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Boards and Directors

In defence of the strengths of our existing corporate governance structure: 'regulators must enforce the laws already available to them. And before legislators rush to legislate, they need to understand the underlying strengths of the corporate governance system we already have' writes AICD Chair Elizabeth Proust.

Writing in The AFR, Australian Institute of Company Directors Chair Elizabeth Proust has questioned the wisdom of 'blurring' the role of non-executive directors and management (and/or further regulatory intervention informed by that view) to address recent governance failures.

- **Blurring of the role of non-executive directors and management:** The role and value of non-executive directors in the Australian corporate governance framework is 'increasingly misunderstood' in that there appears to be an 'emerging view that non-executive directors should be so intimately involved in day-to-day operations that they are able to ensure that nothing ever goes wrong'. This is both unrealistic, given the size and complexity of modern companies she argues, and also indicative of a misunderstanding of the value that non-executive directors bring, as independent from management.
- **Oversight role:** One of the hallmarks of Australia's 'world-respected governance model' Ms Proust argues, is the distinction between the role of the board and that of management. This separation both supports the board's oversight role in holding management to account and protects the interests of shareholders. 'Non-executive directors must be close to, but independent from, management to do their job well' she writes. Ms Proust goes on to caution that 'blurring the line between non-executive director and executive management means boards would no longer be able to challenge management statements and assumptions, because they would have helped form them'.
- **Lack of appreciation of the value of this distinction?** Citing the original draft of legislation to enact the Banking Executive Accountability Regime as an example, Ms Proust argues that there appears to be a move towards 'blurring the boundary between board and management' in the belief that doing so will guard against recurrence of future governance failures. 'This issue was fixed during the consultation phase, but its original inclusion revealed a lack of knowledge from policy makers regarding the governance function of boards. It served as yet another reminder that the devil is always in the detail' she writes.
- **Regulation is not a panacea:** 'While it would be nice to think that we could regulate our way to a world where no employee of any company ever acted unethically, the truth is corporate governance is too complex a matter for all factors and eventualities to be foreseen and proscribed by regulation' she writes.
- **Regulators must enforce the laws readily available to them, before legislators 'rush to legislate':** Before further regulation is imposed, in response to governance failures Ms Proust argues, directors and management need to take accountability for misconduct in their organisations and be transparent about their actions in response, and reflect on learnings from the Financial Services Royal Commission. However, 'regulators must enforce the laws already available to them. And before legislators rush to legislate, they need to understand the underlying strengths of the corporate governance system we already have'.

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

In Brief | AMP has appointed South East Asia head of investment bank Credit Suisse, Francesco De Ferrari, to be its new CEO. Mr Ferrari will commence his new role 1 December. The AFR reports that AMP Chair David Murray has said that Mr Ferrari's 'job, more than anything else is to redesign the business model of AMP'.

[Sources: [registration required] The AFR 22/08/2018; 22/08/2018]

Remuneration

Top Story | CEOs paid less well than their global peers? Melbourne University study suggests ASX 200 CEOs are paid less well than their global peers, but has cautioned this does not 'necessarily' suggest that they are 'underpaid'.

A recent Melbourne University Centre for Corporate Governance and Regulation (MCCGR) study: *CEO Compensation in Australia Global Benchmarking Study*, has found little evidence that ASX 200 CEO compensation is necessarily excessive relative to their global peers. According to the study, most of Australia's largest public companies pay their CEOs less than comparable global firms pay their CEOs. The researchers emphasise that this does not 'necessarily imply that Australian CEOs are "underpaid" or represent "good value"' but may suggest that CEOs elsewhere are 'overpaid' or alternately, that Australian firms are not competing in a global market for CEO talent and that 'local market considerations' can therefore depart from global benchmarks.

Key Points

- **Australian CEOs in almost all industries receive lower compensation than their global peers.**
- **Only 24% of Australian firms are paying their CEOs at or above the levels of their global peers.** Collectively, only 47 of the 200 firms in the sample exhibited CEO remuneration greater than that of benchmark firms.
  - **Healthcare:** 'Without exception, the Australian CEOs appear to receive lower levels of compensation than the apparent global market rate'. Across the sample, remuneration of Australian CEOs is approximately one third that of foreign peers.
  - **Communications, TV and radio:** Of six firms in the sample, only Nine Entertainment Co was found to provide compensation commensurate with the global industry. The five remaining firms all provide markedly lower levels of pay to their CEOs.
  - **Metals and Mining:** There was more variation across the sample in this sector. Larger Australian mining firms (values over $1bn) were found to pay their CEOs relatively less than their global peers, while smaller miners (values below $1bn) tended to provide 'remuneration at a premium compared to global benchmarks'. For example, smaller firms, Saracen Minerals CEO Raleigh Finlayson, was paid $2.7 million against the $596,000 of peers, and Pilbara Minerals and CEO Ken Brinsden, paid $3.3 million against $879,000. At larger firms, BHP CEO Andrew Mackenzie of BHP received $5.9 million compared to $11.7 million for a peer group approximately one-third the size, though the study notes that some larger mining firms pay closer to the global benchmarks. Commenting on why some minters may provide remuneration in excess of global benchmarks, the researchers suggest that it may be because these firms need to attract managerial talent of the highest caliber from a smaller pool of candidates with 'specialised expertise'.
- **No implication that Australian CEOs are '"underpaid" or represent "good value"':** The researchers 'caution that our findings do not necessarily imply that Australian CEOs are "underpaid" or represent "good value" for their firms. Such a conclusion would require evidence on the value provided by these CEOs'. The researchers go on to suggest that one possible explanation is that 'CEOs elsewhere are overpaid' or alternately that 'many Australian firms are not competing in a global market for CEO talent and local market conditions can therefore depart from global benchmarks'.
- **About the study:** The findings are based on an analysis of CEO compensation the 200 largest Australian firms, including almost all of the ASX 200 index. For each firm, a 'peer group' of five global firms (of similar size by market capitalisation and drawn from the same industry) was constructed, and the pay across the group compared. The findings were based on fiscal 2017 data. The writers note that the findings are consistent with a preliminary analysis of CEO compensation in four Australian firms Macquarie Group, Commonwealth Bank (CBA), CSL, and Woolworths Group.

[Sources: University of Melbourne Centre for Corporate Governance and Regulation, Ian D Gow, James P Kavourakis: Cult of excess? A global perspective on CEO compensation 11/04/2018; CEO Compensation in Australia A global Benchmarking study 21/08/2018; [registration required] The AFR 20/08/2018]

Shareholder Activism

In Brief | The ACCR is planning to file shareholder resolutions at Qantas and Virgin, protesting the involvement of both carriers in transporting asylum seekers, subject to meeting the 100 shareholder requirement to do so. The group has taken the step of calling on its mailing list to consider purchasing Qantas shares in order to assist in meeting the 100 shareholder requirement.

