claims made under these policies;
  - consumer claim outcomes within the market were considerably worse than in other insurance markets that had more meaningful competition; and
  - add-on insurance consumers were at risk of unfair sales and adverse outcomes.
- In response to these findings, the Government proposes to enact the Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: Deferred Sales Model for Add-On Insurance and the Corporations (Fees) Amendment (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020.
- This legislation will amend the ASIC Act 2001 (Cth) to implement an industry-wide deferred sales model for the sale of add-on insurance products. The model will separate the sale of an add-on insurance product from the principal product or service being sold, by prohibiting its sale, and restricting communications in relation to this sale, for at least four clear days after the consumer has committed to purchasing the principal product or service.
- There will then be a six week period during which add-on insurance products may be sold to the consumer, however communications in a form other than writing are restricted. After this time, any contact made with the consumer will be subject to anti-hawking obligations.

- Clients will also be entitled to, at any time, inform the provider and any related third parties that they no longer wish to receive offers, requests or invitations relating to these products. Once such a request has been made, it will be an offence to continue to make them.
- Despite the above, providers and their related third parties will remain able to respond to inquiries received from clients about add-on insurance products at any time.
- The model will not apply to:
  - products that are the subject of an ASIC product intervention order that imposes a deferred sales period;
  - comprehensive car insurance;
  - products that the Minister exempts by regulations;
  - products and entities that ASIC exempts; or
  - products recommended by financial advisers.

Add-on Insurance

Recommendation 4.4 – Provide ASIC with the power to impose a cap on commissions for add-on insurance products and insurance-like products

- In addition to considering issues experienced within the add-on insurance market generally, the FSRC explored how it was being sold in car yards specifically.
- Part 7.7A of the Corporations Act currently bans the provision and acceptance of conflicted remuneration (including commissions) between certain product issuers and financial advisers, however this does not capture commissions paid to individuals other than financial advisers, and excludes commissions paid in connection with general insurance or consumer credit insurance (**CCI**) products.
- Currently, commissions paid by insurers to motor vehicle dealers in connection with the sale of CCI taken out by a debtor are capped at 20% of the premium.
- The FSRC ultimately found that the commissions being paid to motor vehicle dealers in connection with the sale of add-on insurance within car yards was contributing to the mis-selling of these products, noting that:
  - commissions paid to dealers regularly exceeded claims payouts to policyholders;
  - insurers were paying higher commissions in an effort to encourage dealers to compete with one another to gain market share; and
  - the industry had taken limited steps to reduce commission amounts, given there were few legal requirements to do so.
- In response to these findings, the Government proposes to enact the Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: Caps on Commissions.
- This legislation will amend the ASIC Act 2001 (Cth) to:
  - enable ASIC to place a cap on the amount of commissions that may be paid to dealers in relation to the sale of add-on risk products, including tyre and rim insurance, mechanical breakdown insurance and consumer credit insurance supplied in connection with the sale or long-term lease of a motor vehicle;

- make it a criminal offence, civil penalty and offence of strict liability for someone to pay or receive a commission that exceeds this cap; and
- provide consumers with a right to recover any commissions paid that exceed this cap.

General insurance

Recommendation 4.5 – Implement a duty to take reasonable care to not make a misrepresentation to an insurer for consumer insurance contracts

