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Boards and Directors

Pepsi Co CEO Indra Nooyi has resigned after 12 years as CEO of a Fortune 500 company: Media reports suggest that her departure casts a spotlight on the lack of women in leadership and separately on the emergence of 'key man' risk as a risk and as an investor concern.

- **Spotlight on the lack of gender balance in senior roles:** The FT comments that Indra Nooyi's 12-year tenure as PepsiCo CEO highlights both the strides (some) women have made in getting to the top levels of business leadership and the dearth of women who have succeeded in doing so. According to The FT Ms Nooyi's departure from PepsiCo in October will reduce from 24 to 23 the number of women heading Fortune 500 companies (down from 32 one year ago). The FT adds that many of those who have resigned over this period were succeeded (as Ms Nooyi will be) by men. This is largely due to the dearth of women in the leadership pipeline the FT argues.
- **'Key man' risk?** Noting that the Pepsi Co share price dropped following news of Ms Nooyi's resignation, Business Insider writes that there is increasing recognition of the risk that the sudden departure of a CEO, including Ms Nooyi, can have on company value and that this risk is increasingly of concern to investors. Reportedly Morgan Stanley has looked at the risks of having a 'hugely important executive such as a CEO or chairman – dubbed a key man – suddenly step down' and has found that companies with 'key-man losses' in 2017, underperformed the rest of the market by 11% on average over the next 12 months, with 32% of those companies underperforming the rest of the market by more than 20%. Further, according to the Morgan Stanley, a quarter of large-cap banks, including JP Morgan, have a key-man risk. This, according to the article, is increasingly of concern to investors who may be difficult to convince of the ability of a successor to a 'key man' to perform as strongly.

[Sources: [registration required] The FT 08/08/2018; Business Insider 07/08/2018]

Remuneration

Earning short term bonuses 'like clockwork'? Transurban CEO Scott Charlton is reportedly set to earn $7m due in the main to a 17% increase in his short term incentive raising questions, The AFR suggests, about the way in which companies set targets.

The AFR writes that CEO Scott Charlton's total pay in the year to June 2018 was $7.05 million, with his short term bonus increasing 17% making his total pay higher than three of the big four bank CEOs. Further, analysis (by The AFR) of Transurban's annual reports over the past five years reportedly shows that Mr Charlton has only once failed to beat his targets for cost control and earnings before interest, tax, depreciation and amortisation and, in terms of long term incentives that Mr Charlton has met them every year for the past five years.

The AFR comments that Mr Charlton's pay has steadily increased even though Transurban stock has 'stagnated over the past three years' and has 'underperformed' against the S&P ASX200 Index. 'The combination of a prolonged under performance in the shares and consistent increases in pay at Transurban could raise questions in the minds of investors about the hurdles used in remuneration targets' the report suggests.

The article goes on to question whether 'Earning short term bonuses like clockwork and matching a critical element of the LTI hurdle every year raises questions about the company's stretch performance targets. Has the board been setting sufficiently tough stretch targets? Is it imprudent to encourage management to take higher risks?' The AFR comments that these questions are of particular relevance in the context of the current debate about bonuses and the 'allegation that they have become part of the normal annual remuneration of leading executives'.

[Note: One of the conclusions in the latest Australian Council of Superannuation Investors (ACSI) annual survey of CEO remuneration in ASX 200 companies was that bonuses increasingly 'resemble variable fixed pay'. See: Governance News 23/07/2018.]

[Source: [registration required] The AFR 07/08/2018]

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[Sources: CBA ASX Announcements: 2018 Annual Report 08/08/2018; 2018 AGM and 2018 Financial Calendar 08/08/2018; CBA media releases: CBA FY18 highlights transcript of the CEO's video 08/085/2018; Results presentation and investor discussion pack 08/08/2018; [registration required] The AFR 08/08/2018; [registration required] The Australian 08/08/2018]

In Brief | Trend towards performance based awards emerging? A new Equilar study examining the mix of compensation provided to CEOs and its correlation to shareholder approval over the past three years has found that companies who receive 'say on pay' approval from their shareholders on executive compensation are shifting pay packages to rely more heavily on performance awards.

[Source: Equilar blog 07/08/2018]

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[Sources: Fortune 07/08/2018; 07/08/2018]

Institutional Shareholders and Stewardship

In Brief | ACSI has announced that Christian Super has become a signatory to the Australian Asset Owner Stewardship Code. ACSI CEO Louise Davidson commented, 'We're seeing a number of asset owners who don't want to wait until next year to begin providing more information about their stewardship activities'.

[Note: The Australian Council of Superannuation Investors (ACSI) released the Australian Asset Owner Stewardship Code (the Code) on 17 May 2018. The Code sets out six principles which signatories must commit to on an 'if not, why not' basis with accompanying guidance on each principle. Signatories will be required to publish a Stewardship Statement for the period 1 July 2018 to 30 June 2019 by (or before) 30 September 2019. See: Governance News 18/05/2018.]

[Source: ACSI media release 02/08/2018]

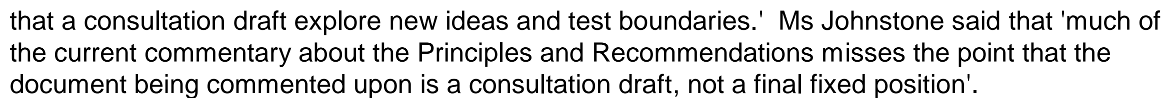
Other Shareholder News

Update | Consultation on proposed changes to the *ASX Corporate Governance Principles and Recommendations*

Proposed changes to the *ASX Principles and Recommendations* are as yet in draft and may change in response to feedback on the consultation process: ASX Corporate Governance Council Chair Elizabeth Johnstone has issued a statement in response to recent debate about proposed amendments.

ASX Corporate Governance Council Chair Elizabeth Johnstone has released a statement in response to recent debate (see: Governance News 06/08/2018) around proposed changes to the *ASX Corporate Governance Principles and Recommendations* (see: Governance News 04/05/2018).

- **The proposals are as yet in draft:** Ms Johnstone welcomed the high level of interest ('almost' 100 submissions received) and debate on the draft proposals adding that 'it is appropriate and important



that a consultation draft explore new ideas and test boundaries.' Ms Johnstone said that 'much of the current commentary about the Principles and Recommendations misses the point that the document being commented upon is a consultation draft, not a final fixed position'.

- **Ms Johnstone rejected:**
  - **The assertion that the proposed changes are the work of 'left wing activists'** commenting that 'It is wrong to label the consultation draft as the work of "left-wing activists" or "social engineers". It is the work of those who invest in, raise capital from, and provide professional support for, the market' she said. Ms Johnstone added that the all 20 members of the Council 'unanimously approved the consultation draft for release as a consultation draft, even though some members may not have agreed with everything it contained. The draft was intended to generate debate and elicit a wide range of views'.
  - **The suggestion that the Principles may have contributed to the 'egregious behaviour' revealed by the Royal Commission:** 'Each new edition of the Principles and Recommendations has been widely regarded as contributing significantly to an uplift in governance standards in Australia. The suggestion some have made that the Principles and Recommendations have contributed to the egregious behaviour revealed by the Hayne Royal Commission is simply wrong. In fact, much of that behaviour violates principle 3 of the existing Principles and Recommendations – act ethically and responsibly' she said.
  - **The assertion that the Principles have led to boards being overwhelmed with lengthy reports:** Similarly, the suggestion some have made that the Principles and Recommendations have contributed to boards being inundated with thousands of pages of board papers is also wrong. The overwhelming majority of the Council's recommendations go to the structures and processes listed entities should have in place as part of a robust governance framework and don't require lengthy ongoing reporting to the board.
- **The Principles remain flexible:** Ms Johnstone stated that Council remains 'firmly committed to retaining' the 'if not why not' framework on the basis that it 'gives listed entities the flexibility to adopt different governance practices to those recommended'. Ms Johnstone noted that 'any board that considers it has a more effective way to address a particular governance issue is free to adopt it. All it has to do is explain why. Listed entities frequently avail themselves of this opportunity. Once informed, the market can then make its assessment'.
- **The concept of the 'social licence to operate' appears to be a key concern for some stakeholders**, Ms Johnstone said. She added that 'As a number have already pointed out in submissions, this issue can be addressed in different terms such as reputation, brand and trust. The Council will listen carefully to the concerns that have been raised about the term "social licence to operate" and consider how best to express and address this issue in the course of preparing the final version of the fourth edition'.
- **Process and timeline are unchanged:** 'This is the process the Council went through with the previous editions of the Principles and Recommendations…As Chair, I am confident the Council will achieve the same result with the fourth edition and issue that document, as scheduled, late this year or early next year' she said.
- **The final version is likely to differ from the draft:** Ms Johnstone said that 'The final form of the Principles and Recommendations will need to be approved by broad consensus of the members of the Council. This will require cooperation and compromise to reach a position broadly acceptable to the diverse stakeholder groups represented on the Council. Consequently, the final version of the fourth edition will almost certainly differ from the consultation draft'.