[Sources: ACCR media release 20/08/2018; The Guardian 09/08/2018]

Other Shareholder News

In Brief | Fortune has released its annual list of the 100 fastest-growing companies (by revenue, profit, and stock return). On average, the companies on the list delivered a 27% return to shareholders over the past three years, outperforming the S&P 500 index (12%). Nearly a third of the 100 entrants are tech companies, and the top 10 include Facebook, Nvidia, and Amazon.

[Sources: Fortune 100 Fastest Growing Companies 2018]

Disclosure and Reporting

Update on progress towards the planned 'codification' of the Sustainability Accounting Standards Board (SASB) standards: The SASB plans to issue 'the world's first complete set of codified standards' on financially material sustainability topics later this year.

The Sustainability Accounting Standards Board (SASB) released its first provisional reporting standards for companies to communicate with investors on financially material sustainability topics close to five years ago. Since then, the SASB has consulted widely with companies and investors, seeking feedback on the standards in preparation for issuing a 'complete set of codified standards on financial material topics' with an explicitly global, rather than US focus, later this year.

The SASB has issued an update on the consultation process and progress towards issuing the 'codified standards'. SASB highlights the following issues as key market concerns, arising from the consultation process and states that they will inform the 'codified standards'.

1. **The quality of sustainability information is a key concern:** 'Where a company discloses its sustainability data isn't as important as the quality of that data' the SASB writes. Though there is a diversity of reporting methods in use, the market is less concerned with where data is disclosed or what form it takes, than with the quality of the data and with the governance and control environment around disclosure (which the market expects to be similar to that used for traditional financial reporting).

- **Global relevance and focus:** The SASB writes that 'there is hunger globally for our standards' noting that they have been downloaded more than 122,000 times from across 38 countries with more than 50% of this interest coming from outside the USA. In response to this global interest, and in the interests of ensuring that the eventual standards are globally relevant, the SASB states that it is recruiting advisory groups to help actively solicit global market input going forward. In addition, the standards board will continue to actively consider the global applicability of the SASV standards. The language used in the standards, and on the website, will also be updated to reflect 'our global outlook while making it easier for all stakeholders to find the information they need'.

By 'adapting to what the market has taught us, we should be well positioned for growing global interest in adopting SASB's standards' SASB writes. The new codified standards are expected to be released later this year.

[Source: SASB blog 16/08/2018]

Highest profile case of SEC Chair Jay Clayton's tenure? Bloomberg writes that the SEC could face a backlash if Tesla CEO Elon Musk is ultimately exonerated of any wrong doing following his recent Tweet (concerning plans to take the company private).

Bloomberg reports (though SEC has not officially confirmed) that the US Securities and Exchange Commission (SEC) was already investigating Tesla Inc before Tesla CEO Elon Musk sent his recent tweet on taking the company private (see: Governance News 13/08/2018). According to Bloomberg, the existing SEC investigation was focused on whether Tesla had issued misleading pronouncements on manufacturing goals and sales targets concerning the production of the model 3 sedan (the first vehicle the company has attempted to mass produce).

However, the article suggests that due to the level of media interest concerning possible action over Mr Musk's recent tweet, and due to perceptions in some quarters that enforcement has been less stringent under SEC Chair Jay Clayton than previously, the SEC may feel 'compelled' to take action more quickly than it ordinarily would. Duke University School of Law professor James Cox is quoted as stating: 'This is so visible that it'd be hard for the SEC not to do something…There's a lot of pressure on the SEC here.' Consequently, Bloomberg suggests that SEC may opt to deal with the two issues in separate investigations, which would enable it to proceed with the original investigation in the usual way (out of the public spotlight until it concludes whether laws have been broken) while proceeding more quickly on the tweet. Bloomberg goes on to quote an unnamed SEC source as expressing the view that 'The agency will take a beating from politicians and in the media if Musk avoids a sanction'.

[Source: Bloomberg 22/08/2018]

In Brief | High price for non-disclosure? Merrill Lynch has agreed to pay $8.9m to settle SEC allegations it failed to disclose a conflict of interest when making decisions on products managed by an (unnamed) outside firm. According to SEC, the settlement amount included more than $4 million in disgorgement, $806,981 in prejudgment interest, a more than $4 million penalty, to be censured and to cease and desist from further violations. Merrill Lynch did not admit or deny the findings.

[Sources: SEC media release 20/08/2018; [registration required] The FT 21/08/2018;

Short and Long-Termism

Share buy-back debate | MSCI has found no 'compelling evidence' that share buybacks have a negative impact on long-term value creation? Responding to concerns from a number of commentators, MSCI has outlined its latest research findings.

Writing on Harvard Law School Forum on Corporate Governance and Financial Regulation, MSCI writes that contrary to 'concerns expressed by many observers' there is 'no compelling evidence' of negative impact from share buy backs on long-term value creation for investors overall.

[Note: The 'observers' referenced above, include INSEAD and W Lazonick among others. Note also that the US Securities and Exchange (SEC) Commissioner Robert Jackson (expressing his personal, as opposed to the SEC's views), recently called for the revision of SEC buyback rules, based on the findings of research carried out by his staff in June. See: Governance News 18/06/2018)]

According to MSCI research:

- Share buybacks have become the favoured means for distributing cash to investors among large-cap companies, exceeding cash dividends every year since 1997 at 388 of the 610 companies (63.6%) we studied.
- According to MSCI, a majority of the companies bought back shares when prices were high rather than low, 'as buybacks have replaced dividends as the dominant way of returning cash to investors at many companies'.
- Companies where index investors were the largest shareholders included a much wider range of buyback impacts, good and bad, than companies where the largest shareholders were buy-and-hold

investors: total returns for the buy-and-hold investor companies were 18% higher, on average, than for the index investor companies from 2007 to 2016.

- Contrary to concerns expressed by many observers, there is no 'compelling evidence of a negative impact from share buybacks on long-term value creation for investors overall. In each of the areas we examined, beginning with MSCI ESG Ratings but also including CAPEX, R&D, new debt issues, and, most importantly, value creation, the companies that were most actively distributing cash to their investors were also the strongest companies'.

Separately, commentator Steve Denning writing in Forbes, cites various studies supporting the opposite view.

[Sources: Harvard Law School Forum on Corporate Governance and Financial Regulation 19/08/2018; Forbes 08/07/2018]

Regulators

Top Story | Heavy new penalties arrive for the Australian Consumer Law

A Bill which increases the maximum penalties under the Australian Consumer Law (ACL): *Treasury Laws Amendment (2018 Measures No 3) Bill 2018*, passed Parliament on 23 August 2018, with no amendments.