- The Insurance Contracts Act 1984 (Cth) (**ICA Act**) currently includes a duty of disclosure for consumer insurance contracts. This duty essentially requires that an insured disclose all matters known to them that will be relevant to the insurer's decision as to whether or not to accept the risk, and if so, on what terms.
- The ICA also allows an insurer, prior to entering into certain "eligible" insurance contracts, to request that the insured answer specific questions that are relevant to the insurer's decision. The insured's duty of disclosure does not extend beyond answering these questions. If the insurer does not make a request, it is taken to have waived compliance with the duty.
- If an insured breaches this duty, the insurer can utilise remedies provided for in Part IV of the ICA that, depending on the breach and type of insurance, may enable them to:
  - reject a claim;
  - reduce a payout; or
  - avoid the contract.
- In his Final Report following the FSRC, Commissioner Hayne noted that the current duty fails to accommodate for differences between what a modern consumer and insurer know to be relevant to an insurer's decision. Consumers acting honestly and reasonably, but having misunderstood the insurer's questions, were being denied cover. He therefore recommended that a duty to take reasonable care not to make a misrepresentation to an insurer should be implemented, shifting the burden onto the insurer, to elicit the correct information from the insured.
- In response to this, the Government proposes to enact the Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: FSRC Rec 4.5 (Duty of Disclosure to Insurer).
- This legislation will amend the *ICA*, replacing the existing duty of disclosure with a duty to take reasonable care not to make a misrepresentation. In determining whether this duty has been met, all relevant circumstances should be taken into account.
- This new duty will apply to consumer contracts of insurance (including general and life insurance contracts, which were previously excluded), where the policy has been obtained for an insured's personal, domestic or household purpose, or the insurer has provided written notice to the insured that the contract is a consumer insurance contract.
- For other types of insurance contracts, the insured's duty to disclose matters relevant to the insurer's decision, and to not make misrepresentations during contract negotiations, continue to apply.

Life insurance

Add an extra condition for life insurers to show they would not have entered into a contract on any terms if they had known about the unintentional misrepresentation or non-disclosure

- As outlined above, Part IV of the ICA imposes, amongst other things, the following on an insured:
  - a duty of disclosure in relation to certain matters relevant to the insurer's decision regarding whether to accept the risk and, if so, on what terms; and
  - an obligation not to make a misrepresentation to the insurer.
- Section 29(3) of the ICA allows a life insurer to avoid a contract of life insurance, within three years of entering into the contract, if the insured fails to comply with either of the above requirements. This applies regardless of whether the circumstances surrounding the failure to comply were not fraudulent.
- During the FSRC, Commissioner Hayne found that these obligations were unfairly weighted in favour of insurers.
- In response to this, the Government proposes to enact the Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: Avoidance of Life Insurance Contacts (FSRC Rec 4.6).
- This legislation will amend the *ICA* to limit the circumstances in which an insurer can avoid a life insurance contract on the basis of a non-fraudulent misrepresentation or non-disclosure by an insured. The insurer will be required to establish that it would not have been prepared to enter into a contract of life insurance, on any terms, had the duty of disclosure been complied with, or the misrepresentation not been made.

Additional commitment in response to recommendation 4.2 – Restrict use of the terms "insurer" and "insurance" if the product or service is not insurance, in circumstances where it is likely that the product or service could mistakenly be believed to be insurance

- The Banking Act 1959 (Cth) currently imposes restrictions on the use of the term 'bank' and other terms, in an effort to avoid client confusion regarding different types of financial services.
- As part of the Government's response to FSRC recommendations made in relation to funeral expenses policies, it will be amending the ICA to restrict the ability of entities to use the terms "insurer" and "insurance", to only those that have a legitimate interest in using this terminology.
- This will be implemented via the enactment the Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: Use of terms "insurance" and "insurer".
- This will make it a strict liability offence for a business to:
  - describe a product or service that is not insurance as "insurance" in circumstances where it is likely that the product or service could mistakenly be believed to be insurance; or
  - describe itself as an "insurer" despite not being appropriately registered or authorised, or not offering an insurance product, in circumstances where the business could mistakenly be believed to offer insurance.
- It is intended that this change will avoid consumer confusion regarding the types and nature of insurance and non-insurance products that are available.

6 HAWKING

The draft legislation prohibits the hawking of both superannuation and insurance products. It relates to the following FSRC recommendations:

- Recommendation 3.4 – No hawking of superannuation products; and
- Recommendation 4.1 – Prohibit the hawking of insurance products.

