



ANNUAL — MEETING —

November 10-13, 2019
Honolulu, HI



Hilton Hawaiian Village
Waikiki Beach Resort

Australian Royal Commission

Misconduct in the Banking, Superannuation and
Financial Services Industry

Hawaii, November 2019



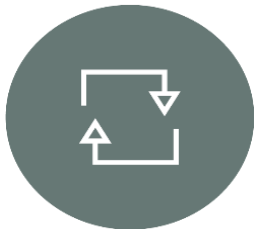
Agenda



BRIDGE TO TOMORROW
2022 INTERNATIONAL
CONGRESS OF ACTUARIES
3-7 APRIL 2022 • SYDNEY



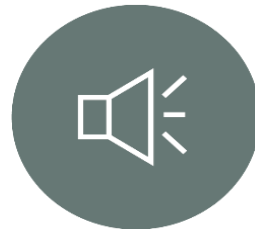
International Actuarial Association
Association Actuarielle Internationale



Background



Royal Commission and
Process



Recommendations
& Impacts



Take-outs for
Property & Casualty

Acknowledgements:

Greg Martin, Chief Actuary and Risk Officer Clearview
Presentation to IAA Washington, May 2019

Nicolette Rubenstein, 2019 Institute President
CPD Tour Presentation 2019

Australian Royal Commission

Misconduct in the Banking, Superannuation and Financial Services Industry

1. Background

Overview of Aus Financial Services Sector

Banking (Banks & ADIs)

Total Assets \$4.8t (US\$3.4t) ¹

4 Big banks (76% of total)

- All own large % of retail super and life insurance

144 entities in total

70 mutuals (mostly small to medium sized)

Superannuation

Total Assets \$2.7t (US\$1.94t) ¹

Industry Funds (38) \$0.6t (24%)

Retail Funds (116) \$0.6t (22%)

Self Managed (597k) \$0.7t (27%)

Public Sector (18) \$0.5t (17%)

Other (2k) \$0.3t (10%)

Insurance (Risk Only)

Total Premium \$88b (US\$62b) ¹

Life Insurance (31) \$17b (19%)

P&C Insurance (96) \$47b (54%)

Medical Funds (38) \$24b

Other Funds Management

Total Assets \$0.6t (US\$0.4t) ¹

Life Insurance \$0.2t (35%)

Retail Funds etc \$0.4t (65%)

(1AUD = 0.7USD)

Population: 25 million

GDP \$1.9T (US\$1.3T)

Key Regulators (“Twin Peaks”)

Australian Prudential Regulation Authority
APRA: Prudential supervisions of regulated entities

Australian Securities & Investments Commission
ASIC: Conduct, Markets, Disclosure, Corporation

Consumer / Media

Greed the common thread in scandals

Banking royal commission told 90% of financial advisers ignored clients' best interests

Inquiry also told that just 35% of all financial advisers have a degree at bachelor level or above

Insurers admit litany of wrongdoing

Miss Han
The country's largest insurers have admitted a litany of misdeeds and conduct falling below community standards, with the disclosure of a royal commission report.
All of the operating subsidiaries of royal commission of the banking royal commission on-premises the country's biggest insurers admitting the commission's findings on ranging from mis-selling to mis-selling, including advertising, systems, and mis-selling.
The country's biggest insurers pre-empted the commission's findings.



Bank royal commission

its final report to

Financial planning rot more than just a few bad apples

By business reporter Andrew Robert
Posted 24 Dec 2018, 6:01am

For the financial planning industry to come back up as the year where the rot is hidden.

"Just a few bad apples", the industry is constantly told us as scandal is revealed, and people's financial lives ruined.



Westpac advice cost couple dream retirement, banking royal commission hears

19 April 2018

Commonwealth Bank charged fees to dead clients, royal commission hears

19 April 2018

Banking royal commission: AMP executive says company put profits before the law

17 April 2018

Banking royal commission — a bald-faced lie

the top
national
argo.

Commonwealth Bank charged fees to dead clients, royal commission hears

Some advisers charged the deceased for financial advice — in one case for a decade
Sign up to receive the top stories in Australia every day at noon
Has your financial future been destroyed by a bank?