Stronger penalties: Schedule 1 of the Bill strengthens the maximum penalties under the ACL, and aligns them with the maximum penalties for breaches of competition law.

Currently, the maximum civil pecuniary penalty and fine for criminal offences is $1.1m for a corporation and $220,000 for other persons (such as individuals). Under the new law, the maximum penalty for non-corporations will be $500,000. The maximum penalty for a corporation under the new law will be the greater of:

- $10m, or
- if the court can determine the value of the benefit obtained directly or indirectly from the offence, act or omission, by the corporation and any related bodies corporate — three times the value of the benefit, or
- if the court cannot determine the value of the benefit — 10% of the 'annual turnover' of the corporation and related bodies corporate in connection with Australia during the 12 month period before and including the month in which the act or omission occurred or started to occur.

The MinterEllison competition team write that the change is part of the ACCC's push to deter companies from breaching consumer laws, so penalties are 'not simply seen as the cost of doing business.'

Detailed summary of the reforms and their potential impact: MinterEllison's Katrina Alidenes, Paul Schoff and Miranda Noble have prepared a summary of the reforms and potential impact which can be accessed on the MinterEllison website here: Heavy new penalties arrive for the Australian Consumer Law

[Source: Treasury Laws Amendment (2018 Measures No 3) Bill 2018; MinterEllison: Heavy new penalties arrive for the Australian Consumer Law]

Leaking investor education reports could have negative consequences for IPOs ASIC cautions.

Among the issues flagged in ASIC's latest market integrity update, was concern over leaked investor education reports. The regulator expressed concern that references to investor education reports are in some instances, being made public before the prospectus for an initial public offering (IPO) has been lodged with ASIC. This is of concern, as in some cases, articles based on these reports 'appear to promote the IPO in a way that may be misleading' ASIC writes.

ASIC cautions that 'the law significantly restricts the ability to publicise IPO offers to retail investors before a prospectus is lodged with us' and notes that it may take action in these circumstances that 'may be detrimental to the IPO'. 'We encourage investment banks and licensees involved in managing IPOs to have robust processes to ensure their investor education reports do not become public before the prospectus is lodged' ASIC writes.

[Source: ASIC Market Integrity Update — Issue 96 — August 2018]

APRA has released guidance on restricted words under the *Banking Act 1959 (Cth)*

On 20 August, the Australian Prudential Regulation Authority (APRA) released guidance on the use of restricted words and expressions related to banking by financial businesses.

- Sections 66 and 66A of the *Banking Act 1959* (Cth) (Banking Act) place restrictions on financial businesses (a business that includes or related to the provision of financial services whether or not in Australia) using certain words and expressions related to banking. Only persons that have been granted approval by APRA can use the following words or expressions in Australia in relation to their financial business (unless an exception under the Banking Act applies): bank, banker, banking, building society, credit union, credit society, credit cooperative, authorised deposit taking institution, and ADI.
- APRA states that permission for financial businesses that are not authorised deposit-taking institutions (ADIs) to use these restricted words or expressions will only be granted 'in very rare or unusual circumstances'.
- Where a business is not a financial business, but propose to use a company name that includes a restricted word or expression, confirmation from APRA that ss 66 or 66A do not apply is required, before registering the name with the Australian Securities and Investments Commission (ASIC).
- Under the Banking Act, there is no restriction on an ADI using the restricted expressions 'authorised deposit-taking institution' and 'ADI'. An ADI is also permitted to use the restricted words 'bank', 'banker' and 'banking' unless APRA determines otherwise. Applicants for authorisation as an ADI should contact APRA about the circumstances in which it may be permissible to use a restricted word or expression.

[Sources: APRA media release 20/08/2018; Guidelines: Restricted words under the Banking Act 1959 20/08/2018]

In Brief | APRA has released general insurance statistics for June 2018: According APRA total industry net profit after tax in the year ended 30 June 2018 was a profit of $3.8 billion (2017: $3.1 billion) which represented a return on net assets of 13.4% (2017: 10.9%).

[Sources: Quarterly Gender Insurance Performance Statistics – highlights 23/08/2018; Quarterly General Insurance Performance Statistics 23/08/2018; Quarterly General Insurance Institution-level Statistics 23/08/2018]

In Brief | ASIC has issued a reminder to ASIC regulated entities regarding the new industry funding model. ASIC regulated organisations may be required to submit information to ASIC on business operations before 27 September. ASIC Commissioner Cathie Armour said the deadline was approaching and that it was important for all regulated entities to complete the process or they may incur penalties.

[Source: 18-245MR Time to act for all ASIC-regulated organisations required to submit information for industry funding]

In Brief | OAIC Commissioner announced: Attorney General Christian Porter has announced that Angelene Falk has been appointed commissioner of the Office of the Australian Information Commission (OAIC) for a three year term.

[Source: Attorney General for Australia Christian Porter media release 17/08/2018]

Corporate Social Responsibility and Sustainability

United States | Legislating a social licence to operate can only be a first step if it's going to work? Writing in response to Senator Elizabeth Warren's recent proposal to introduce a Bill to look beyond maximising shareholder returns, Harvard Professor Rebecca M Henderson argues the proposal does not go far enough.

Writing in response to Senator Elizabeth Warren's recent announcement of her plans to introduce a Bill — *The Accountable Capitalism Act* — which proposes to require large corporations to focus on more than maximising shareholder returns (see: Governance News 20/08/2018) Professor Rebecca M Henderson has argued that the proposal doesn't go far enough. 'Requiring firms to adopt a new charter with obligations to a broader set of stakeholders would have the great benefit of reminding business leaders…that they have more discretion than they often think they have, but it's not clear that it would change behavior unless there were corresponding changes in how managers and investors think about their roles and the incentives they face' she writes.

Professor Henderson suggests that the Bill could be strengthened in the following ways.

- **Mandatory disclosure against non-financial metrics:** Though she welcomes the proposal to require stock based incentives for senior managers to vest over a relatively long period (as a means of increasing focus on longer term objectives) Professor Henderson suggests there should also be a focus on increasing the information available to investors. 'Why not make it mandatory for firms to report against an appropriate set of nonfinancial metrics? There's increasing evidence that, for many firms, focusing on the long term and on a broader range of stakeholders improves performance. Let's give investors the information they need to take this kind of information into account' she suggests.
- **Make 'racing to the bottom' less profitable:** Noting that there are a number of firms eg Aetna, Zeynep Ton, Costco and Trader Joe's which are already active in attempting to 'balance profit and purpos' in various ways, Professor Henderson suggests that they are currently disadvantaged in doing so by having to compete against firms happier to 'take shortcuts'. Therefore she advocates changing 'the rules so that racing to the bottom is no longer the most effective way to compete, and to ensure that treating people well is the profitable thing to do'. For example, by continuing to push for an increase in the minimum wage and 'grappling with the explosion of contract work, ensuring that employers can't evade their responsibilities by simply relabeling employees as contractors'.
- **Employee engagement:** Though employee board representation is a step in the right direction in giving employees a stronger voice, Professor Henderson argues that to be effective it needs to be 'backed up by a rediscovery of the power of employee engagement'. '"Unions" is a dirty word in many business circles, and I'm not a fan of old-style unionization, but there's overwhelming evidence to suggest that wages rise when employees can organize collectively in productive ways. Let's find a 21st-century way to make that happen' she writes.
- **Investing in infrastructure and education:** 'People stay in dead-end jobs they hate because they fear losing their health care. They underinvest in education because they fear struggling under student debt. Let's build a workforce that is equipped to compete in today's world — and then require firms to treat them as we would like to be treated' she writes.