Anti-hawking
Recommendation 3.4 – No hawking of superannuation products
Recommendation 4.1 – Prohibit the hawking of insurance products

- The current anti-hawking provisions, located at Chapter 7 of the *Corporations Act*:
  - prohibit offers to sell or issue financial products in the course of unsolicited phone calls or meetings;
  - include three separate prohibitions, including a general prohibition, a prohibition relating to Managed Investment Scheme (**MIS**) interests specifically and a third prohibition relating to securities; and
  - do not apply consistently to all client types across the three separate prohibitions (ie. the general and MIS prohibitions only apply to offers made to retail clients, the securities prohibition does not apply to sophisticated investors).
- There are also a number of exemptions to the general prohibition on hawking, including offers of financial products under an eligible employee scheme and telephone calls made in accordance with section 992A(3).
- In his Final Report following the FSRC, Commissioner Hayne found that existing hawking prohibitions did not adequately protect consumers. Case studies explored during the FSRC also revealed that the hawking of insurance and superannuation products was often resulting in consumers purchasing products that did not meet their needs.
- In response to this, the Government proposes to enact the Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020: Hawking of Financial Products.
- The Hawking of Financial Products Bill will amend the Corporations Act to ban offers to sell or issue financial products that are made in the course of, or because of, unsolicited contact.
- Unsolicited contact is regarded as contact that is not in response to a positive, clear and informed consumer request, made via telephone, in a face-to-face meeting or by any other form that creates an expectation of immediate response (ie. not solely during phone calls or meetings).
- The Explanatory Materials indicate that this contact includes:
  - online video chat;
  - web chat services;
  - conversation in instant messaging apps;
  - standard email communications; and
  - ordinary corporate transactions such as sending investors offer documents.
- Further, it was recommended that section 992A(3) of the Corporations Act be amended to remove the "technical" exemption for telephone calls as it relates to superannuation products. That is, a superannuation product cannot be offered during an unsolicited telephone call, even where the call

is made between the designated hours / on the designated day, and the person is not on the "No Contact / No Call" etc.

- The new prohibition will apply to offers made to retail clients only, however it will apply to almost all financial products (including majority of securities and interests in MISs).
- Consumers will also have the ability to specify how they wish to be contacted, and can withdraw or vary their request in relation to a particular financial product at any time. This will ultimately provide consumers with greater control over their financial product purchasing decisions.
- If a product issuer breaches the new anti-hawking provision, the consumer will have the right to return the product and obtain a refund. That refund period will be one month after the end of the cooling off period or, if no cooling-off period applies, one month and 14 days after the financial product was issued.
- The right of return is in addition to other civil penalties. In addition, breach will be an offence with a maximum penalty of 6 months' imprisonment or 60 penalty units.

7 ENFORCEABLE CODES

The draft legislation relates to Recommendation 1.15 – Industry Codes of Conduct approved by ASIC may include enforceable code provisions, contravention of which will constitute a breach of law.

Recommendation 1.15 – Industry Codes of Conduct approved by ASIC may include enforceable code provisions contravention of which will constitute a breach of law

- ASIC can designate enforceable code provisions, which, if breached, may attract civil penalties.
- ASIC can approve codes of conduct which may contain enforceable code provisions.
- Breach of such a provision can attract civil penalties and other enforcement action, including issuing infringement notices.
- Introduces a framework for establishing mandatory codes of conduct for the financial services industry.
- Applicants in relation to a code must ensure that an independent review is undertaken every 5 years.

8 ASIC AND APRA – REGULATION OF THE SUPERANNUATION INDUSTRY

The Government has released draft legislation and regulation (the Financial Sector Reform (Hayne Royal Commission Response – Stronger Regulators (2020 Measures)) Bill 2020 (**the Stronger Regulators Bill**) and the Financial Sector Reform (Hayne Royal Commission Response – Stronger Regulators) (Regulation of Superannuation) Regulations 2020) in response to the following superannuation-related FSRC recommendations:

- Recommendations 3.8 and 6.3 – Adjust APRA and ASIC's roles within the superannuation industry to accord with the general principle that APRA is the prudential regulator, and ASIC is the conduct and disclosure regulator;
- Recommendation 6.4 – Give ASIC and APRA joint responsibility for enforceable consumer protection provisions within the Superannuation Industry (Supervision) Act 1993 (the **SIS Act**) ; and
- Recommendation 6.5 – Ensure that APRA remains responsible for prudent and member outcomes regulation.

The proposed reforms seek to clarify the role and responsibilities of ASIC and APRA, and are scheduled to commence on 1 July 2020.