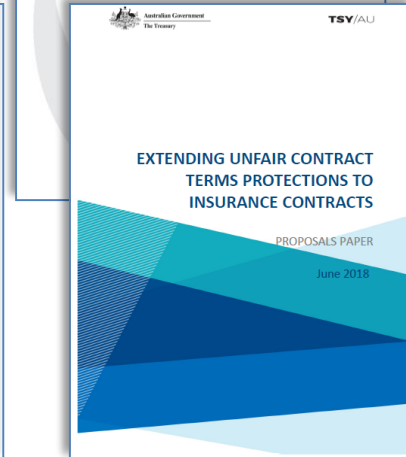
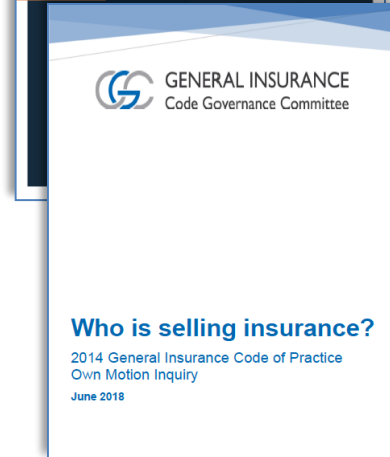
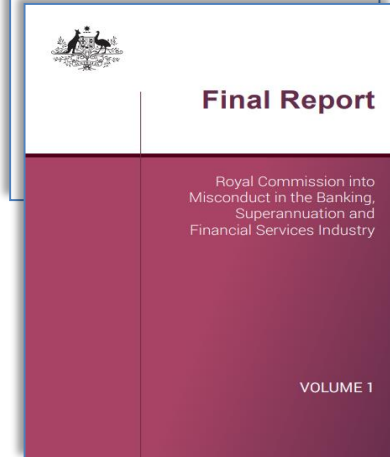
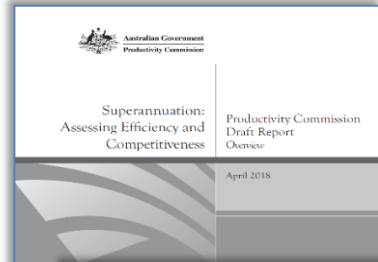
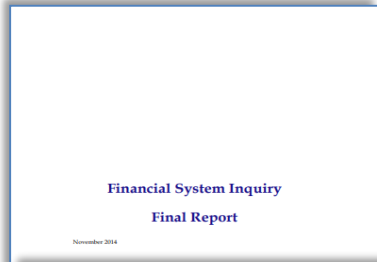


Recent reports & inquiries /

subsequent actions

SAMPLE ONLY

Some linked to scandals....Banking, Financial Advice, Life Insurance, Superannuation, etc....including some individual entities...some about sector improvement....



Australian Royal Commission

Misconduct in the Banking, Superannuation and Financial Services Industry

2. Royal Commission and Process

What is a Royal Commission...

Process

A Royal Commission is a “legal” type process

- In a court room but not ordinary court rules. People appear as witnesses
- Submissions by victims, public, public bodies, others
- Extensive power to demand information; little scope to decline
- Examination in Commission is basically “one way interrogation”
- Commission has no power to convict or make judgements, but can refer...
- Was a bit over a year in its process (from late 2017 to early 2019)
- RC produced an Interim Report in later 2018 and a Final Report 1 Feb 2019
 - Over 2,500 pages altogether

The Royal Commission is established...

"To inquire into and report on misconduct in the banking, superannuation and financial services industry"

- Broad mandate – examined misconduct that breached law or agreed industry guidelines and conduct that did not meet community standards and expectations
- Companies had to self declare all cases of misconduct
- Public submissions - 10,140 submissions received
 - 61% banking
 - 12% superannuation
 - 9% financial advice
 - 18% insurance and general
- Case Study approach in parallel:
diving deeply into the details of specific individual experiences



What is a Royal Commission... Evidence

- Many institutions called to give evidence (banks, insurers, superannuation trustees)
- All called had to provide a catalogue of admissions of breaches (at least 5 years)
- Most had to produce multiple witness statements
- Vast amounts of information was call for...easily millions of documents
- Many called to give evidence, on witness statements and other evidence
 - Board members, executives, managers, regulators, victims, the public
- Was streamed live on the Royal Commission Website and picked up nationally
- Headlines most days in newspapers, online and nightly TV news

Social Media & Community Expectations”

- The Royal Commission generated sustained interest, with over 240,000 social media mentions and 450,000 engagements between the 13 March 2018, when hearings began, and the 28 September 2018 when the interim report was released.
- The Public Hearings were streamed live on webcast.
- Users interacting with the Royal Commission on social media are more likely to become part of a conversation rather than simply liking a post and moving on.

“The audience [become] influencers themselves as they introduce new keywords, hashtags, complaints, ideas, point the finger at individuals and ultimately keep the conversation – and the outrage – going.”