Requiring firms to adopt a new charter might be an important first step, Professor Henderson concludes, 'but it cannot be the last'.

[Source: Harvard Business Review 21/08/2018]

In Brief | The Australian reports that former ASIC Chair Greg Medcraft (now head of the OECD's Financial and Enterprise Affairs Directorate in Paris), appears to be supportive (in principle) of the inclusion of the concept of the 'social licence' to operate in the forthcoming edition of the *ASX Corporate Governance Principles and Recommendations*. 'The social licence is constantly evolving…Businesses need to monitor community expectations closely and make sure they don't fall too short of them. Some still believe that things like responsible business conduct and good corporate governance do not necessarily align with long-term shareholder value' he is quoted as stating.

[Source: [registration required] The Australian 22/08/2018]

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 wrap up: Possible open findings and general submissions

Context

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) fifth round of public hearings into the superannuation sector commenced on 6 August and ran until 17 August. The hearings considered three topics (and accompanying case studies): the duties of RSE licensees; issues arising in relation to Indigenous members and the effectiveness of superannuation regulators. A high level overview of the open findings and general submissions identified by Counsel Assisting Michel Hodge QC in written submissions to the Commissioner is below.

[Note: The case studies considered over the course of the Round 5 hearings have been reported previously in Governance News 13/08/2018 and 20/08/2018.]

Closing statement: Policy Questions

In his closing statement to the Commission, Counsel Assisting Michael Hodge raised several 'policy questions' on which he invited submissions.

- 'Are there structures that raise inherent problems for a superannuation trustee being able to comply with its fiduciary duties'.
- 'If these structures do raise inherent problems, is structural change of entities, mandated by legislation or otherwise, something that is desirable'.
- 'Apart from structural arrangements, are there other types of relationships that present obvious challenges to a trustee in discharging its duties, or where the benefits to the member of those relationships are limited or non-existent'. If so, 'would it be appropriate to make legislative interventions to eliminate those temptations and difficulties for trustees' eg by prohibiting all commissions payable from superannuation products and end grandfathering, at least in relation to superannuation products, and/or to prohibit ongoing advice fees being deducted by trustees from superannuation accounts'.
- 'Is it necessary to strengthen existing laws prohibiting misconduct so as to address misconduct identified during the course of the hearings or potential misconduct identified during the course of the hearings, or is it simply necessary to enforce existing laws'.
- 'What can be done to encourage the regulators to act promptly on misconduct or potential misconduct and is the present allocation of regulatory roles appropriate to achieve specific and general deterrence from misconduct'.
- 'Are there further structural tweaks necessary to make it more likely that consumer interests will be best served in the superannuation industry' eg attaching consumers to a single superannuation account, imposing 'obligations on the shareholders of trustees to exercise powers under their constitution, or when otherwise acting in relation to the trustee, to do so in the best interests of the members'.

Possible open findings/policy questions highlighted in written submissions

Subsequently, in written submissions to the Commission, Counsel Assisting Michael Hodge QC outlined the findings that may be open to the Commissioner to make (or not to make) with respect to each of the case studies considered over the course of the two weeks of the hearings as well as providing further detail in relation to the policy questions identified in his closing statement.

Further Detail: Policy Questions by topic

Advertising

- Is political advertising consistent with the intention behind section 62 of the SIS Act? Is any amendment to the SIS Act warranted, and if so, why?
- Is there identifiable detriment to consumers from advertising by super funds or particular advertising (such as Fox and Henhouse)? Is there identifiable benefit to consumers from advertising by super funds or particular advertising?

Section 68A of the *Superannuation Industry (Supervision) Act 1993* (SIS Act_

- Is it appropriate, as a response to conduct of superannuation trustees that seeks to induce employers to select funds, or affect their decisions as to default funds, to make alterations to section 68A of the SIS Act to widen the prohibition?
- How wide should the prohibition be – should it extend to prohibiting providing benefits to employers for the purpose or with the intention of inducing the selection of the fund as the default fund for employees, or affecting the decision, or being likely to induce or affect?
- Are there matters of principle that would justify such a change? Are there problems that would arise in the application of the law?

Payments from external responsible entities of managed investment schemes

- Is it appropriate for the trustee of a superannuation funds to retain payments from the responsible entity of a managed investment scheme where that payment is derived from the investment of members' money?

Selling of superannuation (branch selling)

- Is it appropriate that superannuation be sold through bank branches? Is it reasonable to think that there is any prospect that this is likely to produce an outcome that is in the best interests of consumers?
- Are there statutory reforms that are required to address this problem (if it is a problem) or are the existing laws with respect to personal financial advice and general financial advice sufficient? What is the nature of the "advice" that a customer of a bank receives when told by a bank branch staff member about the availability of a superannuation product offered by a bank?

Engagement by superannuation funds with Aboriginal and Torres Strait Islander people

- Are the identification procedures used by superannuation funds appropriate for their Aboriginal and Torres Strait Islander members? If those procedures are appropriate, are those identification procedures sufficiently understood and implemented by staff on the ground? If those procedures are not appropriate, what should be changed?
- Should superannuation funds be required to record whether their members identify as Aboriginal or Torres Strait Islander people?
- Should those superannuation funds who do not currently permit the early release of superannuation on the basis of severe financial hardship do so?
- Should the lower life expectancy of Aboriginal and Torres Strait Islander people be taken into account in the decision-making processes of superannuation funds when considering how to administer or release the funds of Aboriginal and Torres Strait Islander people? If so, how?
- Should the categories of person permitted by legislation to be the subject of a binding nomination be changed to reflect Aboriginal and Torres Strait Islander kinship structures? If so, how should the categories be broadened?

Discretion to appoint and remove directors

- Is it appropriate for shareholders of RSE Licensees to retain a broad discretion to appoint and remove directors? Or should there be an obligation imposed on shareholders to exercise such powers in the best interests of the members?

