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Contents

Boards and Directors

Are we too focused on independence at the expense of skills? Chair of Canadian think tank, the Institute for Governance of Private and Public Organizations, Yvan Allaire argues that independence of itself is no guarantee of director/board credibility, or of maintaining effective governance standards.

Writing on Columbia Blue Sky blog, Institute for Governance of Private and Public Organizations Chair Yvan Allaire has questioned whether the focus on ensuring the presence of independent directors on boards is/has been misplaced/over-emphasised, in that it does not necessarily ensure that boards have the requisite skills/knowledge to be 'credible' ie to provide meaningful oversight of management decisions or strategy. Citing the collapse of Lehmann brothers and, more broadly the governance failures that led to the global financial crisis as examples, he suggests that 'A board made up of independent members with impressive biographies is not ipso facto credible' and that 'This helps explain why corporate governance falls short at too many organizations'.

In his view, 'A board of directors is only credible to the extent that a significant number of its members are able to interact knowledgeably with management on the multiple factors that influence performance' which necessarily calls for 'deep and systemic understanding of the company's business model' at board level. On this basis, a focus on skills should be a primary consideration.

Given this, he advocates a change in the approach to selecting board members. Rather than the 'conventional' approach to selecting board members — which he describes as commencing with 'drawing up a list of the different types of professional expertise that would serve the company well' — he advocates that the process should start instead with identifying industries with characteristics in common with the industry in which the target company operates. These should include: 'capital intensity, time horizon of investments, industrial vs consumer markets, international scope of competition, key success factors, and generic strategies'.

Executives with experience of this kind, in his view, will 'more quickly master the essential aspects of the company while also qualifying as independent, thus reconciling independence with credibility'.

He adds that 'If new board members lack credibility, then the board must determine whether they have committed to investing the time necessary to develop it and have the necessary education and intellect and whether the board itself has created programs to enhance the credibility of new members'.

[Sources: Columbia Law School Blue Sky Blog 08/08/2018; [registration required] Allaire, Yvan, Board Members are Independent But are They Legitimate and Credible? (June 7, 2018) Institute for Governance of Private and Public Organizations, Policy Paper No. 10, 2018, ISBN: 978-2-924055-46-5 SSRN]

In Brief | Why boards should take an 'activist' approach to setting strategy: Though there are a range of views as to how hands-on boards should be in setting and monitoring business strategy, Boston Consulting Group argues that given the rapid changes in the current business environment, there is scope for an 'enhanced role' for directors in 'partnering' with management to guide the company's direction. By ensuring there is sufficient focus on the achievement of long-term objectives, actively challenging assumptions, offering counterarguments and offering the benefit of 'cross-domain insights' as well as by closely monitoring execution, boards can bring value to the process (and offer some protection against actual activist threats before they eventuate) they argue.

[Source: [registration required] The Boston Consulting Group: The Board's Role in strategy in a changing environment]

Diversity

The smaller the company the fewer women on boards? A new AICD report on the state of gender diversity in ASX 201-500 companies has found (gender) diversity declines in line with the size of the company.

The Australian Institute of Company Directors (AICD) has released a new report: *Beyond 200: A Study of Gender Diversity in ASX 201-500 companies* which has found that female representation on boards greatly declines outside of the ASX 200, with female board representation at 15.8% across ASX 201-500 companies as compared with 27.9% on ASX 200 boards.

Key Findings

- **The smaller the company the fewer women on boards:** The report found that female board representation declines outside the ASX 200.
  - 17.1% of the directors in the ASX 201-300 are women declining to 14.1% in the ASX 401-500. On average 15.8% of directors in the ASX 201-500 are women (as compared with 27.9% across the ASX 200).
  - 16% of ASX 201-500 companies have achieved 30% female board representation or surpassed this figure, as compared with 42% of ASX 200 boards.
  - 38% of ASX 201-500 boards have zero women as compared with 2.5% of ASX 200 boards.
- **Traditionally 'male-dominated' sectors have the fewest women directors:** The report found that the discrepancy between small and large cap boards is greatest in the traditionally male-dominated sectors of construction, electricity, gas, water and waste services, and mining with women making up 10.3% of boards in ASX 201-500 companies (as compared with 24.1% in the ASX 200).
- **Why are there fewer women on small-cap boards?** The report identifies a number of challenges to improving female representation in smaller companies/reasons why levels of representation may be lower. These include (among others):
  - **Lack of scrutiny:** The report suggests that smaller companies have 'not experienced the same scrutiny' as larger boards. 'It is possible that this, along with the lack of a specific target for improvement, has contributed to the discrepancy in gender diversity between small and large cap boards' the report comments.
  - **Differences between ASX 200 and smaller companies — smaller boards, less frequent turnover, fewer resources:** AICD Chair Elizabeth Proust comments that 'it's important to acknowledge there are differences between the ASX 200 and the lower reaches of the ASX 500. Boards beyond the ASX 200 tend to be smaller, with a lower rate of turnover. And cost is more likely to be a limiting factor, both in terms of remunerating independent directors and employing professional search firms to provide a balanced list of candidates for a board position'.
  - **Existing appointment practices 'effectively shut them out'?** Debbie Goodin MAICD (director of Macquarie Atlas Roads, APA Group, Senex Energy and oOh! Media) is quoted as suggesting that 'Smaller companies tend to have fewer board appointments, limited budgets and, in some cases, a fairly myopic view that they must have someone with board and CEO experience in their particular sector…who is a director of and has experience across both large and small cap boards. There are many mining and industrial companies below the ASX 200 that have relatively few women in their workforce, certainly at a senior level, so, while you may say you're opening the search to women, your parameters could effectively shut them out.'
- **Signs of improvement?**
  - **Exerting their influence:** According to the report, female board representation rises to 22.9% on ASX 201-500 boards chaired by an ASX200 Chair.

- **Newer companies are more likely to have greater gender diversity**: Of the 83 companies that listed on the ASX in the past five years, 25.3% have 30% or more women on their boards. This falls to 13% on the boards of companies that listed before 2013.

- **Pressure from institutional investors may exert pressure on smaller boards to change?** The report suggests that increasingly institutional investors are exerting pressure for boards, including small cap boards, to take action on board diversity in line with market expectations and that this may result in change.

Opportunity for progress, but 'we need to take a more nuanced approach' according to AICD Chair Elizabeth Proust

Commenting on the findings overall, AICD Chair Elizabeth Proust writes that the report 'represents an important step forward by shining a light on some of the issues that have previously gone unremarked' and that it has 'confirmed our [AICD] expectations' with regard to the relatively few women on ASX 201-500 boards. She adds that given the differences between the ASX 200 and smaller companies 'I believe we need to take more nuanced approach to achieving greater gender diversity in the ASX 201-500 — but that doesn't mean progress can't be made'. Ms Proust goes on to say that the AICD 'need to consider what can be done to increase female representation on these boards from the current levels' and suggests that the findings represent an opportunity for the AICD, the 30% Club and other interested groups 'to explore gender diversity on the boards of small cap companies' for example, by ensuring the AICD mentoring program 'gives appropriate consideration to both small and large cap boards'.

The AICD 'look forward to generational change as millennials, who have grown up with diversity, take over as the dominant group in the workplace' Ms Proust writes.

AICD to consider imposing a 30% target for female board representation on ASX201-500? The AFR reports that AICD Chair Elizabeth Proust has said that the AICD will consider whether to impose a 30% target for women directors on the boards of ASX 201-500 companies in the coming months. Reportedly the AICD will also consider lifting the diversity target for ASX 200 boards to either 50% women or set a target for ASX 200 boards to be made up of 40% men, 40% women and the remaining 20% to be either (40:40:20).

