Governance News

4 June 2018

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Contents

Diversity 5

In Brief | No consensus on gender quotas? The AFR reports that former winners of the Women of Influence Awards are in agreement on the need for recruitment firms to be more proactive in putting forward women, lowering the cost of childcare and other measures, but that there is no consensus on whether targets are necessary to ensure more women are promoted to the C-suite in companies, government and not-for-profit organisations. 5

Remuneration 5

United States | Latest Equilar/Associated Press CEO Pay Study 2018 released: S&P 500 CEO pay increased 8.5% last year; CEOs in the healthcare sector had the highest median pay; female representation decreased 5% (from 6% last year) but women CEOs earned more than their male counterparts on average. 5

In Brief | Sloppy reporting? At least 16 companies in the S&P 500 have reportedly changed 2016 pay figures by more than 10% for one or more executives, while 17 did so for 2015 pay, a WSJ analysis of data from MyLogIQ LLC shows. According to The WSJ, many changes are errors caught after companies send proxies to shareholders. 5

Other Shareholder News 5

United States | 'Recycling' elements of the Financial CHOICE Act as a standalone Bill? New legislation has been introduced into the House which proposes to require the SEC to raise resubmission thresholds for shareholder proposals. Glass Lewis suggests this is an attack on shareholder rights. 6

New Zealand | New Bill proposes to provide clarity on 'dry shares': The Companies (Clarification of Dividend Rules in Companies) Amendment Bill proposes to amend s 53 of the Companies Act 1993 NZ to make it clear that a company's constitution can create a class of shares in which some carry the right to dividends and others ('dry shares') which do not. 6

Regulators 6

Australian Securities and Investments Commission (ASIC) 6

Top Story | ASIC areas of focus for 30 June Financial Reporting: New Accounting Standards identified as having the 'greatest impact' for many companies. 6

Top Story | ASIC Chair James Shipton has told the Senate Economics Legislation Committee that the regulator will be adopting a new 'more intrusive, enduring and, with onsite visits, more physical' approach' to supervision. 8

ASIC has given financial services firms an extra seven months to update their disclosure documents to meet new requirements introduced when the AFCA regime commences in November. RG 165 has also been amended to require information about predecessor schemes and AFCA to be provided to complainants from 21 September 2018. 9

Australian Prudential Regulation Authority (APRA) 9

Second APRA deputy chair: Treasurer Scott Morrison announced the reappointment of Helen Rowell as Deputy Chair of APRA and his intention to nominate John Lonsdale as an additional deputy chair subject to the passage of legislation enabling the appointment. 9

In Brief | APRA has released monthly banking statistics for April 2018. 10

Other Developments 10

Singapore | Transparency of short selling activities in Singapore: The Monetary Authority of Singapore (MAS) has announced new requirements for investors to report their short positions and short sell orders in securities listed on the SGX will come into effect from 1 October 2018. 10

Singapore | The Monetary Authority of Singapore has issued a statement of commitment to the FX global code. 10

Corporate Social Responsibility and Sustainability 11

In Brief | UK Modern slavery reporting is patchy at best? Analysis of modern slavery statements by companies in the textile and clothing sector has revealed 62% had not been formally signed by the board (among other quality issues) prompting the researchers to question whether further action is needed. 11

In Brief | Insurer QBE has reportedly committed a minimum $100m towards socially progressive projects in Australia and globally as part of its Premiums4Good program. QBE is reportedly looking towards areas such as affordable housing, renewable energy and healthcare. 11

Financial Services 11

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) 11

Top Story | Royal Commission Round Three Hearings Week 2: Consideration of cases in which small business arrangements with their lenders was varied or came to an end; the role of lenders and the FOS in resolving complaints. 11

The royal commission's investigation has prompted almost a third of Australians to consider switching banks, according to a Customer Owned Banking Association commissioned study. 14

New Zealand | No need for a Financial Services royal commission yet? The Reserve Bank of New Zealand and the Financial Markets Authority have reportedly said that there is no evidence to support a Royal Commission into the NZ system as yet, but that this view could change pending the result of further investigations. 14

In Brief | Round 4 Hearings will be held between 25 June and 29 June in Brisbane and Darwin and will focus on issues affecting Australians in remote and regional communities which relate to farming finance, natural disaster insurance and Aboriginal and Torres Strait Islander Australians' interactions with financial service entities. Further details will be published on the Commission website closer to the hearings. 14

In Brief | In his statement to the senate economics legislation committee, APRA Chair Wayne Byres has said Australians can be reassured that 'the industry is financially sound, and that the financial system is stable' despite the loss of trust in the financial sector. 15

Superannuation 15

Top Story | The PC Draft Final Report into the competition and effectiveness of the superannuation system has made 22 draft recommendations to 'modernise' the system. Submissions are due by 13 July 2018. 15

Initial Responses to the PC Draft Report: Superannuation: Assessing Efficiency and Competitiveness 19

APRA has called for greater focus by superannuation licensees on administering outsourcing arrangements with related parties to effectively manage conflicts of interest. ... 20

Review of superannuation and victims of crime compensation: The Government has released two proposals for consultation which propose to enable victims of crime to access a perpetrator's superannuation in specific circumstances. Consultation closes 15 June 2018. ... 21

In Brief | ASIC is leading representatives from the superannuation industry (Australian Super, HESTA, Super SA, QSuper and Prime Super) and the Australian government to visit remote Pitjantjatjara Yankunytjatjara (APY) Lands as part of ASIC's indigenous Outreach program 'to both learn from and help local Indigenous consumers with their super'. ASIC Deputy Chair Peter Kell said he hopes the trip will lead to real change to improve super trustees' services to Indigenous consumers. ... 22

In Brief | Australia's 53 largest super funds are increasing their engagement in responsible investing according to RIAA's Super Fund Responsible Investment Benchmark Report 2018: 81% are now committed to responsible investment (up from 70% in 2016); 62% are reporting annually on activity; nearly half of super funds offer a total of 75 responsible investment options (compared to 24 funds offering 54 options in 2016) and responsible investment employee numbers have doubled since 2016. ... 22

In Brief | APRA has released its Quarterly Superannuation Performance publication and the Quarterly MySuper Statistics report for the March quarter 2018. Over the March 2018 quarter there was a decrease of 0.2% in total superannuation assets, comprised of an increase of 0.2% in APRA-regulated assets, a decrease of 1.2% in self-managed super fund assets, an increase of 0.1% in exempt public sector superannuation schemes assets and an increase of 0.2% in balance of life office statutory fund assets. ... 22

Insurance 22

In Brief | APRA Senior Manager Peter Kohlhagen has cautioned Private Health Insurers that they need to 'cultivate a sense of "chronic unease" about the risks and threats' facing their institutions given current challenges and added that (among other things) the industry should expect stress testing practices to be strengthened over time. He also said that there was no immediate need to reduce capital levels in the industry. ... 22

Other Developments 22

United States | US Banks loosening terms of business loans? OCC report highlights looser lending practices as a key risk for the Federal Banking System. ... 22

In Brief | ASIC is has released a consultation paper proposing to implement a modified AFS licensing regime for foreign financial service providers (global investment banks or wholesale managed funds). The proposed foreign AFS licence would replace two types of current relief: sufficient equivalence relief and limited connection relief. ASIC states that it will extend the current relief for 12 months until 30 September 2019 to allow for consultation on the proposed changes, and a further transition period of 12 months to 30 September 2020 if ASIC proceeds with foreign AFS licensing. ... 23

In Brief | US President Donald Trump has signed the Financial Services Regulatory Reform Act into law: 'The legislation I'm signing today rolls back the crippling Dodd-Frank regulations that are crushing community banks and credit unions nationwide' he said. ... 23

Accounting and Audit 23

A failure of risk and audit committees not of internal auditors? IIA CEO Peter Jones has reportedly said internal auditors are performing their roles but the information is not reaching senior management and the board. ... 23

Risk Management 24

Plaintiff class actions set to increase? The ALRC has released a discussion paper for consultation recommending the ban on contingency fees be lifted among other changes. MinterEllison Partner, David Taylor commented that 'The ALRC proposals would mark a significant change in the class action funding landscape'. ... 24

Other News	25
The EU has reportedly proposed a ban on single use plastic products. If enacted it will come into force post-Brexit and will not automatically be transposed into UK law.	25

Diversity

In Brief | No consensus on gender quotas? The AFR reports that former winners of the Women of Influence Awards are in agreement on the need for recruitment firms to be more proactive in putting forward women, lowering the cost of childcare and other measures, but that there is no consensus on whether targets are necessary to ensure more women are promoted to the C-suite in companies, government and not-for-profit organisations.

[Source: [registration required] The AFR 28/05/2018]

Remuneration

United States | Latest Equilar/Associated Press CEO Pay Study 2018 released: S&P 500 CEO pay increased 8.5% last year; CEOs in the healthcare sector had the highest median pay; female representation decreased 5% (from 6% last year) but women CEOs earned more than their male counterparts on average.