The AFR has interpreted Ms Johnstone's statement as indicating that Council intends to drop 'a requirement for companies to hold a "social licence to operate" from controversial changes to the ASX Corporate Governance Principles'.

ASX CEO Dominic Stevens is quoted in The AFR as stating that 'The consultation document being discussed in the media was approved for release by the entire council to gather feedback from the market… A variety of views should be tested. The final form of the principles will require the council's broad

consensus. ASX is confident the council will listen carefully to all submissions and reflect them appropriately in the final form of the principles'.

Mr Stevens has reportedly also rejected a call by his predecessor, Elmer Funke Kupper, for the ASX board to 'approve' the Principles and Recommendations on the basis that to do so would undermine the independence of the ASX Corporate Governance Council and 'give the principles which are not mandatory, the force of ASX rules undermining the flexibility of the "if not, why not" reporting framework'.

[Sources: ASX media release 06/08/2018; The Australian 07/08/2018; [registration required] The AFR 06/08/2018; 09/08/2018]

ASIC response to the consultation on the draft *ASX Corporate Governance Principles and Recommendations*: ASIC has suggested an alternate disclosure model and mandatory compliance with 'some or all' of the Principles and Recommendations for larger listed companies.

As flagged by ASX Corporate Governance Council Chair Elizabeth Johnstone in a recent statement (discussed in a separate post above), the ASX Corporate Governance Council has released (non-confidential) submissions received in response to the consultation on proposed amendments to the *ASX Corporate Governance Principles and Recommendations*.

Australian Securities and Investments Commission (ASIC) submission

Among the points raised in the ASIC submission were the following.

- **The current structure may encourage 'boilerplate disclosure'**: ASIC states that it is 'concerned that corporate governance statements in Australia sometime lack transparency and do not adequately reflect the actual corporate governance practices of entities'. ASIC attributes this to the fact that ASX Listing Rule 4.10.3 only requires reporting against the Recommendations and these are drafted in a way that means that entities are often only required to disclose the existence of a governance policy or framework rather than how the policy or framework has been implemented. This is problematic, ASIC writes, both because the existence of a policy doesn't necessarily reflect that it has been implemented/is being implemented and because it can 'lead to the corporate governance statement comprising largely "boilerplate" disclosure which is unlikely to change from year to year'.
- **Alternative model should be considered**: Given the shortcomings of the current approach (as outlined above) ASIC argues that an alternative disclosure model, to improve the effectiveness of governance practices 'without increasing the length of disclosure that needs to be provided to investors on an annual basis' should be considered. ASIC's proposed model would involve presenting information in two separate places.
    1. **In a standalone document describing corporate governance framework**. This document would include information that would not necessarily change or need to be updated and be published in a central, readily accessible location (eg company website). ASIC writes that it expects this document would include 'many of the disclosures that are currently provided to evidence compliance with the Principles and Recommendations' eg whether an entity has a policy or framework in place and a summary of the policy or framework.
    2. **Disclosure of actual governance practices in the annual statement.** For example, in relation to disclosures under proposed Recommendation 3.2 regarding the Code of Conduct, the entity could provide to investors on an annual basis how compliance with the code was implemented, monitored during the year, whether there were any material breaches, whether these were brought to the attention of the board and what was done to address them ASIC writes.
- **Monitoring disclosures?** Noting that active monitoring of corporate governance disclosures is in line with practices in peer markets, ASIC also states that it considers that there needs to be active monitoring and assessment by the ASX of disclosures' made under the Principles and Recommendations to help to increase their practical effectiveness.

- **Mandatory adherence to the Principles and Recommendations for larger listed entities?** To improve governance standards, ASIC suggests that 'some or all' of the Principles and Recommendations should be mandatory for larger listed entities. This may be facilitated, ASIC suggests by 'elevating particular recommendations into the ASX's Listing Rules'. ASIC notes that larger listed entities are already subject to higher expectations in terms of corporate governance in the Listing Rules with Listing Rules 12.7 and 12.8 imposing higher standards on ASX 300 entities with respect to audit and remuneration committees. ASIC suggests that ASX Corporate Governance Council might include 'strong encouragement of compliance with all the Principles and Recommendations by larger listed entities (say within the ASX 200) and for the disclosures made by these entities to be monitored accordingly'.

[Source: ASIC submission review of ASX Corporate Governance Council Principles and Recommendations 01/08/2018]

Submissions on proposed changes to the *ASX Corporate Governance Principles*: A review of the submissions reveals a diversity of views on proposed amendments, including the concept of the 'social licence to operate'.

ASX Corporate Governance Council Chair Elizabeth Johnstone flagged in a recent statement (discussed in a separate post above) that the concept of the 'social licence to operate' appeared to be a key concern for some stakeholders. The views of some stakeholders (in submissions on the proposed changes) on this issue are outlined below.

Social Licence to operate

- **Vanguard Investments Australia**, which has $87 billion invested in Australian listed companies, expressed support for the 'overall framework and philosophy underpinning the ASX Corporate Governance Council Principle and Recommendations, and of the success of the Consultation Draft in in capturing the essentials of contemporary best practice in this critical area of corporate accountability' but raised concerns regarding the 'social purpose language in Principle 3' . Vanguard writes that 'While supporting the updated wording of the Principle itself — that "a listed entity should instill and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner" — we are concerned that some of the associated commentary around the company's "social licence to operate" and conducting business in a "socially responsible manner" is somewhat vague, and risks leading to misaligned expectations between listed entities, security holders, and other stakeholders'. Vanguard 'encourages' the Council to consider whether the 'social purpose language in Principle 3 and associated recommendations might be modified given the enhanced disclosure of these types of risks as required by Recommendation 7.4'.
- **GIA and AICD:** Consistent with statements made last week (see: Governance News 06/08/2018) both the Australian Governance Institute and the Australian Institute of Company Directors submissions raised concerns regarding the increased level of 'prescription ' in some of the proposed revisions and the vagueness of the concept of the 'social licence to operate'.
- **ASA, AIST, ACSI, ASA:** The Australian Shareholders' Association (ASA) submission expressed support for the inclusion of the concept of the 'social licence to operate' as did the Australian Institute of Superannuation Trustees (AIST), the Australian Council of Superannuation Investors (ACSI) and the Australasian Centre for Corporate Responsibility (ACCR). The ASA writes: 'ASA supports the changes introduced in the consultation draft of the 4th edition of the Corporate Governance Principles and Recommendations (Consultation Draft). The changes go to the heart of the social licence to operate of entities listed on the Australian Securities Exchange (ASX). Moreover, we believe that some of the proposed changes could be further strengthened' the submission states.

Annual director elections? On a separate issue, State Street which has 'more than $29bn (US)' of equity assets under management in the Australian market, welcomed 'The Council's focus in the proposed revisions on outlining measures to strengthen board effectiveness and improve board quality' but suggested that the Council recommend Australian companies move to annual board election cycles the address 'current director election practices prevalent in the market, which we believe are limiting investors' ability to hold directors accountable'.

[Sources: Submissions to the consultation draft of the 4th edition of the ASX Corporate Governance Principles and Recommendations: Vanguard 27/07/2018; Governance Institute of Australia 27/07/2018; Australian Institute of Company Directors 27/07/2018; Australian Shareholders'

Association 05/07/2018; Australian Institute of Superannuation Trustees 15/06/2018; Australian Council of Superannuation Investors 07/06/2018; Australasian Centre for Corporate Responsibility 27/07/2018; State Street Global Advisors 27/07/2018]

Overseas Developments

Singapore | MAS has published a revised 'streamlined' and 'less prescriptive' Code of Corporate Governance.

The Monetary Authority of Singapore (MAS) released a revised version revised Code of Corporate Governance (Code) on 6 August.