[Sources: AICD media release 16/08/2018; Beyond 200: A study of gender diversity in ASX 201-500 companies 2018; [registration required] The Australian 16/08/2018; [registration required] The AFR 16/08/2018]

United States | By August 31 2018, California could become the first US state to mandate board gender quotas and as things stand, meeting the new requirements will require significant change writes Equilar, but in the absence of legislation or 'proactive encouragement' change could otherwise take decades.

Commenting on Californian Bill SB 826 which, if passed in the Assembly and signed by Governor Jerry Brown, will mandate gender quotas for companies headquartered in the state with fines attaching for non-compliance, Equilar writes that based on current numbers of women on boards, the state has a long way to go to meet the new requirements.

- Female board representation on Californian boards is slightly below other US states and the national average: Californian boards have an average of 1.65 female members per board, as compared with the national average of 1.75 female members.

- Were proposed legislated board gender quotas (at least two female board members for companies with five total directors or to three female board members for companies with at least six total directors by 2021) applied today, Equilar writes, 79% of public companies would not meet the criteria.

Equilar comments that though the passage of the legislation is 'still a bit rocky' there is evidence of a growing trend towards diversifying boardrooms across the US. For example, Equilar notes that Maine, Ilinois and Ohio have 'already begun promoting resolutions to encourage companies to diversify their boards' and the fact that BlackRock and other institutional investors have publicly stated that they expect at least two female members per board. Equilar goes on to note that the trend is 'well warranted' given the evidence (eg studies by management consulting firms, such as Boston Consulting Group and McKinsey & Co) which have shown that 'diverse boards perform better financially'.

Consequently, Equilar advises that companies should 'anticipate new legislation — not just SB 826 — sprouting throughout more state legislatures and get ahead of this rolling tide' and adds that in the absence of 'proactive encouragement or legislation, it would take decades before a true gender balance is realized'.

[Source: Equilar blog 14/08/2018]

No correlation between board (gender) diversity and gender diversity in the C-suite? ISS writes that despite an overall increase in board (gender) diversity globally, there are very few women in C-suite roles in US companies suggesting that 'deeper cultural shifts' within organisations are required to achieve broader gender parity objectives.

Writing on Harvard Law School Forum on Corporate Governance and Financial Regulation, Institutional Shareholder Services (ISS) writes that despite a focus on, and the achievement of, overall improvements in gender diversity at board level globally, gender diversity in the C-suite 'remains disappointingly low across all markets' suggesting that there is no correlation between board gender diversity and improved gender diversity in the C-suite. According to ISS, this is the case even in markets that have implemented board gender quotas. This has implications for progress towards gender parity in leadership roles going forward. It also indicates, ISS writes, that 'deeper cultural shifts' are required to drive change.

Key Points

- **No correlation between board gender quotas and increased (gender) diversity in the C-suite?** According to ISS, though some markets — eg France, Sweden and Germany — have implemented board gender quotas, the number of women in executive positions is 'embarrassingly low', and in some cases lower than in 'several emerging markets' eg South Africa, Singapore and Thailand that do not have such policies in place. ISS suggests that this is indicative of the need for organisations to make 'deeper cultural shifts' in order to 'overcome potential biases and hurdles to gender equality'.
- **There is increasing focus on increasing the numbers of female executives, but numbers remain low:** ISS writes that over the past decade, gender quotas, policy initiatives, and investor pressure have led to boards improving female board participation in Europe and North America significantly with the percentage of female directors in the Russell 3000 increasing from 10% in 2008 to 18% in 2018. In addition, there has recently been increased focus by policymakers, investors, and advocacy groups for greater gender diversity in all leadership roles, including executive positions which has led to some improvement. For example, since 2012, there has been a 70% increase in the number of female Russell 3000 CEOs, though only 5% of Russell 3000 companies have a female CEO in 2018.
- **Companies need to develop the pipeline of female executive leaders:** According to ISS, only 9% of top executive positions in the Russell 3000 are filled by women, 'which means that companies have a long way to go towards building gender equity within the top ranks where the next generation of CEOs are cultivated'. Within the C-Suite, gender differentiation persists in terms of executive roles, ISS writes with women tending to be more highly concentrated in positions that 'rarely' see promotion to the CEO role eg Human Resources Officer, General Officer, General Counsel or Chief Administrative Officer and less concentrated in roles with profit and loss responsibilities that 'often serve as stepping stones' to the CEO role such as COO, Head of Sales, or CEOs of business units and subsidiary groups.
- **Breaking down barriers to gender diversity in the C-Suite?** The report identifies five of the emerging best practices that companies could adopt to address gender diversity in leadership roles. These are:
    1. **addressing subtle or unconscious bias** in processes and procedures around hiring, assignments and business decisions;
    2. **establishing clear diversity targets and measure progress towards goals** to enable firms to focus on concrete performance results, while also creating a framework of accountability in the company's gender diversity and inclusion program;

3. **focussing on determining the criteria for leadership roles and redefining the path to leadership** to recognise that there may be multiple paths to the CEO position (though this is likely to include early assumption of profit-and-loss responsibilities) any path to top positions;
4. **establishing mentoring and sponsorship programs;** and
5. **providing flexibility and support towards a work/life balance**.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 13/08/2018]

In Brief | The UK Financial Reporting Council (FRC) has announced a launch event for a research project into the latest trends in FTSE 350 companies' diversity and inclusion reporting. The event will include discussion of how FTSE 350 companies are currently reporting on diversity and inclusion in their annual reports, in particular against the principles in the UK Corporate Governance Code. 'With companies that have 250+ employees now required to publish their gender pay gap data, and other areas of diversity increasingly in the spotlight, this area of reporting is very topical and something the FRC champions, for example, as a signatory to the Government's Women in Finance Charter' the FRC writes. The event will be held on 17 September.

[Source: FRC media release 17/09/2018]

Remuneration

In Brief | $23m over 14 years not a competitive enough compensation package? Equilar writes that Netflix is likely to pay the successor to outgoing CFO David Wells more, as according to Equilar's analysis, Mr Wells' pay for 2017 ($5.2 million), was both below the median and the average pay for CFOs in comparable companies. 'Attracting new talent at the executive level requires competitive pay packages, particularly on the same playing field as peer groups. It would come as no surprise if Netflix offers a pay package above the peer median to its next CFO, regardless of whoever that may be' Equilar writes.

[Source: Equilar blog 14/08/2018]

In Brief | The Australian gender pay gap is at a 20 year lows according to the WGEA: Equal Pay Day will fall on 31 August this year, marking the 62 additional days from the end of the previous financial year that Australian women need to work to earn the same pay as men. In making the announcement, WGEA Director Libby Lyons commented that the fact that the national gender pay gap has reached its lowest level in 20 years at 14.6%, is a 'great result' and testimony to the 'work employers have done in addressing issues such as pay equity' but cautions against complacency stating that 'there is still much work to do'.

[Source: WGEA media release 16/08/2018]

Meetings and Proxy Advisers

In Brief | US Bill HR 4015 which would give companies the right to review proxy advisors' work before it goes to clients is unwarranted argues CII. The Council of Institutional Investors has issued a statement refuting WSJ claims that proxy advisory firms dictate voting outcomes and arguing strongly against the need for legislative intervention. CII writes that 'herd voting is a myth', investor independence is clear in voting statistics, proxy advisors generally recommend voting with management, and that the Bill is unwarranted and may 'encourage proxy advisory firms to skew their reports and recommendations toward companies rather than clients'.

[Sources: CII media release 13/08/2018; [registration required] The WSJ 10/08/2018]

Regulators

Australian Prudential Regulation Authority (APRA)

In Brief | Treasurer Scott Morrison has announced that he intends to nominate former Deputy Secretary, Markets Group at the Treasury Mr John Lonsdale as APRA's second Deputy Chair for a five year term. The appointment is conditional on the governor general's approval.