The most recent annual edition of the Equilar and Associated Press study into compensation awards for S&P 500 CEOs has identified trends in compensation awards for CEOs in S&P 500 companies (who have been in the role for at least two years as of fiscal year end 2017).

Overall, the study found that:

- Pay packaged increased 8.5% to $11.7m (since last year).
- There are fewer female CEOs than previous years: Of the 339 executives in the study, 17 were female (four fewer than last year). Those female executives earned a median $13.5 million, compared to $11.5 million at the median for the 322 male executives.
- The healthcare sector had the highest median CEO pay package among S&P 500 companies at $14.9 million, followed by industrial goods at $13.9 million. Utilities CEOs were awarded a median $9.3 million which was the lowest of the industry sectors in the study.
- 37 US states were represented in the study. CEOs at companies based in the state of New York received the highest median pay package (excluding Nevada, where there was only one CEO). There were 38 New York-based CEOs in the study, who were awarded median total compensation of $16.6 million. California was the only state with more CEOs than New York (44 CEOs); followed by Texas (28), Illinois (24) and Massachusetts (16).

[Source: Equilar blog 24/05/2018]

In Brief | Sloppy reporting? At least 16 companies in the S&P 500 have reportedly changed 2016 pay figures by more than 10% for one or more executives, while 17 did so for 2015 pay, a WSJ analysis of data from MyLogIQ LLC shows. According to The WSJ, many changes are errors caught after companies send proxies to shareholders.

[Source: [registration required] The WSJ 30/05/2018]

Other Shareholder News

United States | 'Recycling' elements of the Financial CHOICE Act as a standalone Bill? New legislation has been introduced into the House which proposes to require the SEC to raise resubmission thresholds for shareholder proposals. Glass Lewis suggests this is an attack on shareholder rights.

New legislation (HR 5756) proposing to require the Securities and Exchange Commission (SEC) to adjust certain resubmission thresholds for shareholder proposals was introduced into the House on 10 May.

Glass Lewis comments that the language and intent of the Bill is substantially the same as similar provisions included in Financial CHOICE Act (currently stalled in the Senate). HR 5756 calls for substantial increases to the level of support required for proposals to stay on the ballot: the threshold for first-year submissions would double from 3% to 6% support; more than double from 6% to 15% for second-year, and treble from 10% to 30% in the third-year. As such, in Glass Lewis' view, the Bill is a an attack on shareholder rights and an attempt to 'push back against investors amid a rising swell of shareholder activism'.

Glass Lewis goes on to suggest that making it harder for shareholder proposals to be resubmitted from year to year will make it harder for proponents both to refine their ideas and to build the necessary support over time. This can be a long process, Glass Lewis notes citing climate change and gender pay disparity proposals as examples.

Glass Lewis comments that 'with elections looming and the CHOICE Act still outstanding, it's unclear whether anything will come of this latest bill. Regardless, coming off another proxy season marked by increasing support for shareholder proposals, investors should keep an eye on HR 5756, and any other CHOICE Act provisions that find new life in standalone bills'.

[Sources: HR 5756: To require the Securities and Exchange Commission to adjust certain resubmission thresholds for shareholder proposals; Glass Lewis Blog 25/05/2018]

New Zealand | New Bill proposes to provide clarity on 'dry shares': The Companies (Clarification of Dividend Rules in Companies) Amendment Bill proposes to amend s 53 of the Companies Act 1993 NZ to make it clear that a company's constitution can create a class of shares in which some carry the right to dividends and others ('dry shares') which do not.

The Companies (Clarification of Dividend Rules in Companies) Amendment Bill was recently introduced. The Bill proposes to amend s 53 of the *Companies Act* 1993 (NZ) to make it clear that a company's constitution can create a class of shares in which some carry the right to dividends and others ('dry shares') which do not. The Explanatory Note states that the change would 'clarify that the constitution of a company can provide for shares in the same class to carry different entitlements to dividends in different circumstances —in particular, where the holder is no longer a supplier to the company'.

The Explanatory Note states that the proposed change does not raise any concern about 'discrimination among shareholders by the directors, which is the concern that section 53 is aimed at. They enable companies and their shareholders to tailor their mutual rights and obligations to give effect to their commercial objectives. There are good reasons to permit this flexibility in structuring commercial arrangements, and no good reasons to limit it'.

[Sources: The Companies (Clarification of Dividend Rules in Companies) Amendment Bill Explanatory Note; The Companies (Clarification of Dividend Rules in Companies) Amendment Bill]

Regulators

Australian Securities and Investments Commission (ASIC)

Top Story | ASIC areas of focus for 30 June Financial Reporting: New Accounting Standards identified as having the 'greatest impact' for many companies.

The Australian Securities and Investments Commission (ASIC) has outlined its focus areas for 30 June 2018 financial reports. The regulator has called on companies to focus on new requirements that can materially affect reported assets, liabilities and profits. In particular, ASIC highlights that new accounting standards 'will have the greatest impact' for many companies. ASIC Commissioner John Price commented, 'We are concerned that some companies may not have adequately prepared for the impact of new accounting standards that can significantly affect results reported to the market. So far, surprisingly few companies have made disclosures of the impact of these standards. This may indicate that some companies need to give urgent attention to the impact of the standards on reported results, systems, processes and their businesses'.

New accounting standards

ASIC states that the following new accounting standards will significantly affect the reported results of many companies.

- AASB 9 Financial Instruments (applies from years commencing 1 January 2018).
- AASB 15 Revenue from Contracts with Customers (applies from years commencing 1 January 2018).
- AASB 16 Leases (applies from years commencing 1 January 2019).
- AASB 17 Insurance Contracts (applies from years commencing 1 January 2021).
- Amendments to standards to apply the new definition and recognition criteria in the Conceptual Framework for Financial Reporting (applies from years commencing 1 January 2020).

[Note: Separately, the Australian Prudential Regulation Authority has written to insurers regarding the application of AASB 16 and AASB 17. See: APRA Letters, notes and advice issued to general insurers 31/05/2018]

Impact of the new standards? ASIC writes that the new standards 'may significantly affect how and when revenue can be recognised, the values of financial instruments (including loan provisioning and hedge accounting), reported assets and liabilities relating to leases, accounting by insurance companies, and the general identification and recognition of assets, liabilities, income and expenses'.

New disclosure obligations: ASIC writes that the new standards also introduce new disclosure requirements. Full-year reports at 30 June 2018 must disclose the future impact of the new accounting standards and half-year financial reports at 30 June 2018 must comply with the new requirements for revenue recognition and financial instrument valuation.

ASIC adds that directors and preparers should consider any continuous disclosure obligations and the need to keep the market informed, as well as the impact on any fundraising and other transaction documents.

Other areas of focus

Other areas of focus highlighted by ASIC include the following (among others).

- **Role of directors and management in ensuring the quality of reports**: Referencing both *ASIC Information Sheet 183 Directors and financial reporting* and *ASIC Information Sheet 203 Impairment of non-financial assets: Materials for directors* ASIC emphasises that 'directors are primarily responsible for the quality of the financial report' including ensuring that quality financial information is provided 'on a timely basis'. ASIC adds that companies are required to have appropriate processes, records and analysis to support information in their reports rather than 'simply relying on the independent auditor'. Companies are also expected, ASIC writes, to apply the appropriate expertise and experience particularly in more difficult and complex areas such as accounting estimates (including impairment of non-financial assets), accounting policies (such as revenue recognition) and taxation.
- **Comprehensive reporting of information that may have a material impact (eg impact of climate change):** Referencing *ASIC Regulatory Guide 247 Effective disclosure in an operating and financial review,* ASIC reminds companies that listed entities should disclose information that may have a material impact on the future position/performance of the entity and cites a number of examples of the sort of information this may include: Brexit, cybersecurity; new technology or climate.

ASIC also suggests that directors could consider 'whether it would be worthwhile to disclose additional information that would be relevant under integrated reporting, sustainability reporting or the recommendations of the Task Force on Climate-related Financial Disclosures where that information is not already required for the Operating and Financial Review'.

- **Clarity:** ASIC states that it will continue to focus on material disclosures of information relevant to investors and others using reports and will not pursue 'immaterial disclosures that may add unnecessary clutter to financial reports'. ASIC adds that 'efforts should be made to communicate information more clearly in financial reports'.
- **Proprietary companies:** ASIC states that based on complaints and other intelligence, it continues to review the financial reports of proprietary companies and unlisted public companies. ASIC adds that it has written to more than 1,000 proprietary companies that failed to lodge reports (without an exemption) and would be writing to 'several hundred more' before the end of the year.

[Source: 18-159MR Major changes affecting reported net assets and profit, and other focuses for 30 June 2018 reporting]

Top Story | ASIC Chair James Shipton has told the Senate Economics Legislation Committee that the regulator will be adopting a new 'more intrusive, enduring and, with onsite visits, more physical' approach' to supervision.

In his recent opening address to the Senate Economics Legislation Committee, Australian Securities and Investments Commission (ASIC) Chair James Shipton flagged that the regulator intends to adopt a new 'more intrusive, enduring, and with onsite visits, more physical' approach to supervision. A brief overview of the key points of his address is below.

