

# Royal Commission Fallout

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# Royal Commission Fallout: The big 5 issues

## Corporate Governance & Boards

### WHAT ARE THE KEY THEMES SO FAR?

### WHAT SHOULD I BE THINKING ABOUT?

### WHAT'S NEXT?



#### Informing the Board

- Ensure that there are processes for “bad news” to reach the Board: whistle-blower or “speaking up” systems; red flag risk issues; incident management.
- Ensure that the messenger is not shot.

#### Relationships with regulators

- ASIC and APRA are reacting to criticism of perceived enforcement failures.
- Review relationship structures to ensure effective and co-operative communication lines.
- Consider whether negotiating positions on regulatory issues are consistent not only with regulatory obligations but also with relevant community standards.

#### Governance review

##### Are your governance structures & processes effective?

- Board committee structure.
- Relationship between Board and management, including appropriate reporting lines.
- Concise and effective management reporting.

##### Does your board inculcate the right culture?

- Management of non-financial risks.
- Consequences for conduct failures.
- Customer complaints reporting and analysis.

##### Supervision of intermediaries

- Clarifying the obligations of brokers.
- Supervising and training external representatives.

#### Resolving structural conflicts of interest

- Managing conflicts between duties to different groups of stakeholders.

##### Pressure for structural separation

- Separating advice from product manufacture and distribution.

##### Directors' obligations

- Shareholder primacy under challenge.



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## Financial Advisers & Brokers

### WHAT ARE THE KEY THEMES SO FAR?

### WHAT SHOULD I BE THINKING ABOUT?

### WHAT'S NEXT?



#### Revising adviser and broker remuneration model

#### Pressure to cease grandfathered commissions will continue

#### Ownership by product manufacturers criticised

#### Increased ASIC focus

- Expect a continued focus by ASIC on financial advisers and brokers, both on known issues (e.g. "fee for no service") and emerging issues such as selling practices which risk characterisation by ASIC as personal advice not general advice.

#### Impact on revenue

- If FOFA grandfathering and other exceptions and caps are further narrowed, what impact will this have on revenue?
- Should we move to a pure fee for service model?
- What level would caps on broker commissions be set at and what impact would that have?

#### Approved product lists and preferred platforms

- Revisit approved product lists in light of RC comments on best interest duty and advice on products not on the list.
- Review whether recommending clients invest via a platform is in their best interests and whether advisers should have a range of platforms that they recommend.

#### Commissions

- Remove exceptions to bans on commissions such as grandfathering, the total carve out of general insurance and the caps on life insurance and CCI?

#### Vertical integration

- Although a ban is unlikely, legislative and regulatory barriers to advisers and brokers being owned by product manufacturers?

#### Product distribution and invention

- The Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 is likely to pass early next year and the product intervention power will commence immediately.
- The intervention power could result in banning or restricting the sale of more risky products or products with little consumer benefit. The product distribution obligations will apply to advisers 2 years after the Bill receives assent.



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## Remuneration

### WHAT ARE THE KEY THEMES SO FAR?

### WHAT SHOULD I BE THINKING ABOUT?

### WHAT'S NEXT?



#### Key themes

- Remuneration structures are contributing (or maybe even the root cause) of conduct issues.
- Inadequate use of remuneration adjustments as a consequence management and accountability tool.
- Inadequate governance of remuneration outcomes at board level.

#### Variable remuneration

- Should any “customer facing employees” be paid variable remuneration (ie incentives)? What about senior managers/executives?
- Do your variable remuneration schemes:
  - only reward financial performance?
  - align remuneration practices to culture, values, risk profile, risk appetite as well as financial objectives?
  - allow adjustment of variable remuneration for poor conduct and risk outcomes?

#### BEAR

- How will you comply if BEAR is expanded?
- Reviewing your remuneration practices “holistically” as part of BEAR.

#### Governance

- The need for a consequence management framework for consistent and fair decision making.
- Providing your Board/remuneration committee with enough information for an informed decision about remuneration adjustments.