Key Changes

MAS states that the 'desired outcomes' of the revisions to the code are to: 'support sustained corporate performance and innovation' and to 'strengthen investor confidence in Singapore's capital markets'.

- **'Streamlined' and 'less prescriptive':** Among other things, MAS highlights that the 'streamlined Code' is intended to focus on the tenets of good governance noting that there is a net reduction of 3 principles and 31 provisions, and that the revised code is 'more concise and less prescriptive' to move away from a 'box-ticking mindset'.
- **Emphasis on meaningful disclosure:** In addition, MAS notes that the revised code expectations on disclosure under the 'comply or explain regime'.
- **Measures to strengthen director independence** (eg reducing the shareholding threshold for directors from 10% to 5%, rationalising tests of independence; and 9 year rule for independent directors.)
- **Measures to enhance board composition and diversity** (eg at least one third of the board to comprise independent directors where the Chair is independent and a majority of the board to comprise independent directors were the Chair is not independent; and disclosure of diversity policy and progress made.)
- **Stakeholder engagement:** the changes require boards the consider and balance needs and interests of material stakeholders (ie beyond shareholders).
- **Transparent remuneration practices:** eg disclosure the relationship between remuneration and value creation.

Establishment of a new independent corporate governance advisory committee: In line with the Council's recommendations, MAS states that it will establish an independent Corporate Governance Advisory Committee (CGAC) to advocate good corporate governance practices. The CGAC will monitor companies' implementation of the Code, and provide support to companies by promulgating good practices and areas for improvement. The CGAC will also advise regulators on corporate governance issues. The CGAC will comprise senior practitioners with experience as board Chairmen or directors, corporate governance experts and representatives from diverse stakeholder groups.

Deputy Managing Director (Financial Supervision) Mr Ong Chong Tee commented: 'The Corporate Governance Council has weighed all inputs and feedback carefully in arriving at a set of balanced and meaningful recommendations. The revised Code is more concise and less prescriptive, and is designed to encourage more thoughtful application. It will help spur better corporate governance practices among companies to sustain long-term business performance. The establishment of the CGAC will strengthen the corporate governance eco-system and enhance market discipline.'

Timeline: The revised Code will take effect for Annual Reports covering financial years commencing from 1 January 2019. A longer transition period of three years will be provided for changes in the SGX Listing Rules relating to board composition, to provide companies with more time to make board composition changes. The Council will be dissolved with the issuance of the revised Code.

MAS writes that it expects to establish the CGAC by the end of this year.

Changes to the SGX Listing Rules: MAS notes that the revised Code clarifies 'how companies should adopt the comply or explain regime' and notes that the SGX Listing Rules have been amended to clarify the expectations in this respect, to ensure that companies provide meaningful disclosures to their stakeholders.

[Sources: MAS media release 06/08/2018; Infographic - Corporate Governance Council's recommendations to enhance corporate governance in Singapore; Code of Corporate Governance 06/08/2018; SGX media release 06/08/2018; 06/08/2018; MAS Speech: Fostering a Strong Corporate Governance Ecosystem - Keynote Speech by Mr Ong Chong Tee, Deputy Managing Director, Monetary Authority of Singapore, at Singapore Governance and Transparency Forum 06/08/2018]

In Brief | FRC consultation on the Wates Governance Principles for large private companies: In a blogpost on the FRC website, The Institute For Family Business has expressed support for the proposed principles stating that they will help to promote 'good and workable governance in private businesses' while remaining sufficiently flexible. More particularly, IFB argues non-executive directors potentially add great value to a family business in a number of ways including by bringing an outside perspective, offering constructive challenge and bringing a new set of skills or contacts. Consultation on the Wates Principles closes 7 September and a final version will be published in December 2018.

[Source: The Financial Reporting Council (FRC) released the *Wates Corporate Governance Principles for Large Private Companies* (the Principles) for consultation in June. The FRC states that in addition to improving corporate governance standards, compliance with the Principles will satisfy the reporting requirements under the proposed: *Companies (Miscellaneous Reporting) Regulations 2018*. See: Governance News 15/06/2018]

[Source: FRC blog: Elizabeth Bagger Executive Director of the Institute for Family Business 08/08/2018]

Disclosure and Reporting

Tesla's unconventional choice of platform (Twitter) to announce CEO Elon Musk's plans to privatise the company as well as its substance and timing has sparked substantial media interest. Is it a joke, a matter of enabling great focus on long term goals, potential market manipulation or a response to the short seller threat?

Following an earlier Twitter announcement stating: 'Am considering taking Tesla private at $420. Funding secured,' Tesla CEO and founder Elon Musk has explained (in a blog post) to employees, the reasons behind his plans to take the company private (subject to shareholder approval).

He stated that 'as a public company, we are subject to wild swings in our stock price that can be a major distraction for everyone working at Tesla, all of whom are shareholders. Being public also subjects us to the quarterly earnings cycle that puts enormous pressure on Tesla to make decisions that may be right for a given quarter, but not necessarily right for the long-term. Finally, as the most shorted stock in the history of the stock market, being public means that there are large numbers of people who have the incentive to attack the company'. Mr Musk goes on to say that taking the company private will enable a greater focus on the execution of long-term goals: 'fundamentally believe that we are at our best when everyone is focused on executing, when we can remain focused on our long-term mission, and when there are not perverse incentives for people to try to harm what we're all trying to achieve…free from as much distraction and short-term thinking as possible'.

Mr Musk then outlined the implications (of privatisation were it to be approved) for shareholders and for employees emphasising 'this has nothing to do with accumulating control for myself. I own about 20% of the company now, and I don't envision that being substantially different after any deal is completed'.

According to media reports, the Tesla share price jumped in response to the news.

The unconventional platform chosen by Mr Musk to make the announcement (Twitter), the lack of detail in the announcement and the timing (reportedly 'less than an hour' after the FT disclosures that Saudi Arabia's Public Investment Fund had amassed a 3-5% stake in Tesla, making it one of the company's largest investors) have received wide media coverage. The FT comments: 'whether Musk's tweet was a ploy to crush short sellers, an attempt to manipulate Tesla's stock, or a completely legitimate – albeit unconventional – corporate announcement, one thing is certain: the CEO never fails to entertain'.

Should it be taken seriously? Possible SEC investigation? Both The FT and The New York Times report that given Mr Musk's 'offbeat sense of humour' in past Twitter posts, there has been speculation about whether the post can be taken seriously. Reportedly there was 'immediate speculation that the $420 figure was a reference to 420 (Marijuana Day). If it can be taken seriously, the New York Times suggests that Mr Musk's statement that he had 'funding secured' (when he offered no basis for the offer price) for a possible $70 billion buyout could trigger regulatory scrutiny.

The article goes on to state that the US Securities and Exchange Commission has contacted Tesla to inquire about the accuracy of Mr Musk's tweet and why the announcement was not made in a regulatory filing. Such questions, The New York Times comments, 'typically precede the launch of any formal investigation'.

[Sources: TESLA blog 07/08/2018; The ABC 08/08/2018; The SMH 08/08/2018; The New York Times 08/08/2018; 08/08/2018; [registration required] The FT 08/08/2018; 08/08/2018; Business Insider 08/08/2018]

In Brief | Breach of the Disclosure Guidance and Transparency Rules? ClientEarth has reportedly filed a complaint with the FCA alleging three insurers' failure to disclose climate risk is a breach of the Disclosure Guidance and Transparency Rules.

[Source: [registration required] The FT 06/08/2018]

Regulators

Top Story | $70.1m in additional funding for ASIC announced to 'embed' ASIC staff in the big four banks and AMP among other measures.

Minister for revenue and financial services Kelly O'Dwyer has announced $70.1 million in additional funding for the Australian Securities and Investments Commission (ASIC) 'to boost the resources and capability of ASIC to improve consumer outcomes'.

Ms O'Dwyer said that the package includes the following measures.