Key Points

- **Observations of Australia's financial system**: Mr Shipton reiterated observations he's made previously in recent speeches (see note below) regarding Australia's financial system, and its regulatory structure. More particularly he said there is a 'trust deficit between the financial industry and the broader community; insufficient imbedding of a professional mindset and culture in finance, and insufficient attention, and mitigation, by the finance industry of conflicts of interests'. He commented that these observations are 'very consistent' the reports and recommendations of ASIC in recent times.
- **New approach enforcement:** Noting that many of the issues explored at the Financial Services Royal Commission were 'based on the work' of ASIC's Wealth Management Project — a project focused on the financial advice sector — Mr Shipton reiterated (see note below) that ASIC intends to 'expand and accelerate' the project. Mr Shipton said that this could include making greater use of external resources for ASIC investigations in order to accelerate response times. He also added that the government has agreed in principle to the recommendations of the Taskforce that reviewed ASIC's enforcement powers and outlined the changes in question.

[Note: In his keynote address to the Australian Council of Superannuation Investors (ACSI) annual forum, Mr James Shipton called on industry to act to address the 'trust deficit' in the financial sector. He also flagged that ASIC will 'accelerate and expand' the Wealth Management Project and apply a new supervisory focus to the largest financial institutions and superannuation funds. See: Governance News 18/05/2018. The theme of trust and Mr Shipton's observations of the financial sector were also explored in his inaugural keynote address to the ASIC Annual forum. See: Governance News 23/03/2018.]

- **New supervisory approach**: Mr Shipton said that ASIC currently supervises firms it regulates through a combination of risk-based surveillance and/or reviews aimed at particular firms and thematic review aimed at sectors or subsectors. He said that though effective, and though these approaches would continue to play a role, ASIC intends to adopt new supervisory approaches for 'Australia's largest financial institutions and important sectors'. Mr Shipton said that 'This will involve more intensive, day-to-day supervision, with better co-operation between our fellow regulators, especially with APRA. This approach will be more intrusive, enduring and, with onsite visits, more physical'.

- **Adoption of regtech solutions:** The third new approach, highlighted by Mr Shipton, was ASIC's role in encouraging adoption of regulatory technology solutions in the financial sector. 'ASIC believes Australia can position itself as a world leader in the development, and adoption, of regtech solutions, and we will look at new ways to encourage this' he said.
- **Further initiatives necessary going forward:** Mr Shipton noted that further initiatives to enhance ASIC's approach are to be expected in future and that he looks forward to the recommendations of the Financial Services Royal Commission.
- **Additional funding?** Mr Shipton confirmed that he has submitted a request for funding of these initiatives to the government for consideration and that though he could not pre-empt the formal approval process, the Minister for Financial Services and the Treasurer had received the initiatives in a positive light. Mr Shipton added that 'ASIC looks to maximise the effectiveness of our work within our budget. Deciding what we do and don't do is one of the most difficult parts of ASIC's job. My job is to ensure that ASIC responds to circumstances strategically and with a clear sense of priority'.

[Sources: Opening statement by James Shipton, Chair, Australian Securities and Investments Commission, Senate Economics Legislation Committee 30/05/2018]

ASIC has given financial services firms an extra seven months to update their disclosure documents to meet new requirements introduced when the AFCA regime commences in November. RG 165 has also been amended to require information about predecessor schemes and AFCA to be provided to complainants from 21 September 2018.

The Australian Securities and Investments Commission (ASIC) has announced that it will give financial firms, including superannuation trustees, transitional relief until 1 July 2019 to allow them time to update mandatory disclosure documents and periodic statements with the contact details of the Australian Financial Complaints Authority (AFCA).

Under the disclosure relief provided by ASIC:

- Financial firms will not have to issue significant event notifications under s1017B of the *Corporations Act 2001* (Cth) associated with the transition to AFCA.
- Financial firms will have until 1 July 2019 to update EDR details to refer to AFCA in mandatory disclosure documents, periodic statements and exit statements.
- *Regulatory Guide 165 Licensing: Internal and external dispute resolution* has been amended to require information about predecessor schemes and AFCA to be provided to complainants from 21 September 2018.

ASIC states that it will continue to work with all EDR scheme stakeholders to ensure that the transition to AFCA is as smooth as possible for both financial firms and consumers.

[Note: ASIC Corporations (AFCA transition) Instrument 2018/447, registered on 30 May 2018, provides exemptions from various disclosure obligations in the *Corporations Act* 2001 (Cth) relating to the commencement of the Australian Financial Complaints Authority, until 1 July 2019.]

[Sources:18-158MR ASIC gives disclosure relief during transition to AFCA; Regulatory Guide 165 Licensing: Internal and external dispute resolution]

Australian Prudential Regulation Authority (APRA)

Second APRA deputy chair: Treasurer Scott Morrison announced the reappointment of Helen Rowell as Deputy Chair of APRA and his intention to nominate John Lonsdale as an additional deputy chair subject to the passage of legislation enabling the appointment.

The Treasurer Scott Morrison has announced the reappointment of Helen Rowell as deputy chair of the Australian Prudential Regulation Authority (APRA) for a further five year term from 1 July 2018; and his intention to nominate John Lonsdale for the Governor General's consideration as an additional deputy chair of APRA subject to the passage of legislation introduced on 24 May to amend the *Australian Prudential Regulation Authority Act* 1998 (APRA Act).

[Note: The legislation referred to is: *Treasury Laws Amendment (APRA Governance) Bill 2018* which proposes to amend the *Australian Prudential Regulation Authority Act 1998* (APRA Act) to enable the Governor-General the discretion to appoint a second Deputy Chair of APRA. The Bill is currently before the House of Representatives and is yet to pass either house. See: Governance News 28 May 2018.]

'The reappointment of Mrs Rowell, and the appointment of Mr Lonsdale – alongside the existing APRA Members Mr Wayne Byres (Chairman) and Mr Geoff Summerhayes (Member) – will ensure APRA continues to have a strong blend of supervisory experience, industry knowledge and policy expertise within its Executive Group' Mr Morrison said.

APRA issued a statement welcoming the Treasurer's statement. APRA Chair Wayne Byers said that 'the expansion of APRA's current Executive Group would add further depth and breadth of policy expertise at APRA as it delivers on its mandate to protect the financial well-being of Australian depositors, insurance policyholders and superannuation members'.

[Sources: Treasurer Scott Morrison media release 30/05/2018; APRA media release 30/05/2018]

In Brief | APRA has released monthly banking statistics for April 2018.

[Source: APRA Monthly Banking Statistics — April 2018 31/05/2018]

Other Developments

Singapore | Transparency of short selling activities in Singapore: The Monetary Authority of Singapore (MAS) has announced new requirements for investors to report their short positions and short sell orders in securities listed on the SGX will come into effect from 1 October 2018.

Following consultation, The Monetary Authority of Singapore (MAS) has announced that new requirements for investors to report their short positions and short sell orders in securities listed on the Singapore Exchange (SGX), will come into effect from 1 October 2018. The new requirements will be implemented through the *Securities and Futures (Short Selling) Regulations* 2018.

The new requirements are aimed at improving transparency on short selling activities in the securities market and enabling investors to make more informed trading decisions.

Under the new rules, investors with short positions above a specified threshold (0.2% of total issued shares or units; or S$2,000,000) will have to report these positions to MAS through a new online portal, the Short Position Reporting System (SPRS). MAS will then publish aggregated short positions of each security on a weekly basis.

MAS writes that market participants are now able to access SPRS to familiarise themselves with the system ahead of the commencement of mandatory reporting on 1 October 2018.

[Sources: Monetary Authority of Singapore media release 28/05/2018; Response to Feedback Received: Consultation Paper on Regulations for Short Selling May 2018]

Singapore | The Monetary Authority of Singapore has issued a statement of commitment to the FX global code.

The Monetary Authority of Singapore (MAS) recently issued a statement confirming its commitment to the Foreign Exchange Global Code (Code) developed by the Bank for International Settlements (BIS). The Code applies to the wholesale foreign exchange (FX) market globally and sets out principles to 'promote a robust, fair, liquid, open, and appropriately transparent FX market, underpinned by high ethical standards' MAS writes. MAS adds that it strongly encourages wholesale FX market participants in Singapore to demonstrate adherence to the Code, to promote the integrity and effective functioning of the global FX market.

[Source: Monetary Authority of Singapore media release 28/05/2018]

Corporate Social Responsibility and Sustainability

In Brief | UK Modern slavery reporting is patchy at best? Analysis of modern slavery statements by companies in the textile and clothing sector has revealed 62% had not been formally signed by the board (among other quality issues) prompting the researchers to question whether further action is needed.

[Source: The Conversation 29/05/2018]

In Brief | Insurer QBE has reportedly committed a minimum $100m towards socially progressive projects in Australia and globally as part of its Premiums4Good program. QBE is reportedly looking towards areas such as affordable housing, renewable energy and healthcare.