[Source: Treasurer Scott Morrison media release 16/08/2018]

In Brief | APRA is seeking industry feedback on two proposed approaches intended to aid ADIs in representing and communicating their capital strength (though the proposals would not change the amount or the allocation of capital): 'The reliance of the Australian banking system on international markets for funding makes it important that investors understand and have confidence in the banks' capital strength during ordinary times and in periods of market disruption' APRA Chair Mr Byers said.

[Sources: APRA media release 14/08/2018; Discussion Paper: Improving the transparency comparability and flexibility of the ADI capital framework August 2018; The Australian 15/08/2018]

In Brief | APRA has released its quarterly PHI update for June 2018.

[Source: APRA media release 16/08/2018]

Overseas Developments

Hong Kong | The Hong Kong Securities and Futures Commission has released its latest quarterly report summarising key developments from April to June 2018.

The Securities and Futures Commission (SFC) released its Quarterly Report summarising key developments from April to June 2018. These include the following (among others).

- **Enforcement:**
  - **Disciplinary actions:** Five licensed corporations and three representatives were disciplined resulting in total fines of $83.5 million. Citigroup Global Markets Asia Limited was reprimanded and fined $57 million for failings in its sponsor work on the listing application of Real Gold Mining Limited.
  - **Market surveillance:** 2,152 requests for trading and account records were from intermediaries were triggered by untoward price and turnover movements.
- **The number of licensees and registrants reached 'record highs':** The number of licensees and registrants reached 45,099, up 4.4% year on year, and the number of licensed corporations increased 8.9% to 2,775.
- **Listing applications were up 69.9% on the previous quarter**, the SFC having reviewed 124 new listing applications during the period.
- **Emerging and innovative companies:** Following SFC approval the Hong Kong Stock Exchange published conclusions to its consultation on proposed new rules to expand the listing regime to facilitate the listing of companies from emerging and innovative sectors which took effect on 30 April.
- **Markets:** The increase in daily quotas for both the northbound and southbound trading links under Mainland-Hong Kong Stock Connect came into effect on 1 May.

[Sources: Securities and Futures Commission media release 14/08/2018; Quarterly Report: Regulation for Quality Markets April — June 2018]

Corporate Social Responsibility and Sustainability

United States | Legislating a social licence to operate? Democratic Senator Elizabeth Warren has flagged plans to introduce a Bill requiring large companies to look beyond maximising shareholder value, and instead to take into account the interests of employees and other stakeholders in company decisions.

Writing in The WSJ, US Democratic Senator Elizabeth Warren has announced plans to introduce a Bill — *The Accountable Capitalism Act* — that proposes to:

- **Requirement to take into account the interests of wider stakeholders:** Require US Corporations with more than $1bn in annual revenue to 'get a federal corporate charter'. The new charter would require corporate directors to consider the interests of 'all major corporate stakeholders — not only shareholders — in company decisions'.
- **'Give workers a stronger voice in corporate decision-making'** at large companies by enabling them to elect 'at least 40% of directors' and requiring at least 75% director and shareholder approval of any political expenditures.
- **Address 'self-serving financial incentives in corporate management'** the Bill would prevent directors or officers from selling company shares within five years of receiving them, or within three years of a company stock buyback.

Ms Warren argues that the Bill is necessary, because the shift towards viewing maximising shareholder returns as the primary purpose of corporations has not delivered benefits to, or been in the interests of, the majority of Americans and that as such, 'we should insist on a new deal'.

CNBC reports that Harvard University economics professor Jeffrey Miron has said that the Bill 'would help destroy capitalism' because 'will create a whole set of new rules that the federal government will enforce. Those rules will not be clean, explicit or simple. They'll be messy, they'll be complicated. [It will create a] huge ability for companies to evade and avoid'.

[Sources: [registration required] The WSJ 14/08/2018; CNBC 15/08/2018]

In Brief | RIAA Benchmark Report 2018 New Zealand released: Following on from the recent release of RIAA's Australian RI Benchmark Report, the NZ report has identified similar growth and trends in NZ. According to the report, the majority of professionally managed investments are now invested as responsible investments, with total assets under management having more than doubled in just two years driven primarily by client demand. 'In that short amount of time, we have seen nearly the entire investment industry move to put in place a responsible investment approach, from 2.5% of the industry two years ago' said Simon O'Connor, CEO of Responsible Investment Association Australasia (RIAA).

[Note: The Australian benchmark report referred to above, found that 55.5% of all assets professionally managed in Australia are now invested as responsible investments. See: Governance News 13/08/2018]

[Sources: RIAA media release 16/085/2018; RI Benchmark Report 2018 New Zealand; Factsheet New Zealand]

Financial Services

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

Top Story | Financial Services Royal Commission Round 5 Superannuation Hearings week 2: Overview of week 2 case studies.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) fifth round of public hearings into the conduct of Australian Prudential Regulation Authority (APRA) regulated superannuation trustees (RSE Licensees) commenced on

6 August and ran until 17 August (though, open findings in relation to each of the case studies will not be provided to the Commissioner until 24 August).

A high level overview of some of the case studies relating to the duties of RSE Licensees and the case study concerning superannuation funds and Indigenous members (Q Super case study) is below.

[Note: The ANZ/OnePath, AMP/NM Super and regulator case studies, and the closing statement to this round of hearings, will be covered in the next issue of Governance News which will be available on 27 August.]

Duties of RSE Licensees case studies

The Commission heard a number of case studies concerning the duties of RSE Licensees carrying on from the NAB case study discussed previously in Governance News (see: Governance News 13/08/2018).

Issues to be explored over the course of the hearings, including in relation to the case studies below, as highlighted by Counsel Assisting Michael Hodge QC in his opening statement to the Commission were outlined previously in Governance News here: 13/08/2018.

Use of member funds for the purposes of 'political communication'? AustralianSuper case study

This case study was largely concerned with the use of member funds to pay for online news site The New Daily and with a contribution made by the fund to an industry advertising campaign 'fox and henhouse'. In both cases, the Commission heard, member funds were used – though neither 'investment' returned a financial benefit to members.

- **Use of member funds to pay for the New Daily**: The Commission heard that the acquisition of an interest in The New Daily (a free news site) wasn't perceived by AustralianSuper as being an investment intended to generate an investment return for the members, but rather was viewed by the fund as a marketing tool or 'a tool to enhance the fund's engagement with members' ie both to retain and engage existing members as well as attract new members. As such, Mr Silk said that it is paid for out of the $1.50 per week member fee (which covers all non-investment costs, including marketing costs). The use of members' funds in this way was justified, Mr Silk said because it was 'a worthwhile service to provide to members on the basis that it may yield…engagement dividends' (eg maintaining 'economies of scale' by retaining as well as by gaining members). Asked whether AustralianSuper 'has a view as to whether it can use the fees that it collects to push a policy position in relation to superannuation?' Mr Silk said: 'Absolutely. We believe we can use fees – member fees to advocate for policies that we believe are to the benefit of the fund's members'. The Commissioner asked: 'At the time of the original acquisition, was it any part of the purpose of New Daily that it would act as a voice for or a voice about superannuation and, in particular, industry superannuation?' Mr Silk agreed that this was the case.
- **$500,000 contribution to the industry campaign the 'fox and henhouse':** A number of questions were asked concerning the use of member funds to contribute to an industry advertising campaign called the 'fox and henhouse' which Commissioner Hayne characterised as a form of 'political communication'. Mr Silk said that the purpose of the advertisement was 'to prevent the lobbying effort that was being undertaken by retail wealth management companies, in particular the big banks, to change the default system from a framework that we [industry funds] say provided significant protection for workers to one that exposed workers to significant risks of mis-selling, cross-selling and conflicts of interest that would have done them significant damage'. In addition, the Commission heard that a change of this kind would not be in members' best interests as it would lead to loss of existing members and loss of the flow of new members, possibly to funds with higher fees/lower returns. As such, Australian Super determined that it was in the best interests of members to contribute to the advertising campaign to avert the change. The Commission also heard that APRA had raised concerns both respect to AustralianSuper's use of member funds to contribute towards the advertising campaign, and with respect to the acquisition of The New Daily, to which Mr Silk had provided the same explanation.