Australian Royal Commission

Misconduct in the Banking, Superannuation and Financial Services Industry

3. Recommendations and Impacts

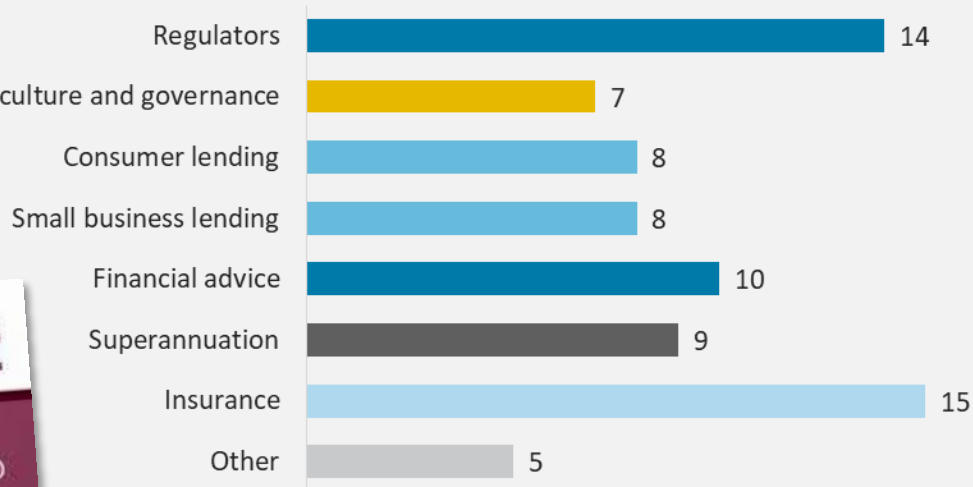
Recommendations... At a glance

Key themes:

- ▲ Simplifications of laws
- ▲ Regulator's enforcement culture
- ▲ Role of remuneration in culture and governance
- ▲ Managing conflicts of interest and non-financial risks
- ▲ Leadership and responsibility
- ▲ Power

The commissioner made 76 recommendations

Remuneration, culture and governance



Source: Gilbert & Tobin

Hayne's main recommendations:

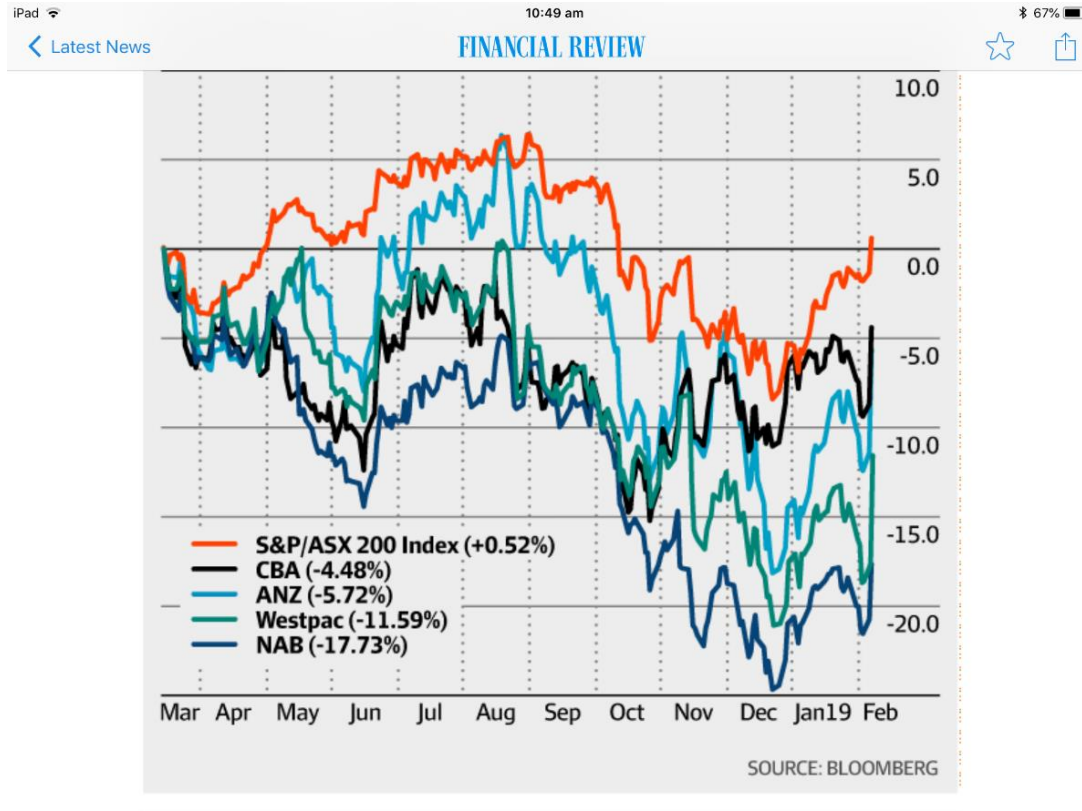
- Mortgage brokers required to act in the best interests of the borrower
- Mortgage brokers to charge borrowers rather than lenders
- Insurance providers required to "take reasonable care"
- Funeral insurance to be subject to financial service laws
- Cap on insurance sales commissions for car dealers
- Reduced cap on life insurance commissions
- Cold call selling of financial products banned
- Ongoing fee arrangements to be reappraised annually
- "Grandfathering" of fee arrangements to stop
- Banks to no longer charge dishonour fees on basic accounts
- Banks to no longer provide overdrafts on basic accounts without consent
- National scheme for mediation of farm debt
- Industry-funded compensation scheme of last resort
- Super fund trustees not to be employees of super fund owner
- Australians to be defaulted into only one super fund, once
- ASIC to use court action as the "starting point" for considering how to take action
- External body to oversee APRA and ASIC