Recommendations 3.8 and 6.3 – Adjust APRA's and ASIC's roles within the superannuation industry to accord with the general principle that APRA is the prudential regulator, and ASIC is the conduct and disclosure regulator

Recommendation 6.5 – Ensure that APRA remains responsible for prudent and member outcomes regulation

- Following the FSRC, Commissioner Hayne recommended adjusting ASIC and APRA's roles within the industry to accord with the general principle that:
  - APRA, as the prudential regulator of the industry, is responsible for establishing and enforcing Prudential Standards and practices, to ensure that financial promises made by superannuation entities are, within reason, met within a stable, efficient and competitive financial system; and
  - ASIC, as the conduct and disclosure regulator, is responsible for overseeing the relationship between registrable superannuation entity (**RSEs**) licensees and individual consumers.
- In response to this, the current section 4 of the SIS Act will be repealed and replaced with a simple outline of the supervisory responsibilities of APRA, ASIC and the Commissioner of Taxation. This will clarify what the role of each regulator is, and assist in highlighting that despite the regulators continuing to operate in a complementary and overlapping way, they will ultimately be focusing on different aspects of conduct.
- General improvements to section 6 and related provisions of the SIS Act will also be introduced, to update and simplify the allocation of the general administration of certain provisions between ASIC and APRA.
- ASIC's role under the SIS Act will also be expanded to include the promotion of consumer protection and market integrity, alongside disclosure and record-keeping.
- The only substantive change to be made to APRA's responsibilities is the reallocation of the general administration of section 68B of the SIS Act (which prohibits the promotion of illegal early release schemes) to ASIC.
- The Commissioner of Taxation's role under the SIS Act is unchanged.

Recommendation 6.4 – Give ASIC and APRA joint responsibility for enforceable consumer protection provisions within the SIS Act

- Commissioner Hayne also recommended that, without limiting APRA's existing powers, ASIC be provided with joint responsibility to administer provisions of the SIS Act that either attract a civil penalty or otherwise give rise to a cause of action against an RSE licensee or director for conduct that may harm a consumer.
- In response to this, the Government's Stronger Regulators Bill proposes to allow APRA and ASIC to co-regulate all provisions of the SIS Act that are underpinned by either consumer protection or member outcomes. The table below identifies which provisions of the SIS Act specifically will be included in this change. This will also further strengthen the expansion of ASIC's role to include the promotion of consumer protection and market integrity, as referenced above.

Expansion of the AFSL regime

- The SIS Act and RSE licensing regime were both primarily designed with prudential supervision in mind, therefore prioritising governance and capital obligations over others. Conversely, the Australian financial services licence (**AFSL**) regime promotes fairness, honesty and professionalism by those who provide financial services, by imposing specific duties on these licensees.
- Under the Government's Stronger Regulators Bill, the AFSL regime will be expanded to include almost all trustees of an RSE licensee across the industry, via the incorporation of a new financial service to s766A of the Corporations Act, being the provision of a "superannuation trustee service". This definition will capture all trustees **except** those of pooled superannuation trusts, in certain circumstances.
- Most importantly, the expansion of the AFSL regime to capture majority of trustees will mean that:
    - each trustee must hold an AFSL that authorises it to provide a superannuation trustee service, as this will be regarded as the provision of a financial service to a retail client; and
    - all relevant AFSL obligations (including those set out in Chapter 7 of the Corporations Act) will apply to these trustees.
- Importantly, regardless of this expansion, RSE licensees must continue to:
    - hold a separate AFSL authorisation to deal in a financial product if they are to issue, vary or dispose of an interest in a superannuation fund; and/or
    - hold a separate AFSL authorisation to provide financial product advice,

  if they intend to provide either of the above services.
- Providers of "superannuation trustee services" will also be captured by the consumer protection provisions set out in the ASIC Act 2001 (Cth).
- Despite the proposed introduction of co-regulation, ASIC will be required to obtain APRA"s agreement prior to pursuing certain enforcement actions (ie. cancelling an AFSL, imposing licence conditions and making banning orders) against RSE licensees.
- Similarly, for RSE licensees that are AFSL holders, APRA must consult ASIC before varying a licence condition, if the variation is likely to affect the AFSL holder"s ability to provide one or more of the financial services that it provides.
- With respect to penalties specifically, the Stronger Regulators Bill:

- requires that, when considering the imposition of a fine for a Corporations Act or ASIC Act offence committed by a superannuation trustee, the court must take into account the impact of this penalty on the beneficiaries of the RSE; and
- amends the *SIS Act's* indemnification rules to prevent superannuation trustees or their directors from using trust assets to pay criminal, civil or administrative penalties incurred following a contravention of any Commonwealth law.