- **Embed 'dedicated' ASIC staff within the big four banks and AMP:** $8 million to implement a new supervisory approach in respect of Australia's five largest financial institutions (the big four banks and AMP) by 'embedding dedicated staff within these institutions to monitor governance and compliance actions'.
- **Additional funds for supervision, enforcement and audit of the superannuation sector:** '$9.4 million to boost supervision of the superannuation sector by strengthening audit and enforcement action to improve transparency and outcomes for superannuation members'.
- **Additional funding to pursue actions against 'well funded' litigants:** $26.2 million to 'accelerate and increase the intensity of ASIC's enforcement activities and enhance its capacity to pursue actions for serious misconduct against well-funded litigants, through the Enforcement Special Account'.
- **Funding for a 'targeted and thematic review into corporate governance':** '$6.8 million to establish a dedicated taskforce which will conduct a proactive, targeted and thematic review into corporate governance to identify and pursue failings in large listed companies, including deploying staff to conduct new on-site surveillance and investigations'.
- **Implementation of whistleblower protection laws:** '$6.6 million to implement the Government's reforms to whistleblower protection laws, so that ASIC can better receive, assess, triage and address whistleblower disclosures about misconduct'.
- **Fintech development:** '$6 million to promote Australia as a world leader in the development and adoption of regulatory technology solutions for the financial services industry'.

Ms O'Dwyer said that the remaining funds would be directed towards improving consumer access to the Financial Advisers Register; enhancing ASIC's enforcement work on the unfair contract term protections for small businesses; and ensuring compliance by licensees and financial advisers with the Future of Financial Advice laws.

Ms O'Dwyer commented that the additional funding follows a decision by ASIC's new Chairman, James Shipton, to re-focus ASIC's strategic direction on proactive enforcement and increase onsite supervisory approaches and builds on the government's existing commitment to ensuring 'ASIC is fit for purpose and can pursue and prosecute those who do the wrong thing ASIC.'

[Note: Mr Shipton has flagged his intention to adopt an 'enhanced supervisory' approach in a number of recent speeches. See: Governance News 30/07/2018; 04/06/2018; 18/05/2018 as well as in the ASIC submission in response to the Productivity Commission's draft report into the efficiency and competitiveness of the superannuation sector.]

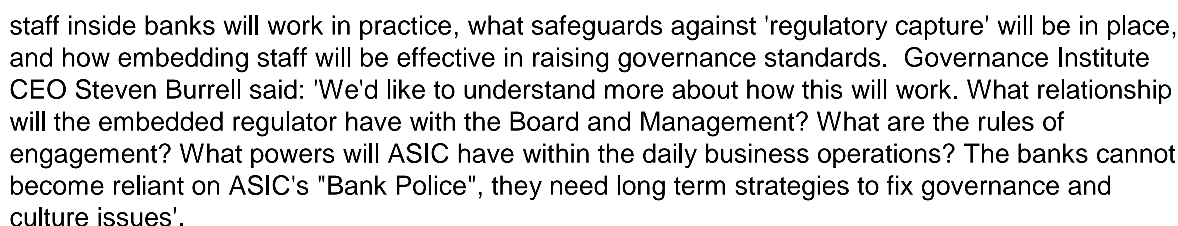
ASIC Chair James Shipton commented that the announcement is 'great news for ASIC, but above all, it is great news for the community and the financial services sector because [it will put ASIC] on an strategic and agile footing'. Mr Shipton went on to highlight that the funding would enable the following.

- **Quicker response times**: The additional funding will enable ASIC to accelerate enforcement initiatives and capabilities in line with community expectations that the regulator move quickly to resolve issues. 'Deterrence capability is front of mind' Mr Shipton said.
- **Superannuation will be an area of focus:** 'As the Minister and the Treasurer mentioned, we will be going onsite' Mr Shipton reiterated. He added that ASIC 'are also going to be doing supervisory approaches, supervisory engagement models in the important area of superannuation…It is absolutely vital that this area be a regulatory focus for us, and this is something that we will be working very closely, in close coordination with our colleagues at APRA, to execute on'.
- **Taskforce:** We also will have a conflicts of interest taskforce and we're going to be looking at conflicts of interest in the financial advice industry. We're going to be looking at conflicts of interest in corporate leadership and in the corporate governance community, and we're also going to be looking across-the-board at corporate governance, particularly where remuneration structures disrupt and mean that the outcome is not as positive for the consumer and the community.
- **Promotion of regtech:** Mr Shipton said that ASIC would invest 'energies and our resources in promoting regulatory technology solutions. Not just because they are good supervisory tools for a regulatory agency like ours, but also because these regulatory tools should be adopted by the financial sector, because the enormity of the task of avoiding misconduct and having fair, efficient and strong systems is not just a human response alone. It needs to have a technological solution, and we stand ready with this additional support and this additional funding to work with industry to develop these regulatory technology solutions so that we can have positive outcomes for the financial sector, but above all, for the community'.

ASIC to focus on identifying 'the harms' to minimise the 'probability of harm occurring': The AFR quotes Mr Shipton as commenting that the shift in ASIC's regulatory and enforcement strategy 'draws heavily' on the work of Malcolm Sparrow and more particularly is informed by the concept called 'the character of harms' which advocates focusing on the potential harms to financial consumers in society as a means of identifying opportunities for 'surgically efficient and effective interventions'. Mr Shipton explained that this focus is important because 'a regulatory agency needs to identify the harms that we want to prevent. It's not so much about risks. Risks will always be there. There will always be the risks of the probability of the harm occurring'.

Industry response

- **ABA says banks are 'committed to ensuring' the measures are implementing 'quickly and efficiently':** In a statement, Australian Banking Association CEO Anna Bligh said 'Restoring trust and confidence in Australia's banks through an open and transparent industry is the joint goal of Government, regulators and the sector' and added that 'Banks will work proactively and in good faith with ASIC on the measures announced today to improve monitoring of regulation and increase the transparency of the financial services industry. While the industry awaits further details of how the new initiatives will operate, it is committed to ensuring it is quickly and efficiently implemented'.
- **More detail needed says Governance Institute:** The Governance Institute has issued a statement in support of the additional funding for the regulator to combat misconduct (in principle) but has also questioned the lack of detail that has so far been provided as to how the proposal to embed ASIC



staff inside banks will work in practice, what safeguards against 'regulatory capture' will be in place, and how embedding staff will be effective in raising governance standards. Governance Institute CEO Steven Burrell said: 'We'd like to understand more about how this will work. What relationship will the embedded regulator have with the Board and Management? What are the rules of engagement? What powers will ASIC have within the daily business operations? The banks cannot become reliant on ASIC's "Bank Police", they need long term strategies to fix governance and culture issues'.

- **Professor Pamela Hanrahan from UNSW Business School** commented that: 'ASIC's announcement that it will embed its enforcement staff into the major banks and AMP is a positive development, but needs to be carefully managed…Formalising ASIC's inspection program in this way represents an important shift in regulatory approach, taking ASIC towards a more real-time oversight of the major players in consumer financial services'. Professor Hanrahan has previously argued 'in view of the highly concentrated nature of the sector, there may even be a case for embedded regulatory engagement with the major vertically integrated financial businesses, along the lines of the Australian Taxation Office's key taxpayer engagement program'.

[Sources: Minister for Revenue and Financial Services Kelly O'Dwyer media release 07/08/2018; [registration required] Joint Press Conference with Treasurer Scott Morrison: Turnbull expands ASIC's armoury 07/08/2018; [registration required] The Australian 08/08/2018; The AFR 07/08/2018; 07/08/2018; 07/08/2018; 08/08/2018; The ABC 07/08/2018; UNSW media release 09/08/2018; ABA media release 07/08/2018; Governance Institute of Australia media release 09/08/2018]

ASIC's latest enforcement report for H1 2018 released: Highlights include $20.44m in civil penalties and $256.69m in compensation and remediation for investors and consumers.

The Australian Securities and Investments Commission (ASIC) released *Report 585 ASIC enforcement outcomes: January to June 2018* on 9 August. The report outlines the enforcement outcomes achieved by ASIC during the period from 1 January to 30 June 2018 (relevant period); provides a high-level overview of some of ASIC's enforcement priorities; and highlights some important cases and decisions during this period.

Enforcement outcomes

- **Investigations:** ASIC commenced 67 investigations and completed 73.
- **Bannings/disqualifications:** ASIC banned or disqualified 68 people or companies from providing financial services or credit. 20 people were disqualified or removed from directing companies.
- **Prosecutions:** 13 people were charged in criminal proceedings, 210 criminal charges were laid, 176 people were charged in summary prosecutions for strict liability offences and 342 criminal charges were laid in summary prosecutions for strict liability offences.
- **Civil penalties:** $20.44m in civil penalties; $256.69m in compensation and remediation for investors and consumers.
- **Infringement notices, compensation and court enforceable undertakings:** 16 infringement notices were issued and $213,200 was paid in infringement notices; 12 court enforceable undertakings were entered into and $7.57m community benefit fund payments were made.