Use of member funds for 'political communication'? Commissioner Hayne invited the parties to consider for the purposes of making later submissions, the question of whether 'political communication' could be in the best interests of members. He said: 'the question, I think, is or may be that payment for a form of political communication directed to the perceived interests of – to what are perceived to be the interests of present or future members – here you arrive at a fork in the road – either is not, in the particular case, or can never be – I think is the proposition that's being considered. Again, another fork in the road. Either is not or cannot ever be in the best interests of members. That's one formulation that might be being alluded to, or perhaps the other formulation is not, in this particular case, or cannot ever be, for sole purposes of maintaining retirement benefits for members'.

Questions were also asked about the composition of the AustralianSuper board, and more particularly about AustralianSuper's view on whether the number of independent directors should be increased.

- **Board composition:** Asked whether the AustralianSuper board had a view on whether the number of independent directors should be increased, Mr Ian Silk said that the board 'is open to that'. He went on to say that, changing the structure of the board in this way is not the board's preferred position. Rather the board's 'starting position' is that the skills, qualifications and experience of directors is the 'overriding' consideration in terms of ensuring optimal board structure. Asked whether the board or shareholders ultimately have power over board appointments, Mr Silk confirmed that the 'board has the clear final say'.

Use of member funds to retain/grow fund membership: Hostplus case study

This case study largely focused on the approach Hostplus takes to attracting and retaining members and the role of the Trustee in respect to 'inactives, smalls, and multiples'. Many Hostplus members, the Commission heard, are young and in casual work, and many have low balance accounts (160,000 accounts have a balance below $6000), hold multiple accounts or have inactive accounts (30% of the fund's members hold inactive accounts). The Commission also heard that the tax deductions resulting from insurance premiums paid by these young members, are an important source of funds for Hostplus. Further, attracting and retaining members is important to the fund for scale reasons, and since 2013 (when choice of fund and MySuper were introduced) retaining and growing membership had been a key focus for the fund.

- **Clarity of communication**: Counsel Assisting Ms Dias noted that the fund communicates with members to 'stop them having their balance rolled over into the ATO where they are a lost member' and questioned the clarity of communication around this, alleging that communications could 'be misunderstood by the reader as suggesting…that they're going to lose their super, it's going to be taken by the ATO' and separately, that communications didn't 'tell the member the information they need to make an appropriate decision'. Mr Elia said that communication could have been clearer, but denied that it was misleading. He added that 'it is a – it is a balancing act for the trustee in order to balance out the overall benefits that a member continues to have by virtue of retaining their membership with Hostplus, and at the same time protecting the member's account balances by virtue of erosion of fees and taxes'.
- **Fees on low balance accounts**: Counsel Assisting went on to question whether consideration had been given by the Hostplus board to statutory requirements to 'offer insurance of a particular kind where it won't inappropriately erode member balances' stating that a review commissioned by the fund, conducted by Rice Warner had found that young members were over-insured. She also alleged that 'Hostplus is reliant on these cohorts with the low balances who are young and not likely to need the cover. They are essentially propping up the fund with their insurance premiums' (which Mr Elia denied is the case).
- **Duty of the trustee with respect to inactive, small or multiple accounts: a matter of balance?** Commissioner Hayne asked Mr Elia: 'Are you able to describe what you see as being the trustee's role, if you like, the trustee's duty, in respect of any or all of those groups, inactives, smalls, and multiples?' Mr Elia responded that 'the trustee…has a duty to act in the best interest of…all the members of the fund. We're a fund of 1.1 million members. So the challenge and the balancing act is to try and strike the right balance between looking at an individual's personal circumstances, and then setting up the structure of the fund, both in terms of its fees and charges, insofar as it relates to insurance, to strike…that right balance. And I think that's the tension at the moment between the trustee's obligation and the legislation as it relates to lost and inactive accounts'. Mr Elia went on to say 'we must remember, someone has to pay. And, ultimately, you have this notion of cross-

subsidisation that will occur from – from bigger account balance holders or higher account balance holders. So I don't have a – the right answer for you, but these are some of the tensions that not only Hostplus but certainly other industry players continually grapple with in terms of the design of the fund'.

- **Sole-purpose test and use of funds for marketing/promotional activity**: Counsel Assisting queried how corporate packages eg payment of $260,000 by the fund, to host employers and other stakeholders each year by taking them to the Australian Open, is 'the best use of trust money'. 'Why do you think employers need to be entertained in this way, to choose or to retain their choice of Hostplus as the default status fund?' she asked. Mr Elia said that it was necessary in order to build relationships (in order to retain default fund status) and to build brand awareness. He also said that it was consistent with industry practice, noting that a number of competitor funds do the same thing: 'It is a competitive market out there…We're not the only organisation that embarks on corporate hospitality, but it's a very, very important part of our retention program, and we do it for the sole purpose of retaining the membership of Hostplus. And we have been very, very successful in retaining those…relationships by and large, and we see that through the growth of the fund' he said. He added that were marketing banned, 'that's perfectly fine by me.' Commissioner Hayne said: 'I think I understand the points you're making, but the premise for them is that performance is not enough to sell; is that right?' to which Mr Elia agreed.

  Noting that APRA had 'expressed concern' about the fund's expenditure, and referencing for example, spending on internal events for staff, Ms Dias queried whether this spending was justified. Mr Elia said that spending on events for internal staff (the partners) is justified in the interests of retaining the loyalty of key staff who deliver strong returns to members, and added that the recommendations of a review of spending had been implemented.

- **Merger not possible?** Counsel assisting also questioned whether the fund had 'given proper consideration to alternative means to secure that end, for instance, merger' to which Mr Elia answered that Hostplus had been in 'numerous merger discussions' over the past 20 years with a small fund in the sector but that 'they fail for various reasons'.

The equal representation model/reasons for failed merger: Energy Superannuation Fund (ESF) case study

This case study was concerned with (among other issues): the operation of the 'equal representation model' of governance (where employers and unions each nominate directors) and with the reasons for the failed merger between ESF and EquipSuper.

- **Equal representation model and board skills:** In the context of outlining the process by which board members are appointed, the Commission heard that, the Trustee ultimately maintains control over the appointment process, and in assessing the suitability of a nominee. Mr Wilson of Energy Super said the Trustee would require that the nominee provide particular skills (as per the skills matrix) and meet particular fit and proper person requirements. This process would also involve, he explained, engagement with the sponsoring organisation, to outline what skills were required, and then engagement with the nominee to ensure that they had the necessary 'passion for the members for the fund' (which he said may not be reflected in a skills matrix) and industry knowledge. The Commissioner asked Mr Wilson 'how hard, in your experience, is it to administer that [the appointment process]? And related to that may be how effective do you think it is what you get out at the other end, as it were, of the process?' Mr Wilson replied that 'it's very effective' and further agreed that it 'yields good governance, adequate governance, proper governance of the fund' with 'no holes' in terms of board skills.