[Source: [registration required] The Sustainability Report 30/05/2018]

Financial Services

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission)

Top Story | Royal Commission Round Three Hearings Week 2: Consideration of cases in which small business arrangements with their lenders was varied or came to an end; the role of lenders and the FOS in resolving complaints.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) third round of public hearings into the provision of credit to lending to small and medium enterprises (SMEs) commenced on 21 May and ran until 1 June. The focus of the second week of hearings was largely on a number of cases in which small business' arrangements with their banks were varied by the lenders or came to an end.

A high level overview of the case studies and the issues to emerge is below.

The proposed new banking code (presently under consideration by the Australian Securities and Investments Commission (ASIC)) and ASIC's implementation of the extension of unfair contract terms legislation to small business contracts were also considered by the commission during the final days of the second week of hearings. These issues will be covered in a separate post in the next issue of Governance News to be published 12/06/2018.

[Note: In his opening statement to the Commission, Counsel Assisting Michael Hodge QC highlighted 'three overarching questions' for consideration over the course of the hearings, and a number of more specific questions to be explored in the case studies. See: Governance News 28/05/2018.

Approach to hardship applications/communication with borrowers: Suncorp case study

This case study concerned five business loans made by Suncorp to Mr Peter Low which eventually became the subject of FOS complaints by the Low family. Mr Rien Low (Peter Low's son) described the steps he'd taken in the aftermath of his father's unexpected death, to seek hardship assistance from Suncorp, his attempts to negotiate a pause in interest repayments on the loans and ultimately to resolve the debts on behalf of his grieving mother and the Low family. The Commission heard that when Mr Low was unsuccessful in negotiating a solution with Suncorp, he lodged an FOS complaint alleging maladministration in relation to the loans.

The Commission heard that the FOS found that one loan was affected by maladministration (Suncorp acted irresponsibly when it approved the loan). FOS directed that Suncorp forgive the interest that had been repaid and stop charging interest or fees on that loan. The remaining loans (which were not found to be been impacted by maladministration) were to be repaid and the parties were directed by FOS to come to some arrangement between themselves to facilitate this. The Commission heard that Suncorp took the approach that the loan impacted by maladministration should be paid back first, and in full, within a short timeframe (ie $220,000 should be paid back in six months rather than over the original life of the loan – a further 17 years).

CEO banking and wealth at Suncorp Group, David Carter was questioned about the approach taken by the lender to approving the loans in this case and the approach taken to responding to the hardship application made by the Low family. He was also questioned about the approach taken by Suncorp to the FOS process. It was alleged that Suncorp prolonged the FOS process, knowing that there had been maladministration in approving the loan. Mr Carter was also asked to explain the approach Suncorp took, following the FOS determination, to requiring that the loan impacted by maladministration be paid back first. It was alleged that the approach taken by Suncorp put the Low family in a worse position than before they approached the FOS (because they were required to pay the loan at a faster rate). Suncorp maintained that though it agreed that the loan should not have been made, its actions following the determination were consistent with the FOS determination and that the timeframe for repayment of the loan was consistent with FOS practice/industry practice.

Financial Ombudsman Service (FOS): Clearer guidance to lenders on FOS expectations; errors in judgement in specific case.

The case studies explored over the course of the Round 3 hearings were drawn from Financial Ombudsman Service (FOS) cases. It was alleged by the Commission that in some cases, lenders sought to delay FOS outcomes and the Commission also heard that some lenders have not always been in agreement with the FOS' interpretation of their lending obligations (see: Governance News 28/05/2018).

Lead ombudsman, banking and finance, of the Financial Ombudsman Service Philip Field was asked to comment generally on the approach taken by FOS to resolving complaints. Mr Low described the FOS process in some detail and commented that generally the process is more familiar to lenders than it is to consumers (who are unrepresented). Asked why the FOS directs consumers to negotiate repayment plans with lenders following determinations (rather than doing so on their behalf) Mr Field explained that the FOS does not assume that there will be any further issue between the lender and the consumer once the determination is made. He also expressed the view that the approach adopted by FOS to resolving disputes was an appropriate basis for the Australian Financial Complaints Authority's (AFCA's) approach going forward.

Questioned specifically about the circumstances of the Low case study, Mr Field was asked whether requiring the payment of the interest-free loan (the loan found to be impacted by maladministration) before the other loans was an FOS requirement. Mr Field said that it was not.

Asked whether FOS guidance on this issue was clear, Mr Field said that FOS ought to make clear in its guidance to lenders that its expectation is that debts from responsible lending are paid off before debts from irresponsible lending.

Mr Field also said that FOS was mistaken in indicating that the loan in the particular case should have been paid off within such a short timeframe.

Variation or non-renewal of loans: CBA/Bankwest case studies

The Commission heard from a number of former Bankwest customers about their experiences following the acquisition of Bankwest by CBA in 2008. More particularly the case studies explored examples of circumstances in which the terms of loans to some Bankwest customers were varied or where loans were not renewed, as CBA applied more stringent risk parameters to the loans in question. Witnesses described the personal and financial impact of the bank's actions and the alleged lack of transparency and fairness in this process (from their point of view).

In his opening statement to the Commission, Counsel Assisting Michael Hodge emphasised that the case studies chosen, did not/do not raise any of the 'ulterior motive theories' circulated about CBA's dealings with the Bankwest loan book. Mr Hodge said that the theories referred to are not consistent with each other but that the common element is that they 'attribute to CBA in its dealings with the Bankwest loan book an ulterior motive to systematically default loans and to default loans for reasons not concerned with what CBA perceived, rightly or wrongly, to be the risk of a particular loan or lending to a particular industry'. Mr Hodge said that: 'we have not seen any primary evidence from primary sources that support these ulterior motive theories, and their logic appears to be premised on misconceptions of the facts'.

The Commission heard from CBA executives that the quality of the Bankwest loan book (with respect to business banking) was poorer than CBA had anticipated and that credit review processes at Bankwest were less stringent than those of CBA. The Commission also heard that that CBA sought to minimise these risks through reviewing the Bankwest's high risk loans (Project Magellan) and acting to address the high concentration of Bankwest's exposure in commercial property which resulted in a number of loans not being renewed or the terms of loans being varied. The Commission also heard that the CBA launched a remedial program to educate Bankwest staff and raise standards in business banking. CBA executives were asked whether the bank should have done more to work with the businesses in question. The Commission heard that in some specific cases, Bankwest's actions may have been outside community expectations, and that in some cases the actions taken at the time would not now be in line with CBA bank policies.

Group chief risk officer Mr David Cohen was also questioned about the effectiveness of CBA's risk function and asked to comment on CBA culture. He said that the risk function may not have been sufficiently challenging of the business in the past, and that recruiting personnel with the appropriate expertise given the shallow talent pool in Australia was one factor (among others) that had contributed to this. He then outlined the risk initiatives that have been implemented (eg risk appetite strategy) or which are in the process of being implemented by CBA, since he took over the role since 2016. Asked whether the process has taken longer than he would have liked, Mr Cohen said it had not and that the timeframe (3-5 years) was a realistic one. Commissioner Hayne also questioned Mr Cohen on the subject of the approach the CBA has taken to identifying risk more recently and following the release of APRA's recent report (see: Governance News 04/05/2018). Mr Cohen said that, CBA though good at logging, tracking and measuring financial risk, had as was pointed out in the APRA report, not sufficiently emphasised non-financial risk such as conduct and reputational issues in the past, and that the bank had lacked an executive forum for considering risks of this kind. He said that an executive committee for considering risks of this kind would be established to improve non-financial risk oversight. The Commissioner suggested that simplification of policies and procedures, and asking 'should I' (as suggested in the APRA report) could assist in improving the effectiveness of the application of policies to which Mr Cohen agreed stating 'I think it requires a sense of returning to the basics'.

Variation or non-renewal of loans: NAB case study

This case study concerned Mr Ross Dillon who described to the commission the actions by National Australia Bank (NAB) in applying 100% of the proceeds from the sale of his principal residence (Goanna Downs) to pay down his business debts (for his music imports business: National Music which was struggling financially). Mr Dillon said that he hadn't expected that 100% of the proceeds from the sale of his home would be used to settle the entirety of the business debt based on his understanding of discussions with NAB. He said that he had planned to put a proportion of the sale proceeds into National Music (as he understood NAB wanted him to do) and to use the remainder to purchase a smaller principal residence and that this had been communicated to NAB. Mr Dillon said that he would not have accepted the price offered for the property (which he said was lower than what another interested buyer may have paid) had he known that the lender would take the action that it did.

Mr Dillon also described to the Commission the negative impact of NAB's decision to substantially reduce the trade facility for his business on the profitability of the business. NAB's barrister, Wendy Harris QC challenged Mr Dillon's recollection of the facts, and more particularly his memory of the communication around the sale of his home and the use by the bank of the proceeds to pay down his business debts. She suggested among other things, that it was unlikely that the NAB representative would have given any assurance of the way the proceeds of the sale would be used (as this was outside the NAB representative's authority) and questioned whether the bank's actions were in fact a surprise to Mr Dillon.