Photo: AAP/Eddie Jim



Specific Impacts – Financial



Bank Shares fall significantly down about 10% below S&P (key market index)

Specific Impacts – Reputations and roles

Royal commission suggests criminal charges over 'widespread' fees-for-no-service scandals

Banking royal commission: How dead people can be charged bank fees



Junk insurance – the Royal Commission digs deeper



'lied' to regulator about advice fees



Specific Impacts – Businesses



CommonwealthBank

CBA announces intention to demerge wealth management and mortgage broking businesses



The ANZ Bank's Australian wealth business is for sale



NAB to exit wealth and MLC



AMP has sold its insurance business for \$3.3 billion



Westpac to sell off financial advice business

Hayne's commandments



1. OBEY THE LAW
2. DO NOT MISLEAD OR DECEIVE
3. BE FAIR
4. PROVIDE SERVICES THAT ARE FIT FOR PURPOSE
5. DELIVER SERVICES WITH REASONABLE CARE AND SKILL
6. WHEN ACTING FOR ANOTHER, ACT IN THE BEST INTERESTS OF THAT OTHER.

Australian Royal Commission

Misconduct in the Banking, Superannuation and Financial Services Industry

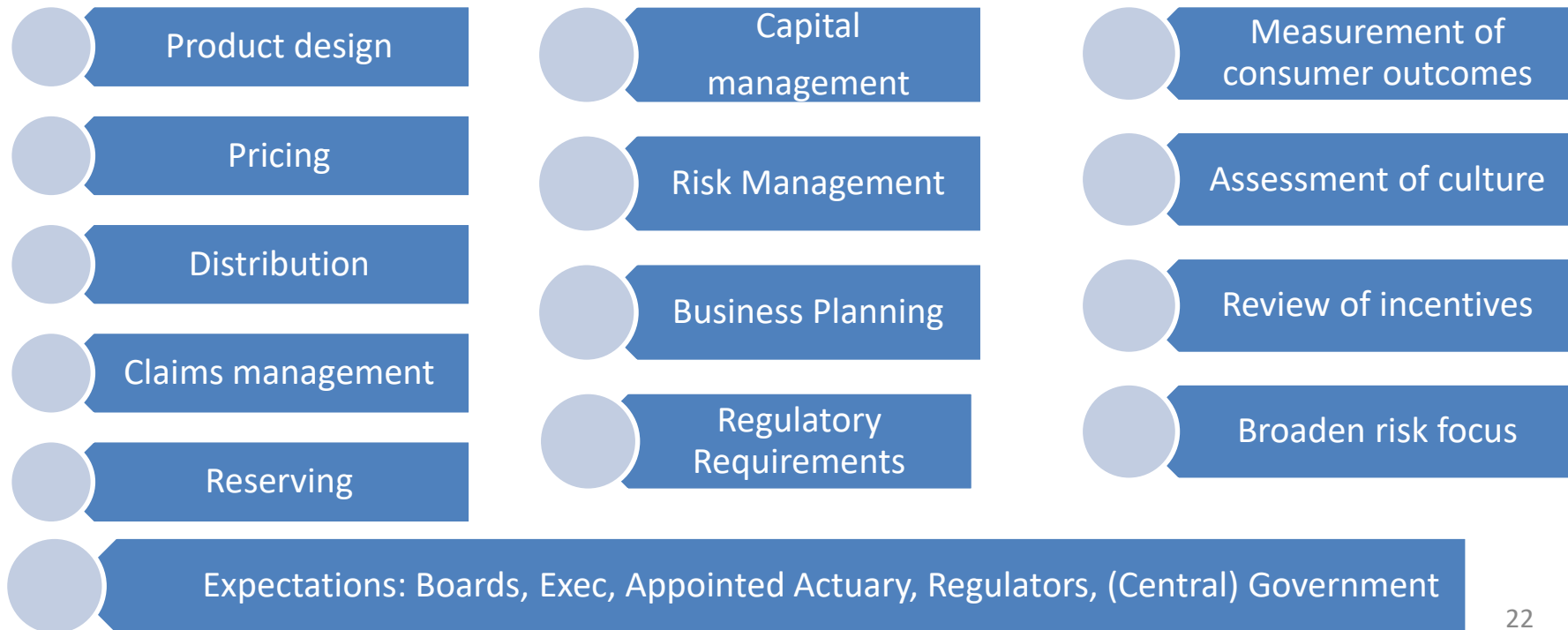
4. Key for Property and Casualty

DDP/PIP and other Reforms.