Further detail

Corporate Governance enforcement outcomes

- **Corporate governance outcomes during the reporting period:** The majority of corporate governance enforcement outcomes were actions against auditors (57%) followed by actions against directors (29%) followed by actions against liquidators (14%). The most common outcome of enforcement actions were administrative remedies (57%), followed by enforceable undertakings (22%). The remaining outcomes comprised criminal (7%), civil (7%) and negotiated outcomes (7).
- **Pending corporate governance matters**: As at 1 July 2018 there were a total of 14 criminal and 29 civil actions pending. These included 11 criminal actions against directors and 22 civil actions against directors and 4 pending civil actions against liquidators.

- **Outcomes relating to SMSF auditors since 2013**: ASIC has taken over 120 matters in relation to SMSF auditors since 2013 including the removal of 76 SMSF auditors from the register, the suspension of 1 SMSF auditor for a period and the imposition of additional conditions on the registration of 24 SMSF auditors. Of the areas 'considered for the enforcement actions' the majority (75) related to non-compliance with independence requirements, 74 related to non-compliance with auditing standards, 25 concerned 'fit and proper issues' and 27 concerned non-compliance with other requirements.
- **'Holding gatekeepers to account' was identified in the report as a particular area of focus during the reporting period.** Company directors and officers, auditors, insolvency practitioners and business advisers are important gatekeepers who hold positions of responsibility and trust, and who are required to lawfully discharge the obligations that these positions carry' ASIC writes.
- **Areas of focus for the next six months:** Over the next six months, ASIC states that it 'will have a particular focus' on the following: 'companies with poor corporate governance; undisclosed associations and substantial holdings in shares in public companies (including beneficial ownership tracing and corporate fraud); related party transactions involving public companies; poor financial reporting by listed companies and other public interest entities; the quality of audits of listed companies and other public interest entities; insolvency practitioners and others who facilitate serious illegal phoenix activity and improper transactions in the face of insolvency; debenture issuers and other companies exposed to risk as a result of a declining property market; and company directors and officers who fail to stop their companies making illegal payments to officials of overseas governments'.

Financial Services enforcement outcomes

- **Financial services outcomes during the reporting period:** The majority of financial enforcement outcomes concerned 'other financial services misconduct' (42%); followed by misconduct in relating to credit (32%); followed by dishonest conduct, misleading statement (18), followed by misappropriation, theft and fraud (7%). The most common outcome of enforcement actions were administrative remedies (58%), followed by civil remedies (19%), negotiated outcomes (11%0, enforceable undertakings (10%) and criminal remedies (2%).
- **Pending financial services matters**: As at 1 July 2018 there were a total of 16 criminal (11 of which concern dishonest conduct, misleading statements and 3 of which concern credit) and 56 civil pending financial services matters. The majority of pending civil matters (27) concern 'other financial services misconduct', 1 of which concerns credit and 18 concerned dishonest conduct, misleading statements.
- **'Consumer credit', 'unconscionable and misleading and deceptive conduct' were highlighted in the report as a particular areas of focus over the period**.
- **Key outcomes from the Wealth Management Project since 2014:** ASIC has banned 50 financial advisers from the industry, removed 1 director from the industry, commenced 2 civil penalty proceedings (against AMP and Westpac respectively) and secured 3 court enforceable undertakings relating to financial advisers under the wealth management project since 2014.
- **Areas of focus for the next six months include:** ASIC states that it will continue to focus on enforcing higher standards in the financial services and advice industry, paying particular attention to: 'responsible lending practices requiring credit licensees to make reasonable inquiries about a customer's financial situation, including verifying customer information in the assessment of suitability for a loan; the responsibility of AFS licensees to monitor and supervise the advice of their financial advice representatives to ensure that the services covered by the licence are provided efficiently, honestly and fairly; the obligation of financial services firms to ensure that clients are provided services for which they are charged [ASIC refers readers to: Report 499 *Financial advice: Fees for no service* (REP 499)]; and the scope of the conflicted remuneration obligations on financial licensees and authorised representatives when they are providing financial advice [ASIC refers readers to Regulatory Guide 246 *Conflicted and other banned remuneration* (RG 246) for more information].'

Market Integrity

- **Market Integrity outcomes during the reporting period:** 66% of outcomes concerned 'other market misconduct'; 17% concerned market integrity rules and 17% concerned market manipulation. The most common outcome of enforcement actions were administrative remedies (33%) and civil remedies (33%) followed by enforceable undertakings (17%) and criminal remedies (17%).
- **Pending market integrity matters**: As at 1 July 2018 there were a total of 11 criminal (3 concerning market manipulation; 4 concerning insider trading and the remainder concerning 'other market misconduct') and 13 civil matters (6 continuous disclosure related; 3 concerning market manipulation; 1 concerning the market integrity rules and 3 concerning 'other market misconduct') pending.
- **Financial benchmarks were highlighted as a particular area of focus**. The report includes a 'Summary of outcomes' relating to the BBSW conduct of ANZ, CBA, NAB and Westpac. Other areas of focus include protecting investors (eg ASIC investigation into AGM Markets, OT Markets and Ozifin), compliance with the listing standards; and market manipulation.
- **Areas of focus for the next six months** include 'poor conduct in fixed income, commodities and currency (FICC) markets; misconduct in relation to initial coin offerings and cryptocurrency markets; serious and organised market misconduct with a focus on cross-border transactions; technology-enabled offending, including cyber-related market misconduct; and financial benchmark integrity—by making sure the banks adhere to court enforceable undertakings'.

Small Business

- **Small business outcomes during the reporting period:** 97% of misconduct concerned 'action against persons'. The remaining 3% efficient registration and licencing. The most common outcome of enforcement actions were criminal (92%).
- **Pending small business matters**: As at 1 July 2018 there were a total of 119 criminal actions pending and 0 civil actions. Of these, 101 concerned actions against persons and 18 concerns efficient registration and licensing.
- **Illegal phoenix activity was highlighted as a particular area of focus over the reporting period.**
- **Areas of focus for the next six months** include: 'unfair contract terms in small business contracts; credit lenders who do not lodge annual compliance certificates in accordance with the National Credit Act; and illegal phoenix activity—addressing this activity and minimising its effects on companies suffering financial distress'.

Law and Policy

ASIC highlights the following.

- **Guidance provided on the duties of directors of mutual companies** (Information Sheet 231 Guidance on the duties of directors of mutual companies) which outlines the criminal offences that directors of mutual companies can be charged with under the Corporations Act 2001 (Cth).
- **Investigation costs recovery** (Information Sheet 204 Recovery of investigation expenses and costs) states that, wherever possible, ASIC 'will seek to recover investigation expenses and costs from persons who have caused those expenses and costs to be incurred'.

[Sources: 18-237MR ASIC's latest enforcement report highlights outcomes from the first half of 2018; ASIC Report 585 (REP 585): ASIC enforcement outcomes: January to June 2018]

Global consultation on the creation of a Global Financial Innovation Network: ASIC and 11 international financial regulators and related organisations are jointly consulting on the proposed creation, role and priorities of a proposed Global Financial Innovation Network (GFIN).

The Australian Securities and Investments Commission (ASIC), in collaboration with 11 international financial regulators and related organisations (including the UK Financial Conduct Authority, US Consumer Financial Protection Bureau (US) and Monetary Authority of Singapore among others), has released a consultation paper on the proposed creation and role of the Global Financial Innovation Network (GFIN).

The GFIN seeks to provide, ASIC writes, both a more efficient way for innovative firms to interact with regulators helping them navigate between countries as they look to scale new ideas; and a new framework for co-operation between financial services regulators on innovation related topics, enabling them to more easily share different experiences and approaches.

The GFIN will have three main functions:

1. to act as a network of regulators to collaborate and share experience of innovation in respective markets, including emerging technologies and business models;
2. to provide a forum for joint policy work and discussions; and
3. to provide firms with an environment in which to trial cross-border solutions.

As part of the consultation, the group is seeking views on the mission statement for the GFIN, its proposed functions, and where it should prioritise activity. In addition, the group is keen to hear from other interested related organisations who wish to get involved.

Timeline and next steps: Feedback is requested by 14 October 2018. Over the course of the next two months, the group will engage with interested parties across the different jurisdictions involved in the project. In late October, the working group will assess feedback and agree on next steps.