Culture and Governance Practices

Mr Hodge noted that the Terms of Reference require the Commissioner to inquire into whether any findings made in respect of conduct is attributable to: 'the particular culture and governance practices of a financial services entity; or broader cultural or governance practices in the relevant industry'. Mr Hodge said that there are 'several cultural and governance practices that may offer explanations for misconduct seen across a range of entities'. These include the following.

Deterrence and Insight

- **To what extent are conduct issues attributable to the views of internal leadership within organisations?** Giving examples of the evidence heard by some witnesses (eg NAB) Mr Hodge suggested that 'some conduct of certain retail superannuation trustees suggests that there may be a cultural issue within the entities arising from a lack of insight into why certain conduct is unacceptable. He went on to say that 'The disparity between the levels of insight demonstrated by different entities suggests that this is not a universal industry-wide issue. However, with respect to the identified entities, the evidence suggests that it is a problem that is reflective of the views of leaders within the organisation'.
- **Lack of effective regulatory oversight?** Mr Hodge questioned to what extent the approach of the regulators has 'adequately addressed problematic cultures at different times'. With respect to ASIC, Mr Hodge said that in light of examples (NAB, ANZ and CBA) there are questions as 'to whether it has struggled to date to act as an effective conduct regulator.' In particular, Mr Hodge said that 'a significant problem with not commencing court proceedings is that no pecuniary penalty or other relief is obtained which would achieve specific and general deterrence. Moreover, it might be thought that the practice of ASIC of accepting enforceable undertakings is more likely to encourage conduct that courts contraventions of statute.' With respect to APRA, Mr Hodge said: 'It might be thought APRA's objective of ensuring financial system stability is not readily reconciled with being an effective conduct regulator'.

General Questions

- What can be done to encourage the regulators to act promptly on misconduct or potential misconduct?
- Is the present allocation of regulatory roles appropriate to achieve specific and general deterrence from misconduct?
- Given that what we are fundamentally concerned with is conduct that in subtle but ongoing ways negatively affects the retirement outcomes of consumers, are either of the regulators best placed to carry the responsibility to protect consumers should the balance between them be restructured or significantly altered?

Relationship between trustees and financial advisers

Mr Hodge said that a 'significant category of misconduct identified in relation to a number of the retail entities the subject of case studies is conduct that benefits financial advisers to the detriment of the members of a superannuation fund.' He then outlined a number of examples including (among others): 'maintaining grandfathered commissions in the absence of proper consideration as to whether the trustee is legally entitled to cease paying those commissions' and deducting adviser fees without adequate systems in place to assess whether services had been provided. Mr Hodge went on to question whether these issues indicate that legislative intervention is warranted. More particularly he suggested that the following changes might be considered.

- To prohibit all commissions payable from superannuation products and end grandfathering, at least in relation to superannuation products;
- To prohibit ongoing service fees (including advice fees and plan service fees) being deducted by trustees from superannuation accounts. Submissions were invited on the following questions.

Mr Hodge invited submissions on the following general questions:

- Are legislative interventions to remove grandfathered commissions and ongoing service fees from superannuation accounts appropriate? If so, why? If not, why not?
- Are there possible detrimental effects on the provision of high quality financial advice by such changes? If it is said that there are such detrimental effects, then the detriments and the reasons for the detriments should be precisely identified.

Managing conflicts

Another category of misconduct identified by Mr Hodge was around the issue of the 'financial interests of other members of the retail group' being 'preferred…to the interests of the members of the superannuation trustee'. He identified the following general questions in relation to this.

- Are there structures that raise inherent problems for a superannuation trustee being able to comply with its fiduciary duties (eg where a trustee is a dual regulated entity (DRE))? Are there other structures such as investment of funds in insurance policies issued by related party insurers or the integration of a superannuation trustee into an advice business that also raise inherent problems? Is it possible to say that these conflicts are ever manageable?
- If certain structures do raise inherent problems, is structural change of entities, mandated by legislation or otherwise, something that is desirable?
- Would it be preferable to extend the obligation to act in the best interests of members of a superannuation fund so that: contravention of the obligation attracts a civil penalty; and the obligation (and the civil penalty for breach) extends to shareholders of trustees and any related bodies corporate (within the meaning of the *Corporations Act 2001* (Cth)) of the trustee in respect of any conduct that will affect the interests of the members of the superannuation fund?
- Are there unforeseen consequences of such a legislative intervention that would make it undesirable to strengthen the SIS Act in this way?

System changes

- Is one way of addressing and discouraging misconduct on the part of superannuation trustees to seek to encourage improvements to outcomes for members whose contributions are made to MySuper products or is the link too tenuous to justify recommending any system changes to the default system?
- Is it appropriate, as a response to misconduct of superannuation trustees, to apply an additional filter to MySuper authorisations so as to require outcome assessments? If so, what are the general parameters for such a system change and who is appropriate to apply the test?
- Is it appropriate, as a response to the conduct of superannuation trustees that might inhibit the consolidation of multiple superannuation accounts of a person, to introduce some form of 'stapling' so that a person's account for receipt of default contributions is linked to the person and travels with the person when she or he changes job? Is this is a practical method of addressing this type of conduct noting that it is not suggested to be misconduct?
- Are there other system changes that might be appropriately tailored responses to misconduct or conduct falling below community standards and expectations of superannuation trustees? If so, what are the general parameters for such a system change?

Topic 1 — Duties of RSE Licensees: Possible open findings in relation to each of the case studies

Nulis Nominees (NAB/MLC) case study

The issues explored in this case study largely concerned the setting and charging of fees. For an overview of the facts and issues explored see: Governance News 13/08/2018.

Possible Open Findings

Possible open findings of misconduct, or conduct falling below community standards and expectations included the following.

- **Available findings in relation to the charging of certain fees:** Mr Hodge said that it is open to the Commissioner to find that the charging of certain fees 'where no service was provided by an adviser to the member may have amounted to misconduct'. He also suggested that the charging of certain fees where no service was provided by an adviser to the member may have amounted to conduct that fell below community standards and expectations. Mr Hodge went on to suggest that it is also open to the Commissioner to find that the conduct of NAB and Nulis in respect of remediation and negotiations with the Australian Securities and Investments Commission (ASIC) may also have 'departed from community standards and expectations' (Mr Hodge suggested that NAB acted in a way that was 'not full and frank with the regulator in respect of the quantum of loss to members or the amount of expected remediation').

- **Available findings in relation to grandfathering of trailing commissions:** Mr Hodge said that it is open to the Commissioner to find that by 'resolving to retain grandfathered commissions in respect of members that were to be transferred to the MLC Super Fund as part of the successor fund transfer which occurred in July 2016, Nulis may have contravened the covenants set out in section 52(2)(c) of the SIS Act which required it to exercise its powers and to perform its duties in the best interests of members'. He added that it is also open to the Commissioner to find that NULIS may have contravened 'the covenants set out in section 52(2)(d)(i) and (d)(iii) of the SIS Act by failing to prioritise the interests of members over the interests of advisers who continued to receive trailing commissions at the expense of those members, as well as the financial interests of the NAB Group'.