The following table identifies those provisions of the SIS Act that are concerned with consumer protection and member outcomes, and are proposed to be co-regulated by both APRA and ASIC:

SIS Act provision	Brief description
▶ section 29JCA	False representations about status as an RSE licensee
▶ section 52 ▶ section 52A	Governing rule covenants for registrable superannuation entities, and the consequences of breaching those covenants
▶ section 54A	Power to prescribe other governing rules covenants in regulations
▶ section 54B	Governing rule covenants for registrable superannuation entities, and the consequences of breaching those covenants
▶ section 62 ▶ section 68	The sole purpose test and prohibition against victimisation, including of trustees, respectively
▶ section 108A	Duty of trustees to identify multiple superannuation accounts of members
▶ section 126K	It is an offence for disqualified persons to be trustees, investment managers or custodians of superannuation entities
▶ Part 21	Civil and criminal consequences of contravening civil penalty provisions (to the extent that the contravention concerns a provision administered by both APRA and ASIC)
▶ section 242K ▶ section 242L ▶ section 242M	Trustee obligations relating to eligible rollover funds and the consequences of breaching those obligations

9 ASIC'S NEW DIRECTIONS POWER

Alongside the proposed changes outlined above in this briefing note, the Government has made an additional commitment in response to Recommendation 7.2, to provide ASIC with powers to give directions to financial services and credit licensees consistent with the recommendations of the ASIC Enforcement Review Taskforce.

Additional commitment in response to Recommendation 7.2 – Provide ASIC with the powers to give directions to financial services and credit licensees consistent with the recommendations of the ASIC Enforcement Review Taskforce.

- In December 2017, the ASIC Enforcement Review Taskforce released its final report, which included a recommendation that ASIC be provided with the power to give directions to AFSL and credit licensees when necessary, in order to address or prevent risks to consumers. ASIC does not currently have this power.
- In his final report following the FSRC, Commissioner Hayne recommended that certain ASIC Enforcement Review Taskforce recommendations relating to the self-reporting of contraventions of law should be carried into effect. The Government has issued draft legislation in response to this recommendation (see section 1 of this briefing note above), and made an additional commitment to provide ASIC with a directions power.
- The Government proposes to enact the Financial Sector Reform (Hayne Royal Commission Response – Stronger Regulators (2020 Measures)) Bill 2020: FSRC Rec 7.2 (ASIC Directions), which will amend the Corporations Act and the Credit Act to provide ASIC with the power to give directions to AFSL and credit licensees in order to prevent or address suspected breaches of financial services law or credit legislation.
- If ASIC has reason to suspect that a licensee has engaged, is engaging or will engage in conduct that constitutes a contravention of a financial services law or credit legislation, and it considers that a delay in making a direction would be prejudicial to the public interest, it may give a direction in writing to the licensee.
- If the timing of the direction is unlikely to be prejudicial to the public interest, ASIC must provide the licensee with the opportunity to appear or be represented at a private hearing, and to make submissions, prior to issuing the direction.
- Once issued, ASIC may vary the direction, in writing, at any time. If the direction requires that a certain task be carried out, and the licensee nominates a certain person, ASIC may approve or not approve the person nominated.
- Licensees may also seek a review of the direction, via the Administrative Appeals Tribunal, at any time.
- If a licensee continues to engage in conduct in contravention of the direction, a civil penalty may be incurred.

10 FINANCIAL REGULATOR ASSESSMENT AUTHORITY

Recommendation 6.14 – The creation of a new authority to assess the effectiveness of each of APRA and ASIC in discharging its statutory functions and meeting its statutory objects.