[Source: 18-232MR Consultation on the proposed establishment of a Global Financial Innovation Network]

'Banks could do more to manage the risks to customers associated with third party access to money in customers' accounts' according to ASIC Report 584: ASIC's review of fraud/risk controls on third party accounts found no 'widespread misconduct' but five Australian banks will take steps to improve their fraud/risk protections.

Following an industry-wide review by ASIC analysing the compliance measures and controls that banks should have in place to address the risk of fraud and other risks associated with third party accounts (ie deposit accounts that can be operated by a third party eg a financial adviser, stockbroker or accountant on a customer's behalf) ASIC has released the following report: *Report 584: Improved protections for deposit accounts with third-party access (REP 584).*

ASIC states that while it did not find widespread misconduct in relation to adviser-operated deposit accounts 'we consider that the banks could do more to manage the risks to customers associated with third party access to money in customers' accounts. Even though the instances of fraud are not widespread, the potential impact of fraud on individual customers is significant'.

ASIC states that five banks (Bendigo and Adelaide Bank, CBA, Macquarie, NAB and Westpac) will make improvements to current processes including:

- ensuring account application forms adequately explain to customers that they will be giving the adviser authority to operate on their account, and sending follow up communications to customers after the account is opened with details of the authority that has been given;
- improved monitoring of the advisers' use of these accounts and their transaction requests, and investigating any suspicious requests; and
- considering the circumstances of any fraud that occurs using these accounts and, where appropriate, remediating a customer who has lost funds due to unauthorised transactions by their adviser.

ASIC notes that Bank of Queensland also provides accounts of this kind but was not included in the review because it had been the subject of a separate earlier investigation.

Context

- ASIC notes that the review found that adviser-operated deposit accounts 'are most popular with older Australians. Of the 497,000 individuals identified through ASIC's report, 73% were aged 50 years or older'.

- ASIC notes that the review was prompted by concerns raised through an investigation of the conduct of persons involved in the Sherwin group which at the time of its collapse in 2013 owed nearly $60m to approximately 400 clients.

[Sources: 18-235MR Banks to improve fraud protection systems following ASIC review; Report 584: Improved protections for deposit accounts with third-party access]

In Brief | Division of regulatory responsibilities in relation to superannuation entities: In a joint statement, ASIC and APRA have outlined their respective responsibilities with respect to the oversight of RSE Licensees. 'APRA is primarily responsible for ensuring RSE licensees prudently manage their business operations in a manner consistent with their member best interest obligations and the delivery of quality member outcomes; and ASIC is primarily responsible for ensuring RSE licensees meet their conduct obligations in their dealings with consumers, including disclosure and advice to members and ensuring members have access to complaints processes'.

[Source: Regulation of superannuation entities by APRA and ASIC 03/08/2018]

In Brief | ASIC's submission in response to the PC Inquiry draft report into superannuation states that ASIC and APRA 'seek to co-operate and co-ordinate their activities as effectively as possible' but argues that both regulators could do with stronger powers. The submission adds that 'ASIC agrees that there is a significant role for strategic conduct regulation in superannuation, in particular that goes beyond disclosure and addresses misconduct relevant to outcomes' and notes that 'ASIC is currently implementing an enhanced approach to its regulation of superannuation' but that a 'greater conduct regulation role would desirably require law reform'.

[Sources: Superannuation: Assessing Efficiency and Competitiveness — Productivity Commission draft report: Submission by the Australian Securities and Investments Commission 07/08/2018; [registration required] The Australian 09/08/2018]

In Brief | As part of the government's national financial literacy strategy, ASIC has announced the release of five 'Women Talk Money' videos featuring discussion with five well known women on a broad range of money related topics including day to day money management and planning for the future (including superannuation) to 'make women more aware of their finances and encourage them to make better decisions'.

[Sources: Minister for Revenue and Financial Services Kelly O'Dwyer media release 09/08/2018; 18-234MR Why women need to talk about money]

Overseas Developments

The IoD has released its response to the Kingman Review on the future of the FRC: The UK Institute of Directors has called for the Financial Reporting Council to spin off its corporate governance arm and focus on its primary role of improving company audits.

In response to the review of the future of the Financial Reporting Council (FRC) being conducted by Sir John Kingman (see: Governance News 20/04/2018) the UK Institute of Directors (IoD) has called for FRC to spin off its corporate governance arm and focus on its main role of improving company audits. This is necessary in light of recent corporate failings, which have 'pointed to the need for a substantial review into the aims of statutory audit and how it is managed by the regulator' the IoD writes.

The IoD proposes:

- The creation of a separate, independent Corporate Governance Commission to oversee the UK's corporate governance framework to allow 'more transparency and accountability from those responsible'.
- In addition, the IoD has suggested there should be an industry-led professional standards board responsible for upholding high standards of director competence and ongoing professional development.

IoD's Head of Corporate Governance Dr Roger Barker commented: 'Corporate governance has been swallowed up within a regulator that now urgently needs to focus its energies on improving the legitimacy of

statutory audit'. Dr Barker went on to say that though the FRC has been proficient in its handling of Britain's corporate governance code, its 'centralised decision-making structure' is 'not conducive to the differing regulatory approaches needed for governance and stewardship on the one hand, and statutory audit on the other'.

[Sources: CityAM 07/08/2018; IoD Business and Politics Round-Up 07/08/2018]

Corporate Social Responsibility and Sustainability

'Environmental, social, corporate governance and ethics considerations now sit alongside financial as critical components informing the investment decisions of the majority of Australia's professional investors': 55.5% of all assets professionally managed in Australia are now invested as responsible investments according to the latest annual RIAA Benchmark Report 2018.

The Responsible Investment Association Australasia (RIAA) has released its 17th annual report*: The Responsible Investment Benchmark Report 2018* into the size, growth and performance of the Australian responsible investment market over the 12 months to 31 December 2017 and how it compares with the broader Australian financial market.

Key Points

- **Assets under management (AUM) using a responsible investment approach continue to rise and increasingly are delivering strong (above benchmark) results**:
  - As at 31 December 2017, the responsible investment industry constituted $866 billion of assets or 55.5% of all professionally managed assets. This is an increase from $622mn in 2016 (growth of 39% year on year).
  - As in the previous year, core responsible investment Australian share funds outperformed the average large cap Australian share funds over three, five and ten year time horizons.
- **Core Responsible Investments using negative or positive screening, sustainability themed investments, impact investing and community finance have reached a record level** of $186.7 billion representing 12% of all professionally managed assets, more than tripling between 2015 and 2017 as negative screens continue to be integrated across both ethical and mainstream investment options. The report comments that for the second year in a row, there has been a significant increase in the use and number of negative screens applied. The most common screens are weapons, tobacco and gambling, with a significant growth in screens over climate, human rights and adult content in the year.
- **Understanding that the consideration of ESG factors will positively impact portfolio performance was identified by asset managers as the top driver of responsible investment growth** with 44% of asset managers identifying it as such. Demand from institutional investors was identified as the next most important driver of growth (42% of asset managers identifying it as such) following by demand from retail investors (30%).
- **The largest factor deterring additional growth was identified with concerns around the lack of understanding and advice** (48% of respondents) following by lack of awareness by members of the public (39%) followed by performance concerns (33%).

'We are now at a stage whereby issues such as climate change, human rights, corporate culture, diversity and a whole range of other important sustainability issues are right at the forefront of consideration by Australia's finance community' the report concludes. The report adds that though 'It's hugely positive to see this strong growth and performance of responsible investment. We now need to shift our focus to the depth and quality of our responsible investment strategies as much as the quantity of assets under management to ensure the finance sector is delivering better investment outcomes that align with the values of Australians'.

[Sources: Responsible Investment Association Australia media release 09/08/2018; Australian Responsible Investment Benchmark Report 2018; Factsheet]

In Brief | The WSJ reports that the US SEC has dropped its investigation into the adequacy of Exxon Mobil's climate change disclosures. However, investigations by the attorneys general of New York and Massachusetts are reportedly continuing into how Exxon has accounted for the impact of climate change on its assets. New York investigators have reportedly alleged that Exxon appears to have used internal estimates to account for climate impacts that differed from public statements. Exxon has reportedly denied those charges and said its statements accurately reflect the 'proxy cost' of carbon it uses in internal estimates.