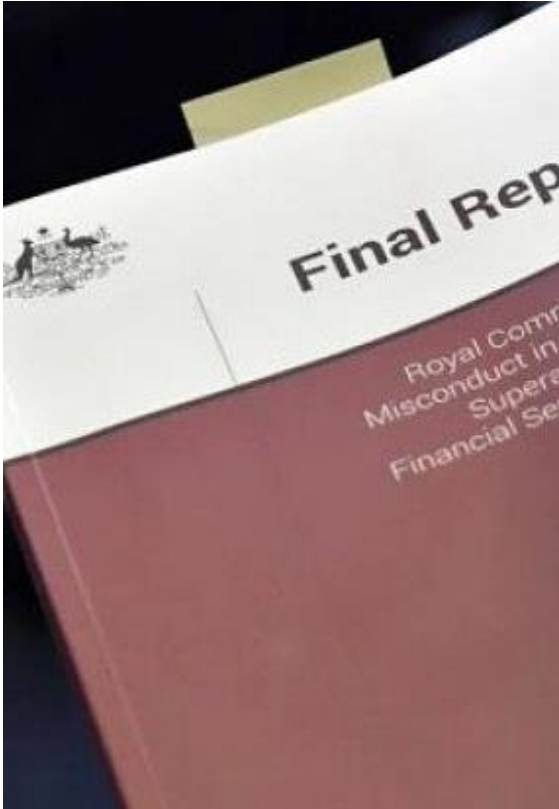
Actuaries and the Institute

Why is the RC response important

The RC has, and will continue to, impact:



Recommendations & implementation roadmap for P&C



Complete: **Design and distribution obligations.**

To be introduced by end-2019:

- Recommendation 4.7: **Extension of unfair contracts terms to insurance contracts.**
- Recommendation 4.8: **Removal of claims handling exemption** – claims handling would be covered under the definition of 'financial service' under the Corporations Act. (Timing ?)

To be consulted on and introduced by June 2020:

- Recommendation 1.15: **Make provisions of industry codes enforceable.**
- Recommendation 4.1: **No hawking of insurance products.**
- Recommendation 4.3: **Deferred sales model for add-on insurance.**

- By end 2020, **extend BEAR** to all APRA-regulated institution and **establish compensation scheme of last resort.**

Design & Distribution Obligations and Product Intervention Powers

What is it

The Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019 (DDO & PIP Act) has passed and received Royal Assent on 5 April 2019.

Design and Distribution Obligations (DDO):

- target market determination
- covers certain retail financial products
- distribute products only to target market – for each product
- take reasonable steps to ensure that distribution is consistent

Product Intervention Powers (PIP)

ASIC is given powers to proactively intervene ...
when the conduct is or is likely to result in significant detriment to retail clients.

Who is impacted?

The DDO & PIP Act applies to financial products and credit products that are issued and distributed to **retail customers**.

The DDO obligations applies to financial products and credit products that are regulated under the *Australian Securities and Investments Commission Act 2001*.

Product issuers of financial products that require a Product Disclosure Statement (PDS) or products that require disclosure to investors. This includes Insurance

All **product distributors** (insurer, underwriting agencies and any other authorised representatives) of impacted products

Exempted currently are: financial products where there are existing similar laws (eg. Motor Compulsory Third Party insurance).

Consequences of non-compliance

- Failure to comply with the provisions gives rise to:
- liability to the state through civil penalty proceedings or criminal prosecution. A contravention of the new regime is both a civil penalty provision and an offence; and
- liability to persons suffering loss or damage through civil action.

DDO regime and the PIP regime recognised in the Treasury laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019, (12 March 2019), amends the civil penalty and criminal offence provisions of the Corporations Act 2001 and the National Consumer Credit Protection Act 2009

Timing

- Product Intervention Powers – Now
- Design and Distribution Obligations – 6 April 2021 (2 years from Royal Assent)

Reforms to the sale of add-on insurance products

Federal Treasury

Consulting on significant reforms

Deferred sales model

- Tiered structure
- Exemption for Motor vehicle insurance
- Draws on UK Financial Conduct Authority model for Guaranteed Asset protection

Cap on certain commissions

- Address reverse competition

Significant impact to

- Travel Insurance
- Ticket event / cancellation
- Consumer credit Insurance (possibly Lenders Mortgage Insurance)
- Range of Motor add-ons
- Home contents insurance