- **Reasons for the failure of the proposed ESF/Equip Super merger:** The Commission heard that though the ESF board were of the view that the proposed merger with Equip Super was in the best interests of members, the merger ultimately did not go forward because Equip Super ultimately did not agree to continuing union board representation and 'compliance with the [ESF] board skills policy'. Asked whether there may be 'circumstances where something is in the best interests of members but not be in the best interests of unions' Mr Wilson said that 'It just so happens when we talk about superannuation funds that the interests of unions and the interests of members of the funds are so aligned as to be indistinguishable. It's what we do'. He added that if union representation at board level could not be guaranteed going forward, then it could have negative consequences for members 'what's going to happen to our members in Far North Queensland, what's going to happen to our members in Cairns and Townsville. Who is going to service them?' he said.

(Alleged) conflicted payments/reasons for failed merger: Catholic Super case study

This case study was largely concerned with two issues: exploring the reasons behind the failed merger of Catholic Super and the Australian Catholic Superannuation Retirement Fund and separately, with (alleged) conflicted payments and the effectiveness of conflict management systems at board level.

- **Why the merger did not go forward:** The Commission heard that despite mutually agreeing to the benefits (for members) of a merger in principle, the two funds were unable to reach agreement to go forward because they could not agree on which fund should merge into which. The Commissioner asked: 'What does it matter a hill of beans which fund merges into which?' Mr Haysey responded: 'We felt, to protect our members' interests and given our structural arrangements as I described earlier, that it wouldn't be in our members' best interests for their retirement savings to be put at risk, given that the – the policies and procedures that were in place to achieve those outstanding returns might, in fact, not be able to be guaranteed going forward' [ie if Catholic Super were not the successor fund].
- **(Alleged) conflicted payments/oversight of conflicts:** The Commission heard that Catholic Super is currently investigating executive Robert Clancy (who has been put on leave by the fund) regarding his delay in disclosing conflicts of interest, namely that his brother and wife held interests in businesses engaged by Catholic Super to undertake various contract work. The Commission heard that Catholic Super paid $1.5m in contracts and $500,000 in sponsorship money to businesses of which Mr Clancy's brother was a director, and his wife a shareholder. The Commission heard, that once disclosed, the 'control' put in place to manage this was that the relationship with the businesses would be managed by Catholic Super CEO or COO (not Robert Clancy). It had since emerged, the Commission heard, that the relationship may not been managed in this way and consequently that it is now under investigation by the fund. The Commission also heard that Mr Clancy was being investigated over his credit card use (unauthorised expenses of $46,000 over a three year period). In addition, questions were asked regarding the practice that allowed senior executive staff to incorporate personal travel and accommodation (and other minor expenditure) provided it was reimbursed, a practice which the Commission heard has since ceased.

Fee arrangements/transition to MySuper: Colonial First State (CFS) and Suncorp case studies

Colonial First State case study: This case study focussed (among other issues) on the approach taken by Colonial First State (CFS) to transferring members to MySuper accounts; the continued payment of 'grandfathered' commissions; and the fee model around CBA financial advisers recommending CFS. In addition, questions were asked about the approach adopted by CFS to engaging with the regulators and around the approach taken, given the 'many hats' worn by the entity, to assessing what is in the best interests of members. A high level summary of some of the issues raised in relation to the issue of transferring MySuper accounts follows.

- **Transfer to My Super Accounts:** Questions centred around the requirement that, as at 1 January 2014, default contributions were required to be paid into an authorised MySuper product. The Commission heard that Colonial First state did not transfer a number of accounts by the deadline and subsequently reported the breach to the Australian Prudential Regulation Authority (APRA). Over the next three and a half years, the Commission heard, CFS transferred the initial 'tranche' (15,000 accounts) and further 'tranches' of accounts as they were identified, and provided updates to the regulator on progress. Counsel Assisting questioned the time taken in transferring the accounts and the clarity of communication with members about it, alleging it was motivated by a desire to maintain commissions (an allegation which was rejected by Ms Elkins). Asked why the process of transferring accounts had not been accelerated as APRA had requested initially, it was explained that the board was 'reluctant' to do so 'because of the operational risk in the business at the time' in transferring large numbers of accounts, rather than smaller 'tranches' due to the other technology projects occurring in the business at the time. Counsel Assisting alleged that CFS had determined that 'rather than implementing a computer project now to transfer the members over, it would just accept that there would be more offences'.

Suncorp case study: This case study was largely concerned with fee arrangements: the monitoring of fee arrangements, the clarity of communication with members concerning fees and the approach taken by Suncorp to transitioning members to MySuper accounts.

- **Use of 'tax surplus':** The Commission heard that the trustee of the Suncorp Master Trust, Suncorp Portfolio Services, collects 15% of superannuation contributions which it remits to the tax office. However, as the trustee is also entitled to claim certain tax deductions, the trustee is left with a 'tax surplus'. The Commission heard that these funds are not paid back to members, but rather are paid to another Suncorp entity in exchange for a broad range of 'additional services' including administrative and other services. Counsel Assisting Michael Hodge QC questioned the adequacy of the fee monitoring systems in place alleging that as there is no clear allocation of funds against specific services, and as the 'additional services' provided may duplicate services provided by other entities, it isn't clear to the trustee (or to members), whether members may have been charged twice for the same service.
- **Transitioning to MySuper accounts:** Questions were also asked about the approach adopted by Suncorp to transitioning clients to MySuper accounts, Counsel Assisting alleging that Suncorp delayed transitioning clients to maintain commissions, and encouraged advisers to 'take steps [contact their clients to make an investment decision] that will maintain grandfathered commission[s]'. Though agreeing that clients were transitioned over the 9-19 June period (ie close to the deadline for transitioning clients), Suncorp disagreed with the allegations.

Dual regulated entity (DRE) structure – acting in the best interests of members: IOOF case study

Among the issues explored in this case study were (alleged) conflicts of interest arising from the structure of IOOF group, and more particularly the DRE structures within the group, the commission exploring with the IOOF witnesses a number of examples of instances in which it was alleged that profit interests had (allegedly) outweighed the best interests of members. The approach taken to managing and rectifying the over-distribution of funds from Questor to members, the reporting of the issue to APRA and the communication to members regarding the issue, was explored in some detail.

- **Use of the 'general fund' to compensate members:** The Commission heard that an asset had mistakenly been recorded as income, and that Questor had distributed it to the then unit holders in 2009. In 2011, the issue was identified, whereupon it was determined that Questor would reduce the distributions to be made to members over the next three years to recover the funds (including the distributions to members who had joined the fund after the error had been made and who therefore received no benefit from the over-distribution). The Commission heard that no consideration was given to the option that Questor replenish the funds itself. Questions were asked as to how the decision to take this approach had been made, Counsel Assisting Michael Hodge QC alleging that Questor acted without prior approval by the board. IOOF CEO Mr Kelaher was also asked whether there 'was any issue with Questor as RSE licensee sitting by and allowing itself, as a responsible entity…to reduce the distributions for three years' which Mr Kelaher denied was the case. Counsel Assisting Mr Hodge went on to allege that 'before the whistleblower notification [concerning the reduced distribution] it had been intended to wait until the end of the three-year period before doing the further assessment of the impact on members and proposed compensation', which Mr Kelaher also denied was the case.

  Ultimately, the commission heard that members were paid (in part) out of the 'general reserve' of the superannuation fund (which Mr Kelaher maintained is 'not an asset of the members'). 'You've used the members' money, which is the reserve, to pay the members?' Mr Hodge asked. 'No, we've used the general reserve to compensate members' Mr Kelaher responded. When asked subsequently whether members would expect that the money be paid by Questor (not taken out of general fund), Mr Kelaher said it would be one interpretation.