- The FSRC highlighted that APRA and ASIC's effectiveness in delivering on their mandates was not subject to consistent and independent expert review over time.
- The proposed Assessment Authority Bill seeks to give effect to Commissioner Hayne's recommendation 6.14 of the FSRC – the creation of a new authority to assess the effectiveness of each of APRA and ASIC in discharging their statutory functions and meeting their statutory objects. This authority will be known as the Financial Regulator Assessment Authority (**FRAA**). The FRAA will be independent of the Government.
- To avoid unreasonably impacting ASIC's and APRA's independence, the FRAA will not have the ability to direct, make, assess or comment on ASIC and APRA's specific enforcement actions, regulatory decisions, complaints and like matters.

Establishment of the FRAA

- The FRAA will have four members. Three of the members will be appointed (the Chair and two other members). The fourth member will be a Departmental member, which will be the Secretary of the Department of State or a nominated Senior Executive Service employee.

Functions and powers of the FRAA

- The FRAA's proposed key functions are set out in Division 3, s 12 of the Bill. The functions include:
  - biennially assessing and reporting to the Minister on APRA's effectiveness and on ASIC's effectiveness;
  - when requested by the Minister, undertaking or causing someone else to undertake capability reviews of each of APRA and ASIC and reporting to the Minister; and
  - reporting to the Minister on an ad hoc basis on any matter relating to either or both of APRA's effectiveness and ASIC's effectiveness. These reports may be of the FRAA's own initiative. Alternatively the Minister may request a report.

The meaning of APRA's and ASIC's effectiveness

- Section 13 of the Bill defines APRA's and ASIC's effectiveness broadly. To fulfil its statutory duty, the FRAA will have to consider the following:
  - the effectiveness of ASIC and APRA in achieving the objects for which they were established:
    - for APRA — in section 8 of the Australian Prudential Regulatory Authority Act 1998; and
    - for ASIC — in section 1 of the Australian Securities and Investments Commission Act 2001;
  - the effectiveness of ASIC and APRA in performing their statutory functions and exercising their statutory powers;
  - the extent to which ASIC and APRA are independent in performing their statutory functions and exercising their statutory powers;

- the effectiveness of ASIC and APRA's frameworks for executive accountability under the Banking Executive Accountability Regime (**BEAR**);
- the extent to which ASIC and APRA comply with the requirement that they cooperate with the FRAA pursuant to Division 4 of Part 2 of the Bill; and
- other matters connected with the performance of either regulator's statutory functions or the exercise of either regulator's statutory powers that are specified in the rules (if any).

Matters that will not be within the FRAA's functions

- The ASIC and APRA are independent entities responsible to the Parliament, they will not be accountable to the FRAA.
- The FRAA will not have the power to direct the regulators to implement any recommendations it makes.
- The FRAA's functions will not include assessing or reporting about the effectiveness of one particular regulatory action or enforcement matter undertaken by APRA or ASIC.

Timing of assessments and capability reviews

- The Authority will be required to undertake the assessments on ASIC and APRA's effectiveness at least once every two years, starting in 2021.
- At least once every 4 years, starting in 2021, the Minister will be required to consider requesting the FRAA to undertake a capability review of APRA and/or ASIC.
- The Minister will be required to cause a copy of an effective report on ASIC or APRA to be tabled in each House of Parliament within 20 sitting days of that House after the report is received by the Minister.

Co-operation with the FRAA and Information Gathering Obligations

- Pursuant to section 20(1) of the Bill, APRA and ASIC, will be required to co-operate with the FRAA to the extent reasonably necessary to enable the FRAA to perform its functions and exercise its powers. "Co-operation" will include:
  - giving the FRAA any information that is requested; and
  - producing any document in APRA's or ASIC's possession that is requested by the FRAA; and
  - answering any questions asked by the FRAA.
- Information gathered by the FRAA will be considered 'protected information' if:
  - the information is prohibited from being disclosed under a law of the Commonwealth; or
  - the disclosure of that information would or could reasonably be expected to found an action for breach of a duty of confidence; or
  - the information is protected by legal professional privilege.
- Pursuant to section 39 of the Bill, the FRAA will be prohibited from including any protected information in a report or review and will be required to consult with APRA and ASIC to ensure that such information is not included.

GET IN TOUCH

We welcome conversations on the Draft Exposure Legislation. If you wish to have your own conversation with us on the report and how it may affect you and your business, please contact us:
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