Chart 1: add-on insurance products by number of products sold⁹

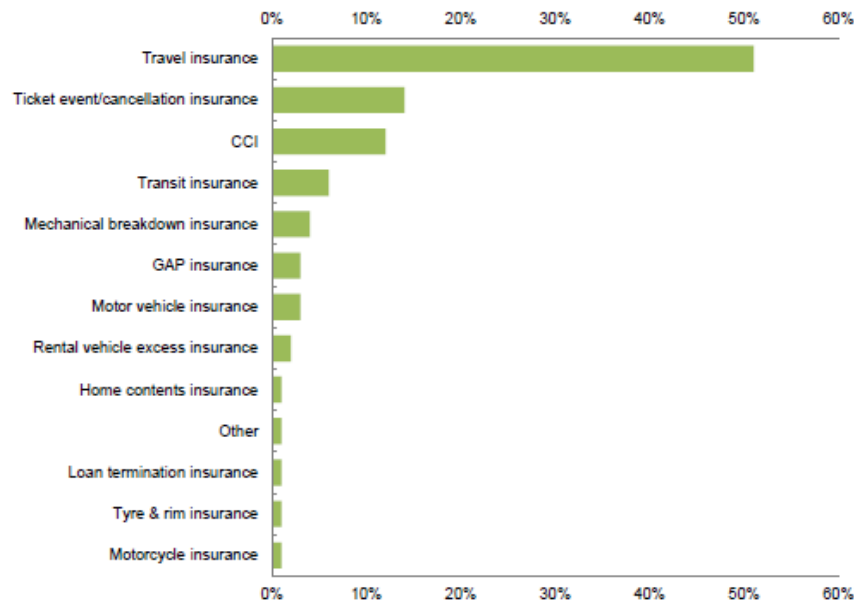


Table 1: Tier summary

Tier	Description of add-on insurance product by tier	Proposed treatment under legislation
1	Products causing significant consumer detriment	ASIC Product Intervention Power
2	Default tier for all add-on insurance products (not in tiers one and three)	Legislated deferred sales model
3	Case-by-case exemptions for products that meet relevant criteria	Legislated ASIC exemptions power

Extending Unfair Contract Terms to Insurance contracts

Federal Treasury Proposal Paper June 2018

- Responses due 28 August 2019

Objectives

- Removes exemption
- Consistency in consumer protection
- Increase incentives for improvements
 - Clarity and transparency
 - Remove unfair terms
- Provide appropriate remedies for the Australian Securities and Investments Commission

Term Unfair

- Causes significant imbalance
- Not reasonably needed to protect interest of party advantaged by the term
- It would cause detriment (financial or otherwise) where applied or relied upon
- Clarity / transparency will be important
- Will consider the contract as a whole

Key Implications

- Address product design: Main Subject Matter clear
- (Re)- Examine Product disclosure statements
- Ensure price and excess / deductibles clearly disclosed
- Examine claim denial terms – e.g. blanket mental health exclusions on Travel Insurance
- Challenges Uberima Fides / Utmost Good Faith
- Third Party beneficiaries able to act against insurer

So what about our profession?

Of the 76 recommendations around half have direct application to actuaries, e.g. :

- Product design and pricing
i.e. designing fit for purpose products that are fair to the customer
- Advising Boards on financial and non financial risks
- Contributing to a culture that drives good conduct
- Helping determine what is 'best interest'
- Balancing the interests of the shareholder and customer

So what about our profession!

Cont...

The areas discussed will impact most areas covered by CPS320, including:

- The Actuarial Valuation Report (AVR)
- The Financial Condition Report (FCR)
- Functions captured by the Actuarial Advice Framework (AAF)

In addition:

- Boards and senior management are likely to require greater actuarial input
- APRA expects more from the Appointed Actuary
- APRA / ASIC - a harder enforcement approach

APRA's expectation:

“In an environment where financial entities face sharper scrutiny and steeper penalties for mistakes, actuaries must find the story behind the numbers, ask boards and management the difficult questions, and be prepared to challenge them if dissatisfied with the answers.”

John Lonsdale,
Deputy Chairman APRA

So what about our profession!

Cont...

- We need to take account of community expectations in everything we do
- We cannot define our roles as pure technical experts
- We need to think about our obligations in assessing and reporting on product profitability – not only what is enough, but what is too much
- We need to take greater account of non financial risks as well as financial risks
- ▲ We need to review what information we provide to the board
- ▲ We need to understand the obligations of our various stakeholders
- ▲ We need to think about our own personal behaviors and how we contribute to an ethical culture

What have we learnt?



- Human fallibility – impact of greed
- Some conflicts of interest cannot be managed
- Deep seated cultural issues
- Lack of focus on non financial risks
- Too slow to put things right
- Gaps in reporting to the board
- Community expectations needs to be the test, not the law



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**Actuarial
Institute**
Australia



International Actuarial Association
Association Actuarielle Internationale

We hope to see you there!