Questioned about the bank's decision to apply 100% of the proceeds to settle the business debts, general manager of strategic business services at the National Australia Bank Limited Ross McNaughton said that in preparing his evidence, he had discovered that NAB had no legal basis for acting as it did (in insisting on the full proceeds of the sale of Mr Dillon's home being used to pay down his business debts) as the property was not direct security for the business loan (though Mr Dillon may have mistakenly understood that it was), and because Mr Dillon's business was not at the time in default. Mr McNaughton also said that that communication with Mr Dillon regarding the sale of the property could have been clearer ie that the bank could have better articulated the bank's position and the basis of its decisions.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: 21 May 2018 – Draft Transcript for Day 20; 25 May 2018 – Draft Transcript for Day 24; 28 May 2018 – Draft Transcript for Day 25; 29 May 2018 – Draft Transcript for Day 26; 30 May 2018 – Draft Transcript for Day 27; 31 May 2018 – Draft Transcript for Day 28]

The royal commission's investigation has prompted almost a third of Australians to consider switching banks, according to a Customer Owned Banking Association commissioned study.

Research commissioned by the Customer Owned Banking Association (COBA) conducted online with 1,025 respondents from 17th to 20th May 2018, suggests people may be (relatively) more likely to consider switching banks in the wake of Financial Services Royal Commission investigations than they were previously.

According to COBA:

- Overall, 32% of those polled said they were more likely to consider switching banking institutions with 8% of people polled indicating that they have already changed their lender.
- 17% of people polled said that the Financial Services Royal Commission has led them to consider changing, but they haven't yet, while an additional 18% are not sure if they will consider changing.

However, 58% of respondents said that they are not considering changing their lender.

The research was released as part of a campaign by COBA to encourage those looking to switch lenders to consider customer owned providers.

[Sources: Customer Owned Banking Association media release 28/05/2018; The Essential Report: COBA questions 22 May 2018; Independent Financial Adviser 28/05/2018]

New Zealand | No need for a Financial Services royal commission yet? The Reserve Bank of New Zealand and the Financial Markets Authority have reportedly said that there is no evidence to support a Royal Commission into the NZ system as yet, but that this view could change pending the result of further investigations.

The Reserve Bank of New Zealand and the Financial Markets Authority have reportedly briefed the NZ Finance and Expenditure Select Committee on the Australian Financial Services Royal Commission and the response by regulators in NZ.

As previously reported in Governance News on 7/05/2018, the Reserve Bank of New Zealand and the Financial Markets Authority wrote to NZ banks in May requesting that they provide 'assurances, including in writing, as to the processes they've followed to check themselves against what's coming out of the [Australian Financial Services] Royal Commission'. A request for the same information was made to life insurers on 23 May.

Based on the information provided by lenders and insurers to date, the regulators have reportedly told the NZ Finance and Expenditure Select Committee that there is no 'evidence of widespread, systemic issues to warrant a commission of inquiry in New Zealand' but that the 'the work we have initiated may test this view'.

Reportedly, the regulators have said that following the initial assessment more information would be requested where necessary: '[the regulators] will be requesting further information and verification where necessary [from lenders and insurers]. A high bar will be set in meeting our expectations and demonstrating a sufficient level of assurance in regard to good conduct and culture. Currently we consider it is appropriate to prioritise our work on banks and life insurers, we haven't made any decision as to whether to expand that focus in the future.'

[Source: Good Returns.co.nz 30/05/2018]

In Brief | Round 4 Hearings will be held between 25 June and 29 June in Brisbane and Darwin and will focus on issues affecting Australians in remote and regional communities which relate to farming finance, natural disaster insurance and Aboriginal and Torres Strait Islander Australians' interactions

with financial service entities. Further details will be published on the Commission website closer to the hearings.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 31/05/2018]

In Brief | In his statement to the senate economics legislation committee, APRA Chair Wayne Byres has said Australians can be reassured that 'the industry is financially sound, and that the financial system is stable' despite the loss of trust in the financial sector.

[Sources: APRA speeches: Wayne Byres, Chair: Opening statement — Senate Economics Legislation Committee 30/05/5018; The SMH 30/05/2018]

Superannuation

Top Story | The PC Draft Final Report into the competition and effectiveness of the superannuation system has made 22 draft recommendations to 'modernise' the system. Submissions are due by 13 July 2018.

The Productivity Commission (PC) released a draft of its final report assessing the efficiency and competitiveness of Australia's superannuation system for consultation on 29 May: *Superannuation: Assessing Efficiency and Competitiveness*. The draft report found that due to inadequate competition, governance and regulation, and the 'twin problems' of unintended multiple accounts and 'entrenched underperformance' the current superannuation system is not delivering value for all members but instead has become, according to Productivity Commission Deputy Chair Karen Chester, 'an unlucky lottery for many Australian workers and their families'.

The report makes 22 draft recommendations to address these issues. A high level overview of the draft findings and recommendations in the report is below.

Draft Findings

The draft findings relate to investment performance; fees and costs, members' needs, member engagement, erosion of member balances; market structure; contestability and behaviour; insurance; fund governance; system governance; competing for default members and an overall assessment. Key findings include the following.

- The report found overall that the superannuation system delivers mixed results to members:
  - While some funds consistently achieve high net returns, a number of products (including defaults) underperform.
  - A third of accounts (10 million) are 'unintended multiple accounts' which 'erode members' balances by $2.6bn a year in unnecessary fees and insurance'.
  - Fees remain a significant drain on net returns.
  - Not all members get value out of insurance in superannuation due to the erosion of balances by duplicate or 'zombie' policies.
  - The system offers products and services that meet most members' needs, but members lack access to quality, comparable information to help them find the best products.
- The report found these outcomes are due to 'inadequate competition, governance and regulation'.
  - Lack of competition: Rivalry between funds in the default sector was found to be 'superficial' and competition in the 'choice' sector was described as 'unhealthy' with a 'proliferation' of over 40,000 products. The report also questions why there have not been more fund mergers: 'Evidence of unrealised economies of scale, persistent underperformance and an entrenched large number of small funds — about half of all APRA regulated funds have less than $1 billion in assets — raises the question of why there have not been more fund mergers, given the likely benefits for members'.

- Regulations and regulators were found to 'focus too much on funds rather than members' and it was suggested that there is some confusion over the roles of the regulators: The report states that the 'key regulators — the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) — are doing well in their core duties of prudential regulation (APRA) and financial product and advice regulation (ASIC)' respectively, but that there is some confusion around the two regulators roles, given both have powers to police bad behaviour by trustee boards. The report adds that 'Strategic conduct regulation appears at times to be missing in action. Ideally, this would involve a regulator proactively identifying actual or potential instances of material member harm, investigating the underlying conduct and taking enforcement action in a way that provides a valuable public deterrent to future poor conduct. To date, there has been a deficit of public exposure of poor conduct (and associated penalties) to demonstrably discourage similar behaviour by others — now and in the future.'
- Poor quality data and disclosure were also found to prohibit accountability to both members and regulators.

Draft Recommendations

The report includes 22 draft recommendations aimed at 'modernising' the superannuation system to address the issues identified above. The draft recommendations include the following.

New way of allocating default members to products and addressing the issue of multiple 'unintended accounts'.

- **Members default once and retain their existing account for new jobs:** The report recommends that default superannuation accounts should only be created for members who are new to the workforce or do not already have a superannuation account (and do not nominate a fund of their own). This fund would then 'follow' the member, not the employer over the course of the members' working life so that, over time, the member would only be paying fees/insurance on one account (rather than multiple accounts).
- **'Best in show' shortlist for new members:** The report recommends that a single shortlist of up to 10 superannuation products should be presented to all members who are new to the workforce (or do not have a superannuation account), from which they could choose a product via a centralised online service (or nominate any other fund). Any member who fails to make a choice within 60 days would be defaulted to one of the products on the shortlist, selected via sequential allocation.
- **Independent panel for 'best in show' selection**: The report recommends that the government establish an independent expert panel to run a competitive process for listing superannuation products on the online shortlist. This panel should select from products submitted by funds that meet a clear set of criteria and are judged to deliver the best outcomes for members. The report recommends that this process should be repeated, and the panel reconstituted, every four years.
- **Enable the ATO to auto-consolidate lost accounts**: The report recommends that the government legislate to enable the ATO to 'auto consolidate' lost accounts into a members' active account and to reduce the 'lost inactive' activity threshold from five to two years.

These measures, the Productivity Commission said, would solve the problem of members with multiple super accounts paying multiple administration fees and insurance premiums as well as the issue of members 'unwittingly' joining poor performing funds as only the best performing funds would be included in the 'best in show' list.

Insurance and fees related measures

- **Annual disclosure of all trailing commissions to members**: The report recommends that funds be required to clearly inform, all members who are subject to trailing financial adviser commissions on an annual basis. In addition, the report recommends all funds should publicly disclose the extent of trailing commissions and number of affected members in their annual reports and provide this information to the Australian Securities and Investments Commission (ASIC).

- **Opt-in insurance for members under 25**: The report recommends that insurance through superannuation should only be provided to members under the age of 25 on an opt in basis and that the government should legislate to require trustees to obtain the express permission of younger members before deducting insurance premiums from these members' accounts.