- **Available findings in relation to MySuper products**: Mr Hodge said the delay the transitioning members to their respective fund's MySuper offering, resulted in members continuing to pay grandfathered commissions, and other fees, including where no adviser was providing any service to the relevant members. As such he said that it is open to the Commissioner to find that MLC Nominees Pty Ltd and Nulis 'may have contravened the covenants set out in s52(2)(c) of the SIS Act which required it to exercise its powers and to perform its duties in the best interests of members'. Mr Hodge went on to say that it is also open to the Commissioner to find that MLC Nominees Pty Ltd and Nulis may have contravened s29VN(a) of the SIS Act by failing to 'promote the financial interests of beneficiaries of their respective funds who held the MySuper product in the period 2013-2017, in particular the returns to those beneficiaries (after the deduction of fees, costs and taxes). The relevant conduct in that regard comprise the failure to appropriately allocate the investment management fee in order to ensure the prudent and diligent investment of funds attributed to the MySuper products'.

- **Culture and governance practices:** Mr Hodge said that it is open to the Commissioner to find that the misconduct in respect of certain fees and grandfathered commissions 'may be attributable, at least in part, to the culture and governance practices within the NAB Group'.

AustralianSuper case study

The issues explored in this case study largely concerned the use of member funds to pay for online news site The New Daily and to contribute to the 'fox and henhouse' industry advertising campaign. See: Governance News 20/08/2018.

Mr Hodge said that 'it is not open to the Commissioner to find that any of the conduct constituted misconduct or conduct falling short of community standards and expectations'.

Policy Questions

Mr Hodge said that the consideration of advertising gives rise to the certain general questions. Namely:

- Is political advertising consistent with the intention behind s62 (Sole Purpose Test) of the SIS Act? Is any amendment to the SIS Act warranted, and if so, why?
- Is there identifiable detriment to consumers from advertising by super funds or particular advertising (such as 'Fox and Henhouse')? Is there identifiable benefit to consumers from advertising by super funds or particular advertising?

Hostplus case study

The issues explored in this case study largely concerned the approach Hostplus takes to attracting and retaining members and the role of the Trustee in respect to 'inactives, smalls, and multiples'. See: Governance News 20/08/2018.

Possible open findings

Possible of conduct falling below community standards and expectations included the following.

- **Member retention strategies:** Mr Hodge said that it is open to the Commissioner to find that, communication with inactive low balance members, 'omitted certain details and gave the impression that the member would lose their superannuation balance to the ATO, which conduct may have fell below community standards and expectations'. More particularly, Mr Hodge said that the letters to members did not sufficiently explain 'the consequence of their choice, there was no explanation of the fees and returns relevant to the member's balance were it to remain with Hostplus in comparison with it being rolled-over to the ATO'. Mr Hodge added that there was no evidence that the trustee had, 'at the relevant time, engaged in' an analysis of whether the exclusion of some members from the ATO roll-over process was in the best interests of those members (though he noted that Hostplus is now undertaking a review of the position of these members). Mr Hodge went on to suggest that it is open to the Commissioner to find that 'Hostplus may have engaged in conduct falling below community standards and expectations by keeping inactive, low balance members in the fund'.

Policy Questions: corporate hospitality expenditure/'inadequacies' in s68A of the SIS Act?

Mr Hodge said that the evidence 'in respect of corporate hospitality expenditure' by Hostplus 'highlights potential inadequacies in section 68A of the SIS Act, as currently framed, and the role of employers in choosing a default fund for their employees'.

Mr Hodge said that despite 'any obligations that may exist at common law or in equity, employers have no express obligation under the SIS Act to act in the best interests of their employees in selecting a default fund. And the SIS Act does not currently proscribe conduct that would prevent funds, including underperforming ones, from offering inducements to employers, such as gifts or hospitality, with a view to persuading an employer to nominate that fund as the default fund for their employees. Section 68A is only enlivened if an offer is made on the "condition" that the person's employees will become members of the trustee's superannuation fund, which criterion will rarely be present in the context raised by Mr Elia's evidence'.

In view of these considerations, Mr Hodge said, submissions are invited in respect of the following questions:

- Is it appropriate, as a response to conduct of superannuation trustees that seeks to induce employers to select funds, or affect their decisions as to default funds, to make alterations to section 68A of the SIS Act to widen the prohibition?
- How wide should the prohibition be – should it extend to prohibiting providing benefits to employers for the purpose or with the intention of inducing the selection of the fund as the default fund for employees, or affecting the decision, or being likely to induce or affect?
- Are there matters of principle that would justify such a change? Are there problems that would arise in the application of the law?

Energy Superannuation Fund (ESF) case study

The issues explored in this case study largely concern 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. For an overview of the facts and issues explored see: Governance News 20/08/2018.

Mr Hodge said that it is 'not open to the Commissioner to find that any of the conduct of Energy Super the subject of the evidence constituted misconduct or conduct falling short of community standards and expectations'.

Catholic Super (CSF) case study

The focus of this case study was largely on two issues: (alleged) conflicted payments/the effectiveness of conflict management systems at board level and the reasons for the failed merger between Catholic Super and the Australian Catholic Superannuation Retirement Fund. For an overview of the facts and issues explored see: Governance News 20/08/2018.

Possible open findings

Possible of conduct falling below community standards and expectations included the following.

- **In relation to the failed merger**, Mr Hodge said that it 'It is not open to the Commissioner to find that any of the conduct of CSF in relation to the merger constituted misconduct or conduct falling short of community standards and expectations'.
- **Conflict management systems:** Mr Hodge said that it is open to the Commissioner to find that the 'may have breached Prudential Standard SPS 521 by failing to have a conflicts management framework which ensured that the RSE licensee identified all potential and actual conflicts in the RSE licensee's business operations and took all reasonably practicable actions to ensure that potential and actual conflicts were avoided or prudently managed'. He added that it 'is also open to the Commissioner to conclude that the insufficient monitoring of the corporate credit card use is, at least, conduct falling below community standards and expectations'.

Colonial First State (CFS) 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. For an overview of the facts and issues explored see: Governance News 20/08/2018.

Possible open findings

Available findings of misconduct, or conduct falling below community standards and expectations included the following.