- **Communication with members:** Questions were asked concerning the level of oversight and reporting of the issue, and also about the clarity of communication to members. The Commission heard that members were informed that 'we identified an historical distribution error that resulted in income being credited to your CMA at a lower rate than it should have been'. Counsel Assisting alleged that this was misleading given that it was decision, not an error. Mr Kelaher agreed that 'on subsequent inspection' the communication could have been more precise, adding 'I'm not sure what turns on it' on the basis that ultimately members were in his view, compensated.
- **APRA's expectation that trustees act in the best interest of members:** The Commission also heard that APRA had raised concerns about the approach taken to managing and rectifying the issue, stating that its expectation was that Questor, 'immediately replenish the super funds general reserves utilising funds from Questor as responsible entity'. Asked to comment on IOOF's response to APRA Mr Kelaher maintained that in his view, in circumstances such as this, Questor was obliged to balance the interests of members of the fund against the interests of members of managed investment schemes of which it is responsible entity. Mr Hodge said that this was not the case, noting that APRA had had challenged this view, and more particularly had said that there was no need to 'engage in this balancing exercise' ie that the interests of members must be paramount. Asked whether he accepted that this was the case, Mr Kelaher said that he 'accepted APRA's position is final'.
- **Dissolving the DRE structure?** The Commission heard that APRA had raised concerns more generally with respect to the structure and governance at IOOF and had 'insisted' that the dual class structure should be dissolved. Mr Kelaher said that the board had considered APRA's request at a recent board meeting and had resolved to appoint an independent chair to the trustee board, and to add an independent director. Commenting on concerns raised by APRA, Mr Kelaher said that the board does not 'share the view of APRA that there are legitimate concerns about these structures' adding that 'it's [the structure] a matter of indifference. These structures had – had evolved over time and were sort of de rigueur 10 years ago. Maybe they weren't appropriate any further. And – so I guess in the current environment, it was seen as that that was the preferred structure. We [the board] really don't have any – any particular barrow to push in that'.

Superannuation funds and Indigenous members

Context/issues to be explored: This case study concerned the treatment of Indigenous people and superannuation. In introducing the case study, Counsel Assisting Rowena Orr QC noted that it follows on from evidence that was given in the previous round of hearings (see: Governance News 09/07/2018; 16/07/2018) concerning dealings between Indigenous people living in regional and remote communities and financial service providers.

Ms Orr then went on to outline some of the major barriers some Indigenous people face in engaging with, and accessing, their retirement savings including (among others): geographical location (isolation), identification issues (lack of flexibility in current identification systems), language barriers (as English is often not a first language); limited financial literacy (in some cases); and issues arising from lack of recognition of kinship obligations. Ms Orr said that despite 'increasing recognition' of some of these issues — including the establishment of the Indigenous Superannuation Working Group, the release by AUSTRAC of updated guidance in relation to the customer identification of people of Aboriginal and Torres Strait Islander background, and the Big Super Day Out event — the Commission had heard evidence (during the last round of hearings) that these barriers continue to prevent a number of Indigenous people from accessing their superannuation entitlements to an extent, because knowledge/recognition of policies agreed by industry are not necessarily well understood or implemented at every level.

Proactive program of engagement/possible ways to improve access and engagement: Q Super case study

Q Super representative Lyn Melcer described to the Commission her visits to remote communities with Australian Securities and Investments Commission (ASIC) Indigenous Outreach Officer Nathan Boyle stating that the visits enabled her to better understand some of the issues (eg barriers to proving identity (among other issues)) at play.

Ms Melcer said: 'I thought we treated – as in our industry, treated all our members equally because we had exactly the same rules for everyone. What Lockhart River showed me was that although that might be right, not everybody starts in the same place'. Ms Melcer when on to give details of a number of examples of the issues she had witnessed on her visits to remote communities, and the improvements to processes used by funds that had been implemented as a result eg implementation of more flexible AUSTRAC guidance on confirmation of identity and simplifying communication to help ensure it is better understood by members (among other measures). Asked whether the 'proactive program' described was an 'impost' on QSuper, Ms Melcer said that it was not and went on to say that she regarded it as an obligation to take the 'additional' steps to assist members to access/engage with the fund. 'As a superannuation fund it – money has to be paid into a superannuation fund. People have no choice about superannuation, they need to go somewhere. So clearly we're obligated to make sure that people can get the money when they need it. In the situations we're talking about, particularly in remote and far remote communities, they need their money. So of all the people who probably need it, this is the category of member who needs to be able to access it. And it is our systems, as in the industry systems, that we've made it difficult for people. So it is also incumbent upon us to help everybody work through the systems we've created, in my personal view' she said.

Asked about possible ways to improve the experience of vulnerable people in remote communities in relation to superannuation, Mr Melcer suggested:

- **Recognition and respect for kinship structures:** Amending the current legislative requirement which only permits a person to nominate their legal personal representative or a dependant to receive death benefits to better reflect kinship structures for example by 'looking at some extension of that definition of dependency to include a cultural – a child who's adopted under cultural law' she said.
- **Early release of superannuation on the basis of severe financial hardship:** Ms Melcer said that Q Super allows the early release of superannuation in cases of severe financial hardship but that this is not universal across the sector.
- **No lowering of the preservation age?** Asked whether lowering the preservation age (in recognition of the fact that many Indigenous people do not live long enough to enjoy the benefit of their retirement savings) should be considered, Ms Mercer said that in her view it should not, 'the argument behind lowering it is because people of Aboriginal and Torres Strait Islander heritage have a lower life expectancy. I don't want to give up on that battle of closing that by saying let's reduce the preservation age and let them get their money earlier but I do acknowledge that's the truth and that that's what happens…So I think that there are other ways that we can do that, we can get – people need to get their money to live as well'. Ms Melcer went on to suggest that one of the options to be considered might be 'guidance around how we handle total and permanent disability payments and maybe one of the criteria that the trustees and doctors can look at is the life expectancy of the person that they're dealing with, the distance from where they are to getting health – to see doctors, just to get treatment, all of those things must alter a person's life expectancy. So if we can be more broad about that, that would be helpful'.
- **No need for financial services entities to ask for clients to identify themselves as Indigenous in order to improve services:** Referencing the evidence given by Mr Boyle and Ms Edwards in Round 4 hearings, regarding the value of financial services entities asking their customers and members to identify themselves as Indigenous, Ms Orr asked Ms Melcer's views. Ms Melcer replied that she disagreed there was a need to collect the information on the basis that to do so is unnecessary provide access to the service for individual members – 'I'm not a believer in collecting personal data unless we have a reason to use the personal data' she said. Ms Melcer gave as an example the fact that 'a bank only needs to look at where the money is coming from to know a person is on income support payments. If they do a bit of extra effort they could put that money into a fee-free account' without having to obtain data identifying the client/member as indigenous.
- **Meeting with members and taking a proactive approach:** Asked what steps superannuation funds should be taking to assist vulnerable Indigenous people living in remote and regional communities and other vulnerable members, Ms Melcer said that visiting communities to better understand the issues in play would be 'step number 1'. Asked whether the superannuation industry does enough to ensure that funds are acting in the best interests of their Indigenous

members in remote communities and other vulnerable members, Ms Mercer said that 'the funds can do more, but I think it's because they just don't know' and reiterated the value in meeting with members.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 9 August 2018 – Draft Transcript for Day 43; 10 August 2018 – Draft Transcript for Day 44; 13 August 2018 – Draft Transcript for Day 45; 14 August 2018 – Draft Transcript for Day 46; 15 August 2018 – Draft Transcript for Day 47; 16 August 2018 – Draft Transcript for Day 48]

The latest Governance Institute Ethics Index has found that Australians are losing faith in corporate ethics, particularly in the banking, finance and insurance sectors, in wake of recent scandals and issues emerging from the Financial Services Royal Commission hearings.