CONGRESS DATES:

3 – 7 April 2022

CONGRESS VENUE:

International Convention Centre Sydney

www.ica2022.org

Further Information:

- The Scene before the commission
- Commission and process
- Detail on the recommendations
- Broader responses (so far)

Thank You

Australian Royal Commission

Misconduct in the Banking, Superannuation and Financial Services Industry

2. Further detail on recommendations

Key Recommendations... Main observations for P&C

Insurance & Underwriting

- Insurance “duty of disclosure” to change to “duty of reasonable care”
- Only avoid a contract if can show would not have entered on any basis
- “Unfair contract terms” legislation to apply to insurance
- “Claims handling” to be deemed a “financial service”

The Regulators APRA & ASIC Themselves

- ASIC: Start at “why not litigate” (not “why litigate”). Take a lot more things to court
- Review APRA and ASIC roles: Clearer Prudential versus Conduct split
- BEAR to apply to APRA/ASIC executives
- New APRA and ASIC oversight body. Capability reviews. Increased governance

Treasury

- Examining reforms to the sale of add-on insurance products
 - Likely introduction of a deferred sale model

Key Recommendations... Main observations for P&C

APRA Focus

- APRA: more focus on non-financial risks, rather than financial risk dominant
 - Misconduct, compliance
 - More focus on remuneration to support non-financial risk management
 - Specific focus on sales (“front line”) staff
- Focus on Culture & Governance
 - Question: Should institutions adopt the RC “6 norms” in their “values”?
 - APRA: Focus on institutions build and monitoring cultures that mitigate misconduct

Sales (especially hawking)

- Unsolicited offer of superannuation and insurance products to be prohibited
 - ASIC to use Design and Distribution Obligations/Product Intervention Powers (**DDO/PIP**) to limit accident and funeral products if remain a concern
- Probable introduction of a deferred sales model for add-on products

Key Recommendations... Main observations for P&C

Expand BEAR to regulated financial services (FEAR?)

- Banking Executive Accountability Regime to be extended
- To Banking, Superannuation, Insurance
- Remuneration: Variable component, minimum deferrals, clawbacks
 - E.g. 40% variable, four year deferral/clawback...
- Specific executive (“Responsible Person”) to be accountable for end-to-end product administration to ensure “no misconduct”

Industry Codes

- All APRA regulated entity codes to be enforceable by ASIC
- Review of General Insurance Code of Practice
 - Likely to capture those distributing products

Other

- Implement compensation scheme of last resort
- Review laws and remove “exceptions” as much as possible
- Law should spell out behavioural norms that are required

Key Recommendations...the rest of the picture

Commissions...on what remains allowed

- Mortgages: No upfront or trail commission should be allowed
 - Move to fee for service
- Review life insurance: ban commission unless underinsurance would emerge
 - Move to fee for service
- Review by 2022 if P&C and other insurance commissions remain “justified”
 - Place a cap on “add-on insurance” anyway
- Bans on commission (volume based payments) to be applied beyond advisers (to aggregators, licensees, etc)
- Existing grandfathered commissions (on investment products) to be banned

Mortgage brokers

- Regulate as “Financial Advisers” (giving personal advice), Best Interests Duty, etc

Financial Advice

- Annual opt-in for ongoing “fees for service”. Clients to provide express authority to product issuer (essentially banning ongoing recurrent fees really)

Key Recommendations...the rest of the picture

Financial Advice & Financial Advisers/Licensees

- Non-independent advisers to give statement explaining non-independence
- Review by 2022 the current best interest duty “safe harbours”
- Licensees mandatory reporting of “bad” advisers to ASIC
- Mandatory for licensees to investigate and remediate adviser misconduct
- New central adviser Disciplinary Scheme
- Higher education standards and increasing professionalism for advisers

Superannuation

- Restrict issuer (trustee) role to be just trustee (no other commercial roles)
- Commentary on advice fees deducted; has to meet “sole purpose test”
- Individuals to have only one “default account” to be allowed

Sales (especially hawking)

- Unsolicited offer of superannuation and insurance products to be prohibited
 - ASIC to use DDO/PIP powers to limit accident and funeral products if remain a concern
- Unsolicited cross-selling of superannuation to be prohibited
- Cannot sell superannuation product for linked benefits (e.g. lower bank product fees)

Key Recommendations...the rest of the picture

Banking & Finance Products

- Strengthen vulnerable customer treatments
- “Small business” definition increase to \$5m loans, 100 employees
- Farm debt mediation scheme to be implemented
 - Default interest margin on farm debt to be zero in drought
 - Distressed farm debt management requirements
- Consumer finance “point of sale” exceptions to be removed
- Execs have to deal with APRA/ASIC in open, constructive and accountable way