- **Transferring members to MySuper products:** Mr Hodge noted that CFIL acknowledged in a breach notification to APRA in 2014 that it was in breach of s29WA of the SIS Act in respect of the contributions of 13,000 members. Mr Hodge said that it is open to the Commissioner to find that CFSIL was right to acknowledge this contravention and that it is also open for the Commissioner to find that this may give rise to further contraventions. These include (among others): possible breach of s 912A(1)(a) of the Corporations Act ('failure to do all things necessary to ensure the financial services covered by its AFSL are provided efficiently, honestly and fairly'); possible breach of section 52(2)(b) and (c) of the SIS Act ('failure to exercise the degree of care, skill and diligence as a prudent superannuation trustee would exercise and to perform their duties and exercise their powers in the best interests of the affected members'); possible breach of section 52(2)(d)(i) and (d)(iii) of the SIS Act ('failure to prioritise the interests of the affected members over the interests of advisers, in, in circumstances where the latter received ongoing commissions which would not otherwise have been received if members' contributions were attributed to a MySuper product and in circumstances where advisers were given the opportunity to maintain those fees by diverting clients from the MySuper product within the time afforded by CFSIL and supported by the communications promulgated by CFSIL'). In addition, Mr Hodge said that CFSIL's communications to members in respect of the MySuper transition may have been in breach of section 52(2)(d)(i) and (d)(iii) of the SIS Act (eg failure to prioritise the interests of affected members over the interests of advisers).
- **Payment of commissions:** Mr Hodge said that it was open to the Commissioner to find (among other things) that CFSIL breached s912(1)(a) if the Corporations Act eg by charging 'conflicted remuneration past the disallowance date of 1 July 2014'. In addition, Mr Hodge said that it was open to the Commissioner to find that CFSIL breached 's52(2)(c) of the SIS Act in respect of continuing to pay conflicted remuneration past the disallowance date of 1 July 2014'.
- **Fee arrangements:** Mr Hodge said that it 'is open to the Commission to find that the Distribution Agreement between CBA and CFSIL may have contravened the conflicted remuneration provisions of the Corporations Act introduced by FOFA [Future of Financial Advice Reforms]. This is because

the Distribution Agreement provides for a benefit (an annual fee of 30% of the total net revenue earned by the trustee in relation to the fund) given to an AFS licensee (CBA) that could reasonably be expected to influence the financial product advice given to a retail client'.

- **Cash fund performance:** Mr Hodge said that it is open to the Commissioner to find that CFSIL may have engaged in misconduct in respect of the cash fund investments of CFSIL members who were not members of the CBA staff fund: 'it is possible that CFSIL contravened sections 29E(1)(a) and 52(2)(c) of the SIS Act by failing to perform its duties, and exercise its powers, in the best interests of members in circumstances where members are still paying a trailing commission on cash investment options and there is no evidence that the trustee has considered whether this is in the best interests of members. Such conduct may also have fallen short of community expectations and standards' Mr Hodge said.

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 (see: Governance News 20/08/2018).

Possible findings

Available findings of misconduct, or conduct falling below community standards and expectations included the following.

- **Retention/use of 'tax surplus':** Mr Hodge said that it is open to the Commissioner to find that SPSL may have contravened its statutory obligations in relation to the use of the tax surplus and representations to members regarding this. For example, Mr Hodge said that it may have contravened ss 29E(1)(a) and 52(2)(c), (d)(i) and (d)(iii) of the SIS Act. This conduct included payment of the surplus to SLSL in circumstances where this failed to prioritise the financial interests of members over the interests of SLSL which obtained a financial benefit to the detriment of members. Mr Hodge also suggested that SPSL may have contravened Prudential Standard SPS 231 (Outsourcing). Mr Hodge went on to say that SPSL 'may also have engaged in conduct in relation to a financial service that was misleading or deceptive, or likely to misleading or deceive, contrary to section 12DA of the ASIC Act and section 1041H of the Corporations Act' eg representations in the Everyday Super PDS regarding the use of the amount of the administration fees which would be charged to members, and the omission of information which would inform members that the cost of administering the fund included the payment of the tax surplus to SLSL. Mr Hodge added that it is open to the Commissioner to find that the above conduct also departed from community standards and expectations.
- **Transition to MySuper product:** Mr Hodge said that it is open to the Commissioner to find that in relation to the transition of members to MySuper products, and communications with members and advisers regarding this, SPSL may have contravened its statutory obligations. For example, he suggested that 'SPSL may have contravened sections 29E(1)(a) and 52(2)(c) of the SIS Act which required it to exercise its powers and to perform its duties in the best interests of members, for whom the delayed transition to a MySuper product may have resulted in greater fees and ongoing commission payments being deducted from their accounts'. He also suggested that 'SPSL may have contravened sections 29E(1)(a) and 52(2)(d)(i), (d)(iii) of the SIS Act by failing to prioritise the interests of members over the interests of financial advisers who obtained a financial benefit, at the expense of members, in the form of ongoing commission payments as a result of SPSL's delayed transition and assistance provided in respect of communications to their clients to take steps to ensure they would not be moved into the fund's MySuper product'.

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. Counsel Assisting explored 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 (see: Governance News 20/08/2018).

Possible open findings

Possible open findings of misconduct or conduct falling below community standards and expectations included the following.

- **Use of member funds (general reserve) to compensate members:** Mr Hodge said that it is open to the Commissioner to find that Questor may have breached its statutory obligations in a number of ways including: breaching s 52(2)(c) of the SIS Act (by reducing distributions to unaffected members by using the general reserve (an asset of the Fund) to compensate those members, and refusing to replenish the general reserve); breaching s 52(2)(d) of the SIS Act; 'engaged in misleading or deceptive conduct in breach of s 12DA ASIC Act' by sending the letter to members 'asserting they would receive compensation for a "historical distribution error"'.
- **Failure to transition members to new pricing model:** In addition, Mr Hodge said that it is open for the Commissioner to find that IIML may have breached s 52(2)(c) SIS Act, and prioritised its own interests over the interests of superannuation members over in breach of s 52(2)(d) SIS Act, by not applying the new pricing to existing members who would be better off, particularly in circumstances in which IIML considered it was unlikely that members would move of their own accord.
- **Duty to act in the best interests of members:** Mr Hodge said that it 'is open to the Commissioner to find that the continued failure of IIML and IOOF Holdings to understand their duties to superannuation members, and to take steps to properly recognise and manage conflicts of interest, constitutes conduct falling below community standards and expectations'.

ANZ/One Path case study

This case study was largely concerned issues arising in relation to the practice of ANZ bankers selling an ANZ superannuation product (Smart Choice Super) through ANZ branches. The Commission heard that ASIC had raised concerns about the practice, including that because the product was being sold in close proximity to personal financial advice (the A to Z review) that it might have been perceived by customers, despite 'de-linking' statements, and cautions that the advice was general advice by ANZ bankers, as 'akin to personal financial advice' when it was actually, 'trying to sell something to the customer'. The Commission also heard that ANZ had recently given an enforceable undertaking to the regulator in relation to the issue.