The third annual Governance Institute of Australia (GIA) Ethics Index, which measures attitudes and perceptions of ethics across a variety of organisations and sectors, was released on 15 August. Overall, The Australian Ethics Index has fallen six points since 2017 which is attributed to 'the poor perception of ethics in the banking sector'.

Key Points

- **The Australian Ethics Index overall has fallen six points since 2017** from 41 to 35. The largest falls were in the corporate sector (which fell 6 points) and the finance sector (banking finance and insurance sector) (which fell 12 points) and the GIA attributes the overall fall 'the poor perception of ethics in the banking sector'.
- **The banking, finance and insurance sector was perceived as the least ethical sector.** According to GIA CEO Steven Burrell's statement, the Banking, Finance and Insurance sector was the lowest category in the Index with a score of -15 (negative 15) for the third year running. 'It has never before scored this badly — 55% of respondents consider the sector unethical and only 28% view it as ethical' Mr Burrell said. Mr Burrell went on to say that Australians also perceive life insurance companies (-26) and retail banks (-17) as unethical, 'arguably influenced by Commissioner Hayne's hearings'. Commenting on the results overall Mr Burrell said that they suggest that 'numerous high profile scandals, and the alarming corporate breaches being revealed on a daily basis by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, are undermining confidence in the sector'. Mr Burrell added that 'If corporations like the banks and other financial institutions continue to be exposed for pursuing profit to the detriment of their customers, we can expect confidence in them to drop even further'.
- **Key concern is executive pay:** The key concern in the banking, finance and insurance sector was executive salaries. Poor corporate culture and governance were also identified as concerns.
- **The education sector (80) was perceived to be the most ethical of all sectors** with every organisation or occupation performing at an index level of somewhat ethical or very ethical. The health sector was perceived as the next most ethical with a score of 70.
- **Media sector:** Facebook (-33) and Twitter (-22) were perceived as the least ethical media platforms, and the ABC was rated the most ethical media platform (46). Commenting on this, Mr Burrell said that 'Facebook's perceived net ethics score is perhaps unsurprising, given the Cambridge Analytica scandal, while Twitter's result shows it continues not to be seen as a reliable source of news'.
- **Most trusted/least trusted professions and organisations?** According to Mr Burrell's statement the most trusted professions were ambulance officers (88), fire fighters (85), and nurses (84) and most ethical organisations were primary schools (71), medical charities (68), and pathology services (68). The least trusted professions were identified by Mr Burrell as Federal politicians (-38), state politicians (-34), or real estate agents (-24) and the least ethical organisations were pay day lenders (-54), life insurance companies (-26), and Federal and state parliaments (-23). Commenting on this, Mr Burrell said: 'The message here is clear — those who are seen to be working selflessly for others are generally more trusted'.

About the research: The research was conducted by an independent firm, with approximately 1000 respondents, drawn from across Australia, over the period 25 May and 7 June 2018.

[Source: Governance Institute media release 15/08/2018]

In Brief | Calls for the timeline and terms of reference to be extended? The senate has agreed to Senator Fraser Anning's non-binding senate motion for the terms of reference for the Financial Services Royal Commission to be extended to include the actions of receivers, liquidators and valuers; and for the timeframe for completion to be extended to allow more time for farmers to be heard. Reportedly, the senator has said he will withhold his support for government legislation if his demands are not met.

[Sources: [registration required] The AFR 14/08/2018; Motions: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 14/08/2018; Australian Banking Association newsletter 16/08/2018]

Where are the CEOs? The Australian has questioned why CEOs (in the main) have not appeared as witnesses at the Financial Services Royal Commission, given the cultural and governance issues being revealed, and the inability of some witnesses to respond to questions. 'The CEOs are the ultimate spokespeople for any bank — they are invariably the highest paid, they are 100 per cent responsible for the culture of a bank' The Australian argues.

[Source: [registration required] The Australian 15/08/2018]

Other Developments

Top Story | Empowering consumer choice – ACCC to regulate the Consumer Data Right.

The MinterEllison competition team writes that the Federal Government has released its Exposure Draft of the *Treasury Laws Amendment (Consumer Data Right) Bill 2018*. The proposed Bill reflects the Government's commitment to implementing a 'Consumer Data Right' (CDR) in line with the recommendations of the Productivity Commission's Review into Open Banking.

The introduction of a CDR is likely to have a profound impact upon competition in the banking (and eventually other) sectors. It is intended that consumers will have the right to access their own data and direct it to be transferred to certain third parties. This is intended to improve consumers' ability to compare product offerings and switch providers where desired. In addition to dealing with a significantly increased regulatory burden, more established businesses will need to consider the commercial implications of a regime that allows consumers to compare and change service providers more easily. Others, such as potential new entrants, 'fintechs' and disruptors will be considering how they can take advantage of this regulatory change.

At the heart of this reform will be the ACCC, who will be given a significant new role as the arbiter of how and to whom data can be shared. Submissions on the Exposure Draft are due by 7 September 2018.

The full article written by MinterEllison's Tova Gordon, Paul Schoff and Geoff Carter: Empowering Consumer Choice — ACCC to regulate the Consumer Data Right is available on the MinterEllison website.

[Sources: MinterEllison: Empowering Consumer Choice — ACCC to regulate the Consumer Data Right August 2018; Treasurer Scott Morrison media release 15/08/2018; Treasury media release 15/08/2018; Exposure draft: Treasury Laws Amendment (Consumer Data Right) Bill 2018; Draft Explanatory Materials; Ready Reckoner; Privacy protections summary; A quick guide to making submissions; ITNews 15/08/2018]

The senate committee has recommended that the 'Protecting your Super' Bill — *Treasury Laws Amendment (Protecting Your Superannuation Package) Bill* 2018 — be passed.

The Senate Economics Legislation Committee has released its report into the *Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018* — which is intended to prevent the erosion of superannuation balances — and has recommended that the Bill be passed.

[Note: Among the measures announced in the Federal Budget 2018-2019 was the 'Protecting your super package'. Exposure draft legislation and explanatory material to implement the reforms was also released by the government for consultation and the legislation was introduced on 21 June. See: Governance News 11/05/2018; 25/06/2018]

The Senate Committee commented that the measures in the Bill are an 'important first step' in addressing the proliferation of superannuation accounts and erosion of members' balances through excessive fees and inappropriate insurance arrangements. The report goes on to comment that despite 'recent industry efforts to reduce inappropriate and duplicate insurance in superannuation, including the development of the Insurance in Superannuation Voluntary Code of Practice and movements by some funds toward age-based pricing for coverage,' industry action has been 'slow and does not go far enough to protect members' interests'.

The report also does not recommend any delay in implementation. Despite the fact that the Committee 'heard strong concerns' from industry regarding the proposed commencement date (1 July 2019) for the legislation on the grounds that it would be 'challenging due to a need to renegotiate the terms of contracts with insurers,' the Committee states it 'considers that renegotiating insurance contracts is not an unfamiliar process to superannuation funds, and believes this process should be achievable within the proposed timeframe'.

The Bill has passed the House of Representatives but is still before the Senate.

[Sources: Senate Standing Committee on economics: Treasury Laws Amendment (Protecting your Superannuation Package) Bill 2018 [provisions] Report 13/08/2018]; Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018]

In Brief | RBS to pay a record penalty for (alleged) crisis-era misconduct: The US Department of Justice has announced that it has reached a settlement with the Royal Bank of Scotland group plc (RBS) to resolve federal civil claims that RBS misled investors in the underwriting and issuing of residential mortgage-backed securities between 2005 and 2008. According to The DOJ the penalty is the largest imposed to date for financial crisis-era misconduct at a single entity under the *Financial Institutions Reform, Recovery, and Enforcement Act* of 1989.