#### Variable remuneration

- Increased focus on metrics based on risk/customer outcomes (including potential upside) – there is a possible tension with shareholder expectations.
- Possible bans on variable remuneration for some roles.
- Extension of deferral periods (even beyond BEAR, perhaps up to 7 years).
- Adoption of FSB supplementary guidance on sound compensation practices.
- Mandating of clawback for bad conduct and not just *malus* adjustments.

#### BEAR

- Likely extension beyond ADIs.
- Expansion of BEAR variable remuneration rules beyond accountable persons.

#### Increased governance of the remuneration framework/outcomes

- Boards need to provide comprehensive guidance on how reductions to variable remuneration should be determined.
- Banks will be expected to have a database/library of consequence management options to assist in learnings and set clear expectations.
- More comprehensive information from risk and audit to allow for sufficient Board review of issues impacting remuneration outcomes – and explanation for adjustments.
- Increased communication of outcomes to reinforce the link between accountability and consequence.
- Focus on collective accountability.



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# Royal Commission Fallout: The big 5 issues

## Consumer & Small Business Lending

### WHAT ARE THE KEY THEMES SO FAR?

### WHAT SHOULD I BE THINKING ABOUT?

### WHAT'S NEXT?



#### Distribution channels

Changes to distribution channels for consumer finance products seem likely:

- Possible introduction of a best interests duty for brokers.
- Possible ban on brokers receiving trail commission.
- Possible removal of POS exemption.

#### Verification of expenses

Changes to the requirements for verification of expenses under the NCCP Act's unsuitability assessment seem likely.

#### Small business lending

It seems unlikely that the NCCP Act will be extended to small business lending. ASIC is likely to continue to regulate through the enforcement of unfair terms provisions.

#### Distribution channels

- If the POS exemption is removed how will white labelled credit cards and auto finance products be distributed (for example, will a credit representative model be adopted)?
- Should alternative distribution channels for consumer finance generally be strengthened (for example, by improving online distribution capability)?

#### Verification of expenses

- How can expenses be verified (other than through the use of a benchmark)? Will open banking provide the solution?

#### Unfair terms for small business lending

- Do my standard form documents take into account ASIC's guidance?

#### Updates to standard form documents

- Updates to standard form documents to reflect ASIC's guidance on unfair terms and the new Banking Code of Practice should continue to be rolled out across small business and consumer products.



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## Regulators & their approach

### WHAT ARE THE KEY THEMES SO FAR?

#### Regulatory architecture, enforcement options and accountability

##### APRA

- In releasing the final report of the Prudential Inquiry into CBA, APRA suggested all regulated financial institutions would benefit from conducting a self-assessment to gauge whether similar issues exist in their own institutions.
- APRA is reviewing enforcement strategy.

##### ASIC

- ASIC Enforcement Review Taskforce proposals to strengthen penalties for corporate and financial sector misconduct.
- ASIC-embedded supervisors.

##### ACCC

- ACCC further developing in the role of competition champion.

### WHAT SHOULD I BE THINKING ABOUT?

#### Breach reporting & regulator engagement

- Do you have historical exposures to breach reporting?
- Do you have effective and cooperative communications with the regulator?
- Do you correctly describe breaches? What haven't you reported?

#### Review governance outcomes from breaches and customer complaints

#### Remediation and organisational response to breach and complaints

### WHAT'S NEXT?



#### More frequent enforcement action and greater targeting of individuals

#### The Royal Commission is focussing on better enforcement of existing laws rather than new laws and regulations, BUT some law reform is likely:

- Increased enforcement powers of ASIC - Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 was introduced 24 October, currently in senate.

#### Questions for further submissions and consideration

- Transferring regulation of consumer protection in financial services from ASIC to the ACCC or a new body.
- Creation of a new regulator to supervise the regulators (ASIC, APRA, ACCC).
- Extension of the BEAR regime to other APRA-regulated companies, and possibly more broadly.



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