ANZ witness, Mr Pankhurst was questioned about the approach taken by ANZ to selling the My Choice product, and more particularly the adequacy of the controls in place in ensure customers were aware that they were not receiving personal advice. Mr Hodge asked: 'And it's indifferent, isn't it, as to whether or not this particular product is in the best interests of the customer?' in that it 'does not care whether or not a customer coming into the ANZ branch would be better off in a superannuation product offered by a different entity compared with the ANZ product?'. Mr Pankhurst agreed that no comparison between products was offered, but noted that the banker selling the product, could refer a person to a full financial planner to go through that process. Mr Pankhurst also disagreed that the 'key risk' in relation to the sales practice was that customers could end up with a less suitable product than their existing funds (because they did not understand the consequences of switching products), stating that in his view, it 'is a general risk with all superannuation products, that customers make decisions without fully understanding exactly what they're…in'. Asked whether 'any of the customer who signed up and made contributions or rollovers into the Smart Choice product were worse off as a result of doing that rather than sticking with their existing superannuation fund' Mr Pankhurst replied in the negative.

Possible open findings

Possible open findings of misconduct, or conduct falling below community standards and expectations included the following.

- **Branch selling practices:** Mr Hodge said that because ANZ was aware there was a risk that customers would believe that branch staff had taken their relevant circumstances into account and were recommending Smart Choice Super; and as a result, customers would switch their superannuation and end up with a less suitable product' it is open to the Commissioner to find that ANZ 'may not have done all things necessary to ensure 'that the financial services covered by its license were provided efficiently, honestly, and fairly in breach of s 912A(1)(a) of the Corporations Act'. Mr Hodge also said that it was open to the Commissioner to find that this conduct departed from community standards and expectations.

Questions for written submissions

- Is it appropriate for the trustee of a superannuation funds to retain payments from the responsible entity of a managed investment scheme where that payment is derived from the investment of members' money?
- Is it appropriate that superannuation be sold through bank branches? Is it reasonable to think that there is any prospect that this is likely to produce an outcome that is in the best interests of consumers?
- Are there statutory reforms that are required to address this problem (if it is a problem) or are the existing laws with respect to personal financial advice and general financial advice sufficient? What is the nature of the "advice" that a customer of a bank receives when told by a bank branch staff member about the availability of a superannuation product offered by a bank?

AMP/NM Super case study

The focus of this case study was largely on the approach taken to transitioning members to MySuper products, the monitoring and oversight of product performance and fee arrangements and the (alleged) negative performance of 'cash' investments over a period of time, the (alleged) conflicts arising from the AMP structure and the trustee's oversight/monitoring of functions 'subcontracted' or 'outsourced' to other agents.

Possible open findings

Possible open findings of misconduct, or conduct falling below community standards and expectations included the following.

- **Outsourcing day to day functions and operations of the funds:** Mr Hodge said that it is open to the Commissioner to find that in outsourcing the day-to-day functions and operations of the Funds the trustees were 'wholly dependent on the information provided to them by Trustee Services', and, 'in turn, Trustee Services were wholly dependent on the information provided to them by the related entities to whom the services had been outsourced'. Mr Hodge added that it is open to the Commissioner to find that this 'may have presented a number of challenges to the trustees in performing their duties and exercising their powers' in the best interest of their members under s 52(2)(c) and s 52(2)(d) of the SIS Act. Mr Hodge went on to say, 'In particular, it is open to the Commissioner to find that the trustees may have breached their duties under ss 52(2)(c) and 52(2)(d) of the SIS Act eg by 'being unable to lower the fees and charges to members on their investments in cash through the SDF Cash Management Trust, or with respect to the MySuper products of the Funds, in that the lowering of fees was a decision to be made ultimately by others in the AMP Group'. Mr Hodge added that it is open to the Commissioner to find that by entering into the outsourcing agreement for the day-to-day administration and operation of the Funds, 'the trustees may have breached their duties under s 52(2)(h) of the SIS Act not to enter into any contract that would prevent the trustees from, or hinder the trustees in, properly performing or exercising the trustees' functions and powers' eg by 'rendering the trustees unable to make the ultimate decision as to the pricing of the MySuper products of the Funds' and 'allowed others in the AMP Group to make decisions as to the timing of the transfer of ADAs to MySuper products that may ultimately not have been in the best interests of members' (among others).
- **Best interests duty:** Mr Hodge said that it is 'open to the Commissioner to find that the trustees may have breached their duties to ensure that, where there was a conflict between the duties of the trustee to the members, or the interests of the members, and interests of an associate of the trustee, the interests of the members could and would be given priority in accordance with s 52(2)(d) of the SIS Act'.
- **Negative return on cash investments:** Mr Hodge said that it is 'open to the Commissioner to find that by generating a negative return on cash investments in the SDF Cash Management Trust, the trustees may have breached their duties under s 52(2)(b) and s 52(6) of the SIS Act, and their obligations under Prudential Standard SPS 530 and s 912A of the Corporations Act'. Mr Hodge went on to say that it is 'open to the Commission to find that the trustees may have breached their obligation under s 29VN(a) of the SIS Act to promote the financial interests of the beneficiaries of the Funds who hold a MySuper product'.

Topic 2: Superannuation funds and Indigenous members

In introducing the Q Super case study, Counsel Assisting Rowena Orr QC noted that the issues arising follow 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.

Questions arising from the Q Super case study

- Are the identification procedures used by superannuation funds appropriate for their Aboriginal and Torres Strait Islander members?
- If those procedures are appropriate, are those identification procedures sufficiently understood and implemented by staff on the ground?
- If those procedures are not appropriate, what should be changed?
- Should superannuation funds be required to record whether their members identify as Aboriginal or Torres Strait Islander people?
- Should those superannuation funds who do not currently permit the early release of superannuation on the basis of severe financial hardship do so?
- Should the lower life expectancy of Aboriginal and Torres Strait Islander people be taken into account in the decision-making processes of superannuation funds when considering how to administer or release the funds of Aboriginal and Torres Strait Islander people? If so, how?
- Should the categories of person permitted by legislation to be the subject of a binding nomination be changed to reflect Aboriginal and Torres Strait Islander kinship structures? If so, how should the categories be broadened?

Topic 3: Effectiveness of superannuation regulators APRA and ASIC

The focus of questions was on the enforcement approach taken by both the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) in relation to the superannuation sector. In particular, the effectiveness of the regulators' current approach to enforcement, the extent to which the regulators use their existing powers to address misconduct and deter future misconduct and the effectiveness of their respective approaches.

Australian Prudential Regulation Authority (APRA) case study

The Commission heard evidence from two APRA witnesses: Deputy Chairman, Helen Rowell and Stephen Glenfield, General Manager of APRA's Specialised Institutions