- **Cease insurance on accounts without contributions:** The government should legislate to require trustees to cease all insurance cover on accounts where no contributions have been obtained for the past 13 months, unless they have obtained the express permission of the member to continue providing the insurance cover.

- **Cap Fees:** The government should legislate to extend MySuper regulations limiting exit and switching fees to cost recovery levels to all new members and new accumulation and retirement products.

[Note: Many of these measures including proposals to cap administration/investment fees; implement 'opt in' for certain accounts and to consolidate inactive, low balance accounts were included in the 'protecting your super package' announced in the Federal budget 2018-2019. Draft legislation: *Treasury Laws Amendment (Protecting Superannuation) Bill* 2018 and explanatory material to implement the package was released for consultation earlier this month and closed on 29 May. See: Governance News 14/05/2018.]

- **Independent Review of Insurance in Superannuation**: The report recommends that the government commission a formal independent review of insurance in superannuation to evaluate the effectiveness of initiatives to date, examine the costs and benefits of retaining current insurance arrangements on an opt-out (as opposed to an opt-in) basis, and consider if further regulatory intervention or policy change is required.

Industry Code of Conduct

- **Signing on to the Insurance Code of Conduct to be a Mysuper condition**: The report proposes that the adoption of the *Insurance in Superannuation Voluntary Code of Practice* should be a mandatory requirement of funds to obtain or retain MySuper authorisation.

- **Insurance Code Taskforce**: The report recommends that the government should establish a joint regulator taskforce to advance the *Insurance in Superannuation Voluntary Code of Practice* and maximise the benefits of the code in improving member outcomes. Both ASIC and APRA should be members of the taskforce, with ASIC taking the lead. The taskforce should: monitor and report on adoption and implementation of the code by funds; provide guidance on and monitor enhancements to strengthen the code, particularly implementation of standard definitions and moving to a short-form annual insurance statement for members; advise the industry what further steps need to be taken for the code to meet ASIC's definition of an enforceable code of conduct. The taskforce should annually report findings on industry progress on the code.

  The report suggests code owners should be given two years to strengthen the code and make it binding and enforceable on signatories before further regulatory intervention is considered.

Lifting the performance of boards: Stronger regulatory oversight and stronger governance rules

- **Stronger oversight of MySuper outcomes test by APRA**: The report recommends that the government legislate to enable APRA to apply the MySuper outcomes test. The report also recommends that the authorisation rules for MySuper should be further strengthened.

- **Stronger governance rules for board appointments:** The report recommends that the government should legislate to require trustees of all superannuation funds to use and disclose a process to evaluate and report on their board's performance including any board skills gaps. The report proposes that APRA should be provided with the outcomes of such evaluations as soon as they have been completed and that legislative restrictions on the ability of superannuation funds to appoint independent directors to trustee boards should be removed. More particularly, the report recommends that fund boards should include one third independent directors.

[Note: Legislation which among other things, would require RSEs to have a least one third independent directors and for the Chair to be one of these independent directors: *Superannuation Laws Amendment*

(Strengthening Trustee Arrangements) Bill 2017 was introduced into the Senate last year, but has not progressed due to lack of support see: Governance News 30/10/2018]

- **Stronger oversight (by APRA) of outsourcing arrangements:** The report recommends that APRA should require all APRA regulated superannuation funds to conduct formal due diligence of their outsourcing arrangements, at least every three years, to ensure the arrangements provide value for money and report annually. APRA should also expedite efforts to address inconsistencies in reporting practices.

[Note: APRA has recently conducted thematic reviews and made recommendations to improve the governance of superannuation boards (see: Governance News: 18/05/2018) and separately, outsourcing arrangements (dealt with in a separate post in this issue of Governance News 04/06/2018). The SMH quotes Deputy Chair of the Productivity Commission Karen Chester as commenting that the PC report recommendations are 'heading in the same direction' as APRA's recommendations on these issues but are 'much further down the road than APRA…We're going further and making recommendations what should be made compulsory for trustee boards.' See: The SMH 29/05/2018]

- **Stronger oversight (by ASIC) on fees:** The report states that 'Information should be simple, comparable and easy for members to understand require all superannuation funds to publicly disclose to current and prospective members the proportion of costs paid to service providers that are associated with related party outsourcing arrangements proactively investigate (questionable) cases where mergers between superannuation funds stalled or did not proceed review exit and switching fees faced by existing members, with a focus on whether these fees are related to the underlying performance of the product, and whether they unreasonably impede members moving to products that better meet their needs'.

Disclosure and Reporting

- **Reporting on merger activity**: The Australian Government should require trustee boards of all APRA regulated superannuation funds to disclose to APRA when they enter a memorandum of understanding with another fund in relation to a merger attempt. For mergers that ultimately do not proceed, the board should be required to disclose to APRA (at the time) the reasons why the merger did not proceed, and the members' best interests assessment that informed the decision.
- **Simple 'member-friendly-dashboard for all products:** The report found that there was a lack of quality, accessible and comparable information on products for members. On this basis, the report proposes that the government should require funds to 'publish simple, single page product dashboards for all superannuation products'. More particularly, the report recommends that 'ASIC should: prioritise the implementation of choice product dashboards to achieve full compliance by 1 July 2019 revise the dashboards to simplify the content and provide more easily comprehensible metrics (drawing on robust consumer testing) by end 2019 immediately publish all available MySuper and choice product dashboards on a single website, with the information clearly and readily accessible from the area of myGov that allows for consolidation of accounts'.
- **Superannuation data working group:** The Australian Government should establish a superannuation data working group, comprised of APRA, ASIC, the ATO, the ABS and the Commonwealth Treasury (with Treasury taking the lead). This group should: identify ways to improve the consistency and scope of data collection and release across the system, with a focus on member outcomes evaluate the costs and benefits of reporting changes, including strategies for implementation identify areas where legislative or regulatory change may be necessary to support better data collection report annually to the Council of Financial Regulators on its progress, and on the data analytics capabilities of each regulator.

Timeline

- Submissions on the report are due by 13 July 2018.
- The Commission will hold public hearings in Sydney on Wednesday 20 June, in Melbourne on Thursday 21 June and at a location to be determined on Friday 22 June. The Commission will

consider holding public hearings in other capital cities if there is sufficient interest (of at least four participants). Further details have been published on the Commission's website.

- Transcripts of the hearings will be made available publicly on the Commission's website. In addition, the hearings will also be live streamed.
- No timeframe is given for delivery of the final report.

[Sources: Productivity Commission Draft Report: Superannuation: Assessing Efficiency and Competitiveness 29/05/2018; Public Hearings 31/05/2018; [registration required] The AFR 27/05/2018; 27/05/2018]

Initial Responses to the PC Draft Report: Superannuation: Assessing Efficiency and Competitiveness

The Productivity Commission Draft Report: *Superannuation: Assessing Efficiency and Competitiveness* has received wide media coverage. An overview of the initial response to the report, as reported in the media, by the government and by industry is below.

- **Minister for Revenue and Financial Services Kelly O'Dwyer** said that the government has already taken steps to implement many of the recommendations in the report (ie they were already on foot prior to the release of the report) and though she stopped short of committing to implementing all draft recommendations expressed her own support for the proposed changes to default superannuation. 'We need to find a much better way of making sure that members' money follows to the member and I think they've come up with a really clever solution to be able to have a best-in-show arrangement where you've got the top 10 performing funds being selected by an independent organisation that will be able to look at the key metrics that will be in members best interests rather than the Fair Work Commission, which we know is an industrial commission , which is highly politicised and not always acting in the interests of members' she said.
- **Australian Prudential Regulation Authority (APRA) Chair Wayne Byers** commented, in the context of his opening statement to the senate economics and legislation committee that: 'Many of the findings in the Productivity Commission report into superannuation released this week are consistent with APRA's approach to supervising RSE licensees. In particular, they align with APRA's focus on enhancing the delivery of member outcomes through our engagement with trustees with "outlier" underperforming funds and products.'
- **Australian Institute of Superannuation Trustees (AIST)** CEO Eva Scheerlinck is quoted in Financial Standard as welcoming the report generally, but questioning its call for a new default selection system. 'While the report acknowledges the superior performance of most default not-for-profit funds it then inexplicably recommends dismantling the very system that has delivered these results' Ms Sheerlinck is quoted as stating.
- **Association of Superannuation Funds of Australia (ASFA)** CEO Martin Fahy is quoted in Financial Standard as stating: 'The proposal to allocate default superannuation to 10 so called "best-in-show" funds would dramatically change the retirement funding landscape, and raises questions with respect to innovation, competitive intensity and diversity.' Mr Fahy is quoted in Super Review as stating that 'many smaller funds are able to provide niche offerings to their members, including tailored insurance and investment options, and the importance of this to members should not be underestimated'.
- **Industry Super Australia** CEO David Whiteley is quoted in The New Daily as stating that the removal of super from the Fair Work Commission was unnecessary. 'The empirical evidence shows the industry funds and other not-for-profit funds are the best funds in the system. The empirical findings show the system works. We obviously support a merits-based selection process. But it should be done through the Fair Work Commission.' Commenting on the proposal to have young people select their own super Mr Whiteley reportedly said: 'They suggest teenagers at the start of their careers should choose a super fund for what could be the rest of their life. They are forcing teenagers to make decisions about their retirement. It's a bewildering, baffling proposal'.
- **The Financial Services Council**, which represents the for-profit sector, reportedly welcomed the proposals. Chief executive Sally Loan is quoted in The New Daily as saying that 'in the main' the

report showed the super system was "working well for most Australians. However it has found that a key driver of poor outcomes is having default funds tied to employers and workplace relations through enterprise agreements and modern awards. They note that this has worked in favour of the funds, not consumers. Giving consumers just one default fund that they can carry from job to job will also address the chronic and massive problem of multiple accounts, which still afflicts our system to the great detriment of consumers.'