[Source: [registration required] The WSJ 03/08/2018]

Financial Services

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

Top Story | Financial Services Royal Commission Round 5 Hearings: Overview of week 1 hearings on superannuation.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) commenced its fifth round of public hearings on 6 August. The focus of this round of hearings, which will run until 17 August, is on the conduct of Australian Prudential Regulation Authority (APRA) regulated superannuation trustees. More particularly the hearings will focus on how these funds fulfil their duties to members and the extent to which structural or governance arrangements may affect the fulfilment of those duties.

The hearings will also consider related issues such as selling practices in relation to superannuation, the relationship between trustees and financial advisers, the current legal regime and the effectiveness of regulators.

A high level overview of the issues to be explored during the hearings as highlighted by Counsel Assisting Michael Hodge QC in his opening statement to the Commission and of some of the issues arising in relation to the NULIS (NAB/MLC) case study is below.

Different approach in this round of hearings

As previously, specific topics were explored/will be explored by reference to case studies (as published previously on the Commission's website) though Counsel Assisting Michael Hodge QC explained that there would be no consumer witnesses due to the nature of matters under investigation which he said are 'unobserved and unobservable for most Australians'.

In addition, Mr Hodge said that the closing statement at the end of the round of hearings would not 'address in detail the specific findings' that may be open to the Commissioner to make in relation to specific entities. Instead, it will provide the Commissioner with a summary of the types of policy issues in respect of which submissions are sought and possible general findings Mr Hodge said.

He indicated that written submissions addressing possible open findings in relation to each of case studies would be provided to the Commissioner by 24 August 2018, together with a written articulation of the policy issues. The provision of those written submissions, Mr Hodge said will mark the formal close of round 5.

Key concerns raised in submissions

Of the 7961 submissions so far received (in total), Mr Hodge said 1244 (15.6%) were identified by the consumer as relating to superannuation. Key themes included: non-disclosure/failure to provide service in exchange for fees for financial advice, management or administration; the 'provision or supposed provision' of insurance by superannuation funds which have not been sought by the member and concerns about the . 'the complexity of superannuation, particularly in respect of insurance policies that are included as a default in superannuation products'.

Context

Mr Hodge described the 'significance' of the superannuation sector to the community and to the Australian economy noting that as at March 2018, Australians had superannuation savings comprising $2.6 trillion of assets equivalent to 144% of the country's nominal gross domestic product. He then described the three types of superannuation trustees, noting that the Commission would focus on the conduct of APRA regulated funds (registrable superannuation entity licensees (RSE licensees)).

Me Hodge went on to describe the three existing 'safeguards' in place to protect 'Australian's retirement savings' namely:

- **Consumer oversight**: Mr Hodge said that consumer oversight is limited due to various factors including low levels of financial literacy, high levels of disengagement, the 'opaque' nature of available information and the risk of poor financial advice.
- **ASIC/APRA oversight**: Mr Hodge described the current regulatory framework, noting (among other things) the criticisms made of it in the recent Productivity Commission draft report into the superannuation sector. He observed that there is 'not presently a dedicated conduct regulator for superannuation trustees in Australia. APRA is, and views itself as, a prudential regulator that adopts a different approach to other regulators. ASIC considers that its jurisdiction in relation to superannuation trustees is limited [to disclosure and complaints handling]'.
- **'Compliance by the trustees themselves with their duties and legal obligations'.** Mr Hodge commented that 'trustees are surrounded by temptation. To preference the interests of their sponsoring organisations, to act in the interests of other parts of their corporate group, to choose profit over the interests of members, to establish structures that consign to others the responsibility for the fund, and thereby relieve the trustee of visibility of anything that might be troubling. Their duties oblige them to resist all of these temptations'. He went on to say that the Commission's review of documents identified fewer examples 'of conduct of the industry fund trustees that raise questions warranting oral consideration as to whether the conduct is misconduct or conduct falling below community standards or inappropriate use of retirement savings when compared with that of the retail funds that will appear in this round of hearings. In a number of cases, though certainly not all, the conduct of the industry funds which we have identified as warranting consideration during the oral hearings, is very nuanced'.

Two underlying questions for consideration

Mr Hodge identified two underlying questions for investigation.

1. 'What happens when we leave these trustees alone in the dark with our money? Can they be trusted to do the right thing?'
2. 'If they [trustees] can [be trusted to do the right thing], does that mean that the current regulatory system is adequate? If they can't, what must be done to protect Australians' retirement savings and to what extent do the entities that own or control the trustees who are not obliged to act in members' best interests, act in ways that are ultimately detrimental to members, even if they do not technically cause the trustee to breach the trustees' duties'.

Mr Hodge added that the Commission will not be considering conduct that is presently the subject of litigation before the court.

Mr Hodge also noted said that statements from United Super (CBUS) would be tendered, but no witnesses would be called to give oral evidence.

Further detail: specific questions to be explored

1. **The ways in which trustees or their related entities seek to cause members to join or stay with their fund.**
    - **The selling practices of banks in relation to the superannuation products offered by their related party trustee**, including the requirement (as holders of financial services licences) for representatives to act in the customers' best interests when providing advice about superannuation as a complex financial product.

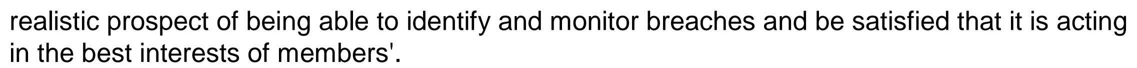
- **Marketing payments:** Payments by industry funds to their sponsoring organisations or affiliates of the trustee 'to assist, or purportedly to assist, with the marketing of their funds'. Mr Hodge clarified that 'By sponsoring organisations, we mean the organisations that own the shares in the trustee or are associated with those owners'.
- **The continued payment of grandfathered Commissions by retail funds**. Mr Hodge noted: 'None of the industry funds that we have reviewed were paying Commission. However, save for Mercer, the major retail funds in respect of which you will hear oral evidence are all, five years after FOFA came into effect, paying very substantial amounts of Commission. You may very well wonder, Commissioner, how the payment of Commission to financial advisers could be in the best interests of members of superannuation funds. You may also wonder how the payment of Commission satisfies the sole purpose test'.
- **The approach of trustees to members who have multiple superannuation accounts**, either within the same fund or in a different fund.

2. **Trustees monitoring of the use and performance of members' funds**.

- **Fee for no service issues:** Mr Hodge said that the Commission would investigate the issue of payment for financial advice or other services being drawn from the assets of the fund. Mr Hodge said that 'The payment for such advice has given rise to a substantial number of fees for no service issues' some of which were addressed in round 2 hearings. He said: 'We return to them here from a different perspective. In round 2 we considered these issues from the perspective of the providers of financial advice. In this round we consider fees for no service from the perspective of the so-called product manufacturer. That is, in this case, the superannuation trustee'.
- **Monitoring of product performance:** Mr Hodge said that the Commission would investigate the ways in which funds monitor the performance of the products that they are offering and how they engage in performance attribution. He added that the Commission would also consider the way in which trustees go about carrying out their statutory obligation to perform an annual MySuper scale test and the possible reasons behind the low return (by certain retail funds) on the 'very low returns on cash'.
- **The transfer of accrued default amounts to a MySuper product.**
- **Spend on marketing and advertising by industry funds**. In particular, Mr Hodge said that the Commission would consider two examples: The New Daily (an online publication that was originally funded by a group of industry funds and was then transferred to Industry Super Holdings) and the 'fox and hen house' ad and 'how it satisfies the sole purpose test. How does it maintain retirement benefits.

3. **The structural and governance arrangements that exist for trustees.**

- **Provision of advice to members**: Mr Hodge said that the Commission would consider 'The structural arrangements for the monitoring of advice provided by financial advisers but paid for out of the assets of the super fund and, therefore, subject to the sole purpose test and the trustees' best interests duties. One example of an issue in relation to the monitoring of advice given by financial advisers is advice to members to make an investment choice'.
- **Payments from third party managed investment schemes**: Circumstances where 'the entity within a retail group' receives 'payments from third party managed investment schemes where those payments are calculated by reference to the investments of the super fund' would also be considered by the Commission.
- **Dual regulated entities:** Mr Hodge said that the Commission would consider 'the use of a particular structural arrangement by retail funds whereby the trustee is a dual regulated entity, or DRE. This is, as we understand it, a structure of some concern to APRA. It was the structure of Trio Capital'.
- **'Outsourcing' of breach identification and monitoring:** Mr Hodge said that 'The outsourcing of functions to other parts of the retail group in a way that prevents the trustee from having any



realistic prospect of being able to identify and monitor breaches and be satisfied that it is acting in the best interests of members'.