[Sources: US Department of Justice media release 14/08/2018]

In Brief | US SEC has announced that Citigroup will pay $10.5 million in penalties to settle two SEC enforcement actions alleging 'it fell short of its obligations to supervise its traders and maintain appropriate controls to guard against fraud'. 'Citigroup's lax supervision and weak internal accounting controls allowed a handful of rogue traders to mismark positions over several years and, separately, resulted in the unnecessary loss of hundreds of millions of dollars of its shareholders' assets to fraud' SEC writes.

[Sources: Securities and Exchange Commission media release 16/08/2018]

Accounting and Audit

Should ASIC 'name and shame' firms that perform poor quality audits? Incoming Deloitte CEO Richard Deutsch argues that it should.

Noting that currently the Australian Securities and Investment Commission's (ASIC's) risk-targeted audit inspections do not identify individual firms (in contrast with the UK Financial Reporting Council's approach), and further that the most recent ASIC report found serious issues audit quality in a number of firms, The AFR reports that the incoming CEO of Deloitte Australia, Richard Deutsch, has suggested that ASIC's approach should change. More particularly, The AFR reports that Mr Deutsch has suggested that ASIC should 'name and shame' firms that fall below an 'acceptable threshold' of audit quality over 'consecutive years'. Failure over a period of time, before being named is important, Mr Deutsch reportedly said, as results could vary markedly year to year.

Separately, Mr Deutsch reportedly said that he plans to:

- **Grow the audit business** (which is reportedly the smallest of the big four presently), 'Our external market share in the ASX200 stock market by market cap... is roughly 15 per cent and from a strategic perspective we do want to grow our market share…But we probably don't want market share more than about 20 to 25 per cent. We think that's about the right place to pitch our audit practice' as it allows the audit practice to grow without getting in the way of the bigger advisory/consultancy practice.

- **Continue to promote 'diverse and inclusive culture' at the company**: 'I think here we embrace…difference. I think that's why we do have quite a special culture around diversity and inclusion. I think that the inclusion part for us is critical' Mr Deutsch said. In addition, he reportedly identified the achievement of gender parity at partner level as a goal: 'I would ultimately like us to be at gender parity. I'm not going to give you a definitive timeline but I'm committed to gender parity so I'll doing everything I can to push that and to accelerate the proportion of female partners in the partnership' he said. The AFR writes that Deloitte currently has the highest level of women partners of the big four with females making up 28.4% (or 224, of its 788 partners).
- **Double digit revenue growth:** Mr Deutsch also reportedly said that he intended to maintain the double digit revenue growth experienced under outgoing CEO Ms Hook (who is reportedly leaving the role to become CEO of the new Deloitte Asia Pacific).

[Source: [registration required] The AFR 14/08/2018]

Risk Management

In Brief | Australia should look to China on innovation: The 2018 edition of the Global Innovation Index (GII) on the theme 'Energizing the World with Innovation' has ranked Australia 20th overall, and 6th in the South East Asia, East Asia and Oceania region behind Singapore (4th overall, 1st in the region); The Republic of Korea (12th overall, 2nd in the region); Japan (13th overall, 3rd in the region); Hong Kong (14th overall, 4th in the region); and China (17th overall, 5th in the region). The report argues that 'China's rapid rise [in the rankings] shows the way for other middle income economies'.

[Sources: Global Innovation Index 2018; [registration required] The AFR 15/08/2018]

In Brief | Could a Code of Conduct prevent a 'speak up' culture? The Australian Medical Association has cautioned that proposed revisions to the Code of Conduct for doctors 'could be interpreted as coercing doctors into complying with relevant laws that are inconsistent with professional accepted standards of medical ethics in Australia' including (among others) raising concerns that proposed revisions could be seen as 'trying to control what doctors say in the public arena by stifling doctors' right to publicly express both personal and professional opinions'. The draft code's public consultation period has been extended until August 17.

[Sources: Australian Medical Association media release 07/08/2018; [registration required] The SMH 15/08/2018]

Restructuring and Insolvency

Top Story | Legislation to combat illegal phoenix activity released for consultation.

In line with measures announced in the 2018 Federal Budget, the government has released a package of proposed insolvency reforms: *Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2018*, *Insolvency Practice Rules (Corporations) Amendment (Restricting Related Creditor Voting Rights) Rules 2018* and accompanying explanatory material, for consultation. Consultation concludes on 27 September.

A high level overview of the proposed reforms is below.

Key Points

The Exposure Draft: *Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2018* implements four measures that were announced in the 2018 Federal Budget, to combat illegal phoenix activity.

- **Creates new phoenix offences (with criminal and civil penalties attaching) to target those who conduct or facilitate illegal phoenixing:** Schedule 1 of the Exposure Draft Bill proposes to amend the *Corporations Act 2001* (Cth) to 'improve the mechanisms available to combat illegal phoenix activity, specifically creditor-defeating dispositions: transfers of company assets that prevent, hinder or significantly delay creditors' access to the company's assets in liquidation'. In particular, the amendments introduce new (civil and criminal) offences for:

- company officers that fail to prevent the company from making creditor-defeating dispositions; and
- other persons that facilitate a company making a creditor-defeating disposition. Commenting on this measure, Minister for Revenue and Financial Services Kelly O'Dwyer said that it would help ensure 'pre-insolvency advisers and other facilitators of illegal phoenix activities will also be on the hook'.
- The offences will be supported by an extension of the existing liquidator asset clawback avenues to cover illegal phoenix transactions.
- The draft explanatory memorandum notes that the offices are subject to a 'number of important safeguards to ensure' to ensure they do not 'affect legitimate businesses and commercial transactions'.

- **Recovery by ASIC**: The draft Bill proposes to give the Australian Securities and Investments Commission (ASIC) specific powers to make orders to recover – for the benefit of a company's creditors – company property disposed of or benefits received under a voidable creditor-defeating disposition. ASIC may use these powers to recover property for a company in liquidation on its own initiative or on the application of a liquidator. The draft explanatory memorandum states that 'This is intended to both overcome difficulties faced by liquidators where the company has insufficient funds to cover the cost of court action, and to allow ASIC to intervene where a liquidator is not fulfilling its obligations to recover company property'.
- **Restrictions on director resignations (to prevent them from avoiding personal liability):** Schedule 2 'ensures directors are held accountable for misconduct by preventing directors from improperly backdating resignations or ceasing to be a director when this would leave the company with no directors'.
- **Makes directors personally liable for GST liabilities:** Schedule 3 allows the 'Commissioner to collect estimates of anticipated GST liabilities and make company directors personally liable for their company's GST liabilities in certain circumstances'.
- **Extends the ATO's existing power to retain refunds where there are outstanding tax lodgements:** Schedule 4 authorises the 'Commissioner to retain tax refunds where a taxpayer has failed to lodge a return or provide other information that may affect the amount the Commissioner refunds. This ensures taxpayers satisfy their tax obligations and pay outstanding amounts of tax before being entitled to a tax refund'.

Restrict the voting rights of related creditors of the phoenix company at meetings regarding the appointment or removal and replacement of a liquidator: Separately, the exposure draft: *Insolvency Practice Rules (Corporations) Amendment (Restricting Related Creditor Voting Rights) Rules 2018* proposes to implement another element of the Budget package, to prevent related creditors facilitating illegal phoenix activity by unduly influencing the removal or replacement of external administrators. This is implemented through amendments to the *Insolvency Practice Rules (Corporations) 2016*.

[Sources: Minister for Revenue and Financial Services Kelly O'Dwyer media release 16/08/2018; Treasury media release 16/08/2018; Exposure Draft: Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2018; Exposure Draft: Insolvency Practice Rules (Corporations) Amendment (Restricting Related Creditor Voting Rights) Rules 2018; Draft Explanatory Memorandum; Draft Explanatory Statement]