- **Lack of action by industry to address issues?** Commenting broadly on the on the draft report, Helen Hodgson (Associate Professor, Curtin Law School and Curtin Business School) expresses concern that despite the fact that overall the current structure of not-for-profit funds is serving members well, 'that many of the problems identified by the new report are the same ones that arose in the 2014 Financial System Inquiry, the 2015 Cooper Review, and in the evidence to the Financial Services Royal Commission…Most of these issues raised have been part of the discussion for the past decade. The fact that they are still on the table shows a level of inertia in the system, and a reluctance by the industry to address its problems'.

[Sources: Minister for Revenue and Financial Services Kelly O'Dwyer Transcript: Interview with Hamish Macdonald, ABC Radio National Breakfast 29/05/2018; APRA speeches: Wayne Byres, Chair: Opening statement — Senate Economics Legislation Committee 30/05/5018; Financial Standard 29/05/2018; The New Daily 29/05/2018; Super Review 29/05/2018; The Conversation 30/05/2018]

APRA has called for greater focus by superannuation licensees on administering outsourcing arrangements with related parties to effectively manage conflicts of interest.

The Australian Prudential Regulation Authority (APRA) has written to registrable superannuation entities (RSEs) outlining the findings its thematic review of related party arrangements for registrable superannuation entity (RSE) licensees. APRA Deputy Chairman Helen Rowell said the prevalence of outsourcing in the superannuation industry to deliver key services has made robust oversight of service provider relationships essential to deliver appropriate member outcomes. Among other things, APRA recommends greater focus by superannuation licensees on administering outsourcing arrangements with related parties to effectively manage conflicts of interest.

Scope of the review: APRA's review of 14 licensees, representing a cross-section fund type, size and ownership structure, took place over 2016 and 2017. APRA states that the review was by concerns that some licensees' management of commercial relationships with related parties could detract from the outcomes delivered to their members.

APRA notes that the review of related party arrangements was carried out in conjunction with the thematic review of board governance released on 17 May (see: Governance News 18/05/2018).

Key Findings and Draft recommendations

Overall, the report found that while RSE licensees had improved their handling of related party arrangements since APRA's 2014 conflicts of interest thematic review, there is room for improvement. A high level overview of the key findings and recommendations is below.

- **Need for improved contract management — ensuring related party contracts are for a set period and contain clear termination provisions**: APRA found a general improvement in the use of key performance indicators in related party service contracts since the 2014 review, but also found that there was significant variance amongst the sampled RSE licensees in the adequacy of the criteria, the reporting of performance and the options to address performance issues, including penalty provisions. APRA also noted an absence of clear termination triggers in a number of the agreements reviewed.

  To address this APRA recommends that 'RSE licensees ensure that related party arrangements are formalised, contain clear and objective performance measurements, and appropriate termination and penalty provisions, and a fixed term for review. Reporting against the relevant measures and triggers should be timely, rigorous and subject to appropriate review and oversight by the RSE licensee'.

- **Need to undertake service provider benchmarking to ensure terms and prices are commensurate with others available in the market.** APRA found that some of the sampled RSE licensees were not ensuring that their selection or benchmarking processes for related party service providers was comprehensive and rigorous.

To address this, APRA recommends that 'RSE licensees undertake rigorous market-based benchmarking of pricing and services prior to engaging a related party service provider, including utilising independent advice and assessment where appropriate'.

- **Need to proactively consider and document how decisions to use related party service providers are in the best interests of superannuation members:** Within the sample, APRA found inconsistent interpretation and application by RSE licensees of the prudential requirements in relation to related party arrangements. In particular, APRA found that this was the case in the following areas: assessing materiality of the service provision; documentation of decision making on related party arrangements; and reflecting related party arrangements in conflicts of interest policies.

  To address this, APRA made two recommendations:

  - 'That decision-making by RSE licensees on the use of related party providers is documented, including assessing materiality and demonstrating that the arrangement is in the best interests of members'; and
  - 'that RSE licensees review their conflicts management frameworks to ensure they are current and appropriately reflect existing related party arrangements'.

- **Need for improved data reporting:** APRA found considerable inconsistency in, and variation in the quality of, data reported under Reporting Standard SRS 331.0 Services (SRS 331.0). APRA states that some RSEs did not accurately classify services with a related party as being with an associate, or incorrectly reported the services provided by the associate. APRA states that these data quality issues 'inhibit APRA's ability to efficiently and effectively assess any prudential concerns that may arise in relation to related party arrangements'.

  To address this APRA recommended that 'RSE licensees review their processes for ensuring that arrangements with related party service providers are accurately reported as 'associates' on the relevant reporting forms and consistent with the reporting form guidance'.

[Sources: Australian Prudential Regulation Authority media release 29/05/2018; Letter to RSE licensees — Related Party Arrangements Thematic Review 29/05/2018]

Review of superannuation and victims of crime compensation: The Government has released two proposals for consultation which propose to enable victims of crime to access a perpetrator's superannuation in specific circumstances. Consultation closes 15 June 2018.

In December 2017, the government commenced a review into the early release of superannuation, including whether a perpetrator's superannuation should be available to meet unpaid victims of crime compensation orders. The government recently released two draft proposals for consultation that would provide victims of crime with access to a perpetrator's superannuation in specific circumstances.

- The first paper proposes to allow victims of crime to claw back 'out of character' contributions made by perpetrators. The aim is to prevent perpetrators from using superannuation to shield their assets from victims of crime.
- The second paper proposes to allow victims of serious, violent crimes to be able to access a perpetrator's superannuation as compensation, where other assets have been exhausted, subject to appropriate limits and thresholds.

Minister for Revenue and Financial Services, Kelly O'Dwyer said: 'The purpose of this consultation process is to seek detailed feedback on the two draft proposals. The Government is particularly interested in views on the likely effectiveness of the draft proposals, including their interaction with existing state and territory criminal and civil procedures.'

Timing: Consultation closes on 15 June 2018.

[Sources: Review of superannuation and victims of crime compensation Consultation Paper 28/05/2018; Minister for Revenue and Financial Services Kelly O'Dwyer media release 28/05/2018]

In Brief | ASIC is leading representatives from the superannuation industry (Australian Super, HESTA, Super SA, QSuper and Prime Super) and the Australian government to visit remote Pitjantjatjara Yankunytjatjara (APY) Lands as part of ASIC's indigenous Outreach program 'to both learn from and help local Indigenous consumers with their super'. ASIC Deputy Chair Peter Kell said he hopes the trip will lead to real change to improve super trustees' services to Indigenous consumers.

[Source: 18-155MR ASIC leads super industry on outreach trip to the APY Lands]

In Brief | Australia's 53 largest super funds are increasing their engagement in responsible investing according to RIAA's Super Fund Responsible Investment Benchmark Report 2018: 81% are now committed to responsible investment (up from 70% in 2016); 62% are reporting annually on activity; nearly half of super funds offer a total of 75 responsible investment options (compared to 24 funds offering 54 options in 2016) and responsible investment employee numbers have doubled since 2016.

[Sources: Responsible Investment Association Australia media release 31/05/2018; RIAA's Super Fund Responsible Investment Benchmark Report 2018]

In Brief | APRA has released its Quarterly Superannuation Performance publication and the Quarterly MySuper Statistics report for the March quarter 2018. Over the March 2018 quarter there was a decrease of 0.2% in total superannuation assets, comprised of an increase of 0.2% in APRA-regulated assets, a decrease of 1.2% in self-managed super fund assets, an increase of 0.1% in exempt public sector superannuation schemes assets and an increase of 0.2% in balance of life office statutory fund assets.

[Source: Australian Prudential Regulation Authority media release 29/05/2018]

Insurance

In Brief | APRA Senior Manager Peter Kohlhagen has cautioned Private Health Insurers that they need to 'cultivate a sense of "chronic unease" about the risks and threats' facing their institutions given current challenges and added that (among other things) the industry should expect stress testing practices to be strengthened over time. He also said that there was no immediate need to reduce capital levels in the industry.

[Source: Australian Prudential Regulation Authority Speech: Combating complacency in a new era of PHI instability by Peter Kohlhagen, Senior Manager, Policy Development - Health Insurance Summit, Sydney 31/05/2018]

Other Developments

United States | US Banks loosening terms of business loans? OCC report highlights looser lending practices as a key risk for the Federal Banking System.