- **The appointment of directors to the boards of corporate trustees of industry funds.** Mr Hodge said that the Commission will consider both:
  - 'the exercise by a sponsoring organisation of its constitutional rights to replace directors in a manner that may raise a question as to whether the change of directors was in the best interests of members or detrimental to sound corporate governance'; and
  - 'whether a sponsoring organisation wishing to retain an unfettered right to appoint directors might be a barrier to a merger'.

NULIS Nominees (NAB/MLC) case study

Counsel Assisting Mr Hodge QC questions to Paul Carter and Nicole Smith (NULIS (MLC/NAB) representatives, focused on the following issues (among others).

- **How certain fees and/or Commissions were set and charged**.
- **Grandfathering of Commissions**: The basis for the trustee's decision to continue the 'grandfathering' of Commissions from five NAB super funds following the merger of the funds into a single fund, MLC Super Fund in 2016 and more particularly the benefits for members in maintaining commissions. Mr Hodge alleged that 'the approach of the trustee to retaining grandfathered commissions…was not in the best interests of the members and was a failure to prioritise the interests of the members over the interests of members of the NAB group' to which Ms Smith responded in the negative.
- **Transitioning members to MySuper products:** The approach of the trustee to managing and monitoring the transition of members to the MySuper product was also the subject of questioning. The Commission alleged that the process 'was inadequate and did not involve sufficient systems for the trustee to be satisfied that the best interests of the members were being prioritised over the interests of the NAB Group' which Ms Smith rejected.
- **Communication regarding members' ability to switch off fees on request**: The clarity of communication with customers regarding the ability to switch certain fees off entirely upon request was the subject of questioning by the Commission. The Commission alleged that references in the Product Disclosure Statement to 'negotiating' a lower fee was not sufficiently clear because no negotiation was required. NAB agreed that that communication could have been clearer on this point.
- **(Alleged) fee for no service conduct:** The approach taken to investigating whether certain fees could continue to be charged for advice when the customers' accounts were not linked to an adviser was a focus of number of questions from Mr Hodge. It was alleged that 'What you [NAB] did was to systematically look for any way to avoid having to refund all of the money to customers?' (an allegation which NAB rejected). The Commission also alleged that 'the approach of NULIS and the other trustees within the NAB Group of standing by while NAB Wealth and the executive management team sought persistently, over several years, in its interactions with ASIC and with the trustee, to seek to retain fees where it had not properly reviewed or concluded that there was services provided in exchange for those fees was a failure to act in the best interests of the members and a failure to prioritise the interests of the members over the interests of the NAB Group.' This allegation was rejected by Ms Smith.
- **(Alleged) delay in turning off fees/determining approach to remediating customers:** The time taken to determine whether certain fees could continue to be charged and whether/to what extent customers should be remediated was also a focus of questions, the Commission alleging that the time taken was excessive and the approach to remediating customers flawed. Mr Hodge also queried whether there were 'conflicts' involved in the trustee advising on remediating customers given the refund would reduce profits of the administrator (which was part of the NAB group). Though there were conflicts, Ms Smith disagreed that they 'hopeless' as alleged.

- **The adequacy of breach identification and monitoring systems** and more particularly, whether the trustee had sufficient oversight over these processes was also a focus of questions.
- **The approach taken to dealing with the regulators** (ASIC and APRA) including informing ASIC and engaging with ASIC's ongoing investigation into potential breaches, and the timing of informing ASIC of 'significant' breaches. The Commission heard that of 297 significant breaches reported to ASIC in the 2014-2017 period 84 were received by ASIC (according to NAB documents) outside of the 10 business days allowed to report (the Commission heard that ASIC put the number of reports received after the 10 day reporting period at 110).

  With respect to the ongoing ASIC investigation, Ms Smith was asked about the approach taken to engaging with the regulator and whether a civil proceeding had ever been contemplated. The Commissioner also asked whether there had been 'any contemplation of a criminal proceeding… Did you think yourself that taking money to which there was no entitlement raised a question of the criminal law?' the Commissioner asked. Ms Smith responded to this in the negative.

  The AFR has since reported that NAB CEO Andrew Thorburn has commented: 'ASIC has made some claims against us that they suspect we have had some breaches and those are unresolved. They are suspected and not proven…We do not believe they are criminal breaches and we certainly do not believe they are criminal acts.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 6 August 2018 – Draft Transcript for Day 40; 7 August 2018 – Draft Transcript for Day 41; 8 August 2018 – Draft Transcript for Day 42; 9 August 2018 – Draft Transcript for Day 43;[registration required] The AFR 09/08/2018]

In Brief | Financial sector criminality must be met with criminal charges? In light of recent revelations at the Financial Services Royal Commission, Centre Alliance Senator Rex Patrick has demanded that ASIC commence criminal proceedings where criminality is suspected. 'Charging dead people fees and "taking money to which there was no entitlement" is not a ledger error — it is theft and should be treated as such,' said Senator Patrick. 'There can be no discretion exercised here. The alleged action of banking officials and executives cannot simply be dealt with by a civil penalty levied at a bank who may well treat a fine as a 'cost of doing business'. Mr Patrick also called on the government to take 'legislative action' to immediately end the payment of 'grandfathered conflicted remuneration'.

[Source: Senator Rex Patrick media release 09/08/2018]

Other Developments

Fee for no service remediation may rise to $850m according to ASIC's latest update.

ASIC has reported that AMP, ANZ, CBA, NAB and Westpac have now paid or offered customers $222.3m in refunds and interest for failing to provide advice to customers while charging them ongoing advice fees ($6.4m of this since ASIC's last update in December 2017).

In addition, ASIC said it is overseeing fees-for-no-service (FFNS) remediation programs by other AFS licensees that have identified potential FFNS failings, including Bendigo Financial Planning Ltd, Police Financial Services Ltd (trading as BankVic), State Super Financial Services Australia Limited (trading as StatePlus), and Yellow Brick Road Wealth Management Pty Ltd.

The total amount now paid or offered to customers across both groups of licensees is $259.6m. ASIC said it is also aware that 5 AFS licensees or institutions have provisioned for future remediation payments, with 4 of these to date providing to ASIC amounts for future remediation. If all of these provisions are paid in full, fees for no service remediation may exceed $850m ASIC writes.

Guidance on remediating FFNS breaches: ASIC has also issued a new information sheet: *Information Sheet 232 Fees for no service: Remediation* setting out ASIC's expectations of AFS licensees remediating FFNS breaches. ASIC writes that the new information sheet should be read in conjunction with *Regulatory Guide 256 Client review and remediation conducted by advice licensees* (RG 256).

[Sources: 18-229MR Update on financial advice institutions' fees for no service refund programs; Information sheet 232: Fees for no service: remediation; [registration required] The Australian 08/08/2018]

In Brief | The existing broker model is working? Australian Finance Group's submission in response to the Productivity Commission's final report into competition in the financial system cautions that scrapping broker commissions would be counterproductive. AFG CEO David Bailey argued that any move to ban trailing commissions for mortgage brokers would have the impact of consolidating the lending base of the banks, cutting competition and driving up prices.

[Sources: Australian Finance Group media release 06/08/2018; [registration required] The Age 07/08/2018]

In Brief | Facebook wants large US banks to share detailed financial information? Facebook has reportedly asked large US banks (JPMorgan Chase, Wells Fargo, Citigroup and US Bancorp) to discuss potential offerings it could host for bank customers on Facebook Messenger. Alphabet's Google and Amazon.com have also reportedly asked banks to share data if they join with them in order to provide basic banking services on applications such as Google Assistant and Alexa.

[Source: [registration required] The Australian 08/08/2018]

Restructuring and Insolvency

In Brief | Former directors face questioning over Carillion's collapse: The Guardian reports that nearly seven months after Carillion entered liquidation, The Insolvency Service has finished transferring 278 contracts to new suppliers and officials are now expected to devote more time to an investigation into why the company failed, including a closer examination of the role played by former directors. The inquiry will run alongside two parallel investigations by the FCA and FRC into Carillion's failure.

[Source: The Guardian 07/08/2018]