Penalties & sanctions

- Lots of increased penalties proposed....new specific sanctions

Conflict management

- A lot of commentary (not recommendations) about difficulty of managing conflicts
- Increased requirements/restrictions on related party arrangements (e.g. inhouse insurance products in superannuation)
- Greater requirements for superannuation trustees in terms of member best interests

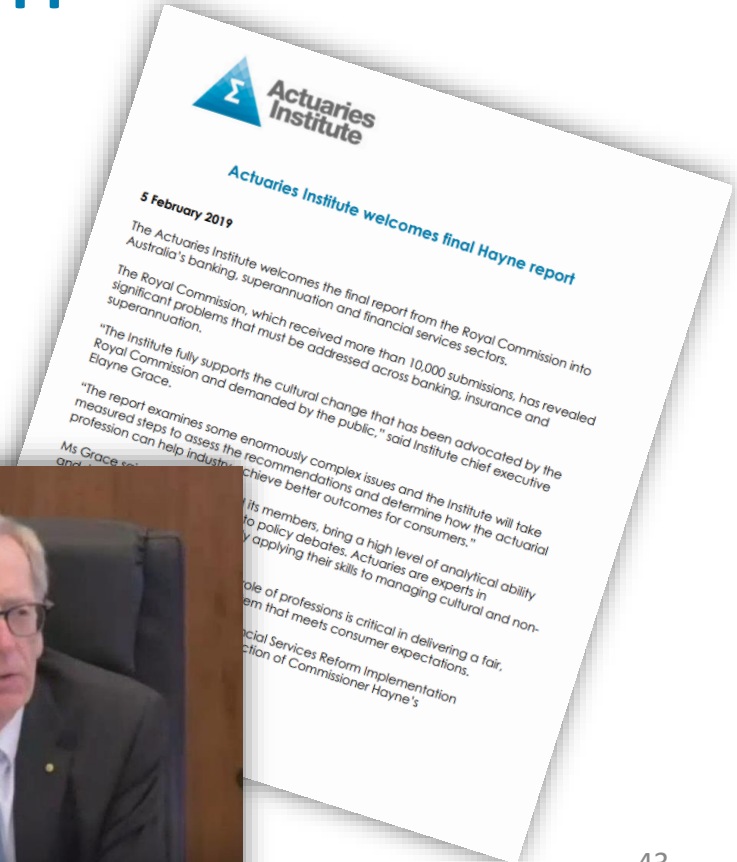
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4. Response & Actions (So far)

Royal Commission

- CPD Professionalism Tour
- The Social Condition Report paper (Laughlin/ Bernau)
- Review of Code of Conduct
- Role of Appointed Actuary
 - 5 new Professional Standards



- Following the Final report....a Federal Election was due...
- Both sides of politics promised to implement all recommendations
 - However, both side of politics seemed to have backed away from the recommendations on banning mortgage broking commission; Concerns over industry competition - biggest impacts on the smallest banks and risk of re-centralisation of mortgage provision
- There was already an extensive program of regulatory change coming
 - Now being added to....fast execution....not always complete...little time to implement
 - Some legislation regarding tougher penalties has already been passed. Legislation banning grandfathered commission and changes to claims handling already drafted
 - Financial sector under a lot of pressure
- Regulators taking a more assertive stance
 - ASIC: Publicly stated their enforcement teams assessing taking (litigation) action in respect of 12 case studies addressed by the Royal Commission plus 16 other case studies
 - APRA: Taking action against a significant listed financial services group: Chairperson, CEO and other Exec.s named
 - A number of pre-existing investigations/remediations being expanded in scope and detail
- Significant fall out generally....e.g...in addition to the above
 - 1 of the big 4 banks: Chairperson and CEO resigned
 - Large financial services group: Chairperson, multiple Board members and CEO resigned

The banking and wealth industry completely restructured



CBA announces intention to demerge wealth management and mortgage broking businesses



The ANZ Bank's Australian wealth business is for sale



NAB to exit wealth and MLC



AMP has sold its insurance business for \$3.3 billion



Westpac to sell off financial advice business

Big Board & Management Changes



Regulators change approach



Widespread review of remuneration

BEAR

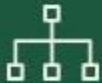
The key elements



REQUIREMENT FOR REGISTRATION OF AN ADI'S "ACCOUNTABLE PERSONS"



STATUTORY OBLIGATIONS TO ACT WITH HONESTY AND INTEGRITY, WITH DUE SKILL, CARE AND DILIGENCE AND DEAL WITH APRA IN AN OPEN, CONSTRUCTIVE AND COOPERATIVE WAY



A REQUIREMENT FOR ACCOUNTABILITY MAPS AND STATEMENTS



DEFERRED REMUNERATION REQUIREMENTS





ANNUAL — MEETING —

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