The Office of the Comptroller of the Currency (OCC) has issued a report: *OCC Semiannual Risk Perspective for Spring 2018*, which identified: credit, operational, compliance, and interest rate risks as 'key themes' for the federal banking system.

The report covers risks facing US national banks and federal savings associations based on data as of March 31, 2018 and presents data in five main areas: the operating environment, bank performance, special topics in emerging risk, trends in key risks, and supervisory actions.

Key Points

- The OCC found evidence of 'eased underwriting' due to strong competition for loans. 'The accommodating credit environment warrants a continued focus on underwriting practices to monitor and assess credit risk and lender complacency' OCC states.

- The OCC also highlights operational risk as a key issue as lenders adapt business models, transform technology and operating processes, and respond to evolving cyber threats.
- Compliance risk (management of money laundering risks and implementation of changes to policies and procedures to comply with amended regulatory requirements) was also highlighted in the report.
- The OCC also suggests that continued increase in market interest rates may lead to higher funding costs for banks, as economic growth increases loan demand and competition for funding 'pressures banks to raise deposit yields'.

[Sources: US Department of Treasury: Office of the Comptroller of the Currency media release 24/05/2018; [registration required] The WSJ 29/05/2018; OCC Semiannual Risk Perspective for Spring 2018*]*

In Brief | ASIC is has released a consultation paper proposing to implement a modified AFS licensing regime for foreign financial service providers (global investment banks or wholesale managed funds). The proposed foreign AFS licence would replace two types of current relief: sufficient equivalence relief and limited connection relief. ASIC states that it will extend the current relief for 12 months until 30 September 2019 to allow for consultation on the proposed changes, and a further transition period of 12 months to 30 September 2020 if ASIC proceeds with foreign AFS licensing.

[Sources: 18-162MR ASIC consults on foreign financial services providers relief proposals; CP 301 Foreign financial services providers]

In Brief | US President Donald Trump has signed the Financial Services Regulatory Reform Act into law: 'The legislation I'm signing today rolls back the crippling Dodd-Frank regulations that are crushing community banks and credit unions nationwide' he said.

[Note: Having passed the senate in March, the US House of Representatives passed S 2155 - Economic Growth, Regulatory Relief and Consumer Protection Act on 22 May. See: Governance News 28/05/2018.]

[Source: Whitehouse media release: Remarks by President Trump at the Signing of S 20155 Economic Growth, Regulatory Relief and Consumer Protection Act 24/05/2018]

Accounting and Audit

A failure of risk and audit committees not of internal auditors? IIA CEO Peter Jones has reportedly said internal auditors are performing their roles but the information is not reaching senior management and the board.

The AFR reports that Chair of the ASX Corporate Governance Council Elizabeth Johnstone has expressed the view that internal auditors have lost their authority within large corporations, and has cautioned that this needs to change — that internal auditors need to 'speak truth to power' — if a repeat of the cultural issues identified by the Australian Prudential Regulation Authority (APRA) in the recent report of the prudential inquiry into the CBA are to be avoided in future (see: Governance News 04/05/2018).

In response, CEO of the Institute of Internal Auditors (IIA), Peter Jones is quoted in The AFR as challenging this view. Referencing the fact that the Financial Services Royal Commission's reliance many internal audit reports to highlight issues not followed through appropriately as evidence that internal auditors are performing their roles, Mr Jones suggests that the issue lies not with internal auditors but at risk and audit committee level. 'Where the system is failing is not in the internal audit function, but at the audit and risk committee level. The messages from the internal auditors are not getting through to the boards. Their reports are being filtered by either senior management before they get to the audit and risk committees or the committees are not insisting that management acts on the findings quickly enough' Mr Jones reportedly said.

The article goes on to quote Mr Jones as adding that though unable to point to any specific instances, the IIA is aware of circumstances where auditors are being ignored or punished for performing their roles: 'internal auditors have had their reports diluted or suppressed, and in some cases the internal auditors have been moved sideways or dismissed' he is quoted as stating.

[Sources: [registration required] The AFR 22/05/2018; 28/05/2018]

Risk Management

Plaintiff class actions set to increase? The ALRC has released a discussion paper for consultation recommending the ban on contingency fees be lifted among other changes. MinterEllison Partner, David Taylor commented that 'The ALRC proposals would mark a significant change in the class action funding landscape'.

The Australian Law Reform Commission released a discussion paper for consultation on 31 May: *Inquiry into Class Action Proceedings and Third-Party Litigation Funders discussion paper (DP 85).*

The paper makes a 16 proposals and asks 11 questions that focus on the introduction of regulation appropriate for third-party litigation funders and strengthening the role of the Federal Court to further supervise funded class action proceedings.

Proposals put forward in the paper include the following (among others):

- **Lift ban on contingency fee arrangements (with some limitations)**: Subject to court approval and 'Confined to solicitors acting for the representative plaintiff in class action proceedings, statutes regulating the legal profession should permit solicitors to enter into contingency fee agreements'. The ALRC suggests that the following limitations should apply:
  - 'an action that is funded through a contingency fee agreement cannot also be directly funded by a litigation funder or another funding entity which is also charging on a contingent basis;
  - a contingency fee cannot be recovered in addition to professional fees for legal services charged on a time-cost basis; and
  - under a contingency fee agreement, solicitors must advance the cost of disbursements and indemnify the representative class member against an adverse costs order'.
  - The ALRC further suggests that contingency fee agreements in class actions proceedings should only be permitted with the leave of the Court and suggests that Part IVA of the Federal Court of Australia Act 1976 (Cth_) should be amended to reflect this.
- **Review of continuous disclosure obligations:** The ALRC also suggests that the government should commission a review of the legal and economic impact of the continuous disclosure obligations of entities listed on public stock exchanges and those relating to misleading and deceptive conduct contained in the *Corporations Act 2001* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth) with regards to:
  - 'the propensity for corporate entities to be the target of funded shareholder class actions in Australia;
  - the value of the investments of shareholders of the corporate entity at the time when that entity is the target of the class action; and
  - the availability and cost of directors and officers liability cover within the Australian market. is the proposal that percentage-based contingency fees for solicitors on their clients' winnings in lawsuits should be allowed in class actions, subject to course permission and supervision'.
- **Licensing regime for funders**: The ALRC proposes that the *Corporations Act (2001) (*Cth) should be amended to require third-party litigation funders to obtain and maintain a 'litigation funding licence' to operate in Australia which may include capital adequacy requirements.

MinterEllison Partner, David Taylor **commented**: 'The ALRC proposals would mark a significant change in the class action funding landscape. If contingency-style fees are introduced in Australia we suspect an increased number of class actions being commenced in Australia, as plaintiff law firms rush to access a percentage of the lucrative class action settlement "pie". That may encourage actions on a more speculative basis being commenced quickly to secure that percentage. This is not something that will be welcomed by Australian businesses. Additionally, the idea of linking a lawyer's financial return so directly to a settlement or judgment award has historically raised (and will likely continue to raise) a number of concerns across the

Australian legal landscape. Put simply, does such an arrangement raise a conflict of interest between the lawyer and his clients? The ALRC has attempted to address these concerns by certain limitations to, and court supervision of, such arrangements. Furthermore, the continuous disclosure reforms, licensing requirements and other proposals by the ALRC could go some way to lessening the impact of these changes. Indeed, with the growing concern regarding insurers exiting the market for coverage of these types of claims, it might be suspected that some of the more novel proposals to limit class actions (such as a voluntary redress scheme) may garner serious attention from the government.'

Timing: Consultation on the proposals closes 30 July 2018. The ALRC will present its final report to the Attorney General 21 December 2018.

[Sources: Australian Law Reform Commission media release 31/05/2018; Inquiry into Class Action Proceedings and Third-Party Litigation Funders discussion paper 31/05/2018; [registration required] The Australian 01/06/2018; [registration required] The AFR 31/05/2018]

Other News

The EU has reportedly proposed a ban on single use plastic products. If enacted it will come into force post-Brexit and will not automatically be transposed into UK law.

The EU has reportedly proposed a ban on single-use plastic products, including plastic straws, cutlery, cotton buds, plates and balloon sticks, in order to protect marine life. The proposal also includes plans for all plastic bottles to be collected for recycling by 2025.

Officials in Brussels have estimated that the ban will help to prevent damage to the environment that would cost the equivalent of €22bn by 2030. It will also help to avoid 3.4 million tonnes of carbon emissions and save consumers €6.5bn. The bank will reportedly not come into force until after Brexit and therefore will not be among the legislation to be automatically transposed into UK law.

In a speech announcing the plan, EU's First Vice-President Frans Timmersman reportedly called for all European countries 'to act together to tackle this problem' of plastic waste and called on the UK's Environment Secretary Michael Gove to take steps, 'What I hope for after today is a race to the top, and I invite all those who said the EU is too slow – whether they are Michael Gove or others – to join us in this race to the top. Let's see who does best at this.'

[Source: The Guardian 29/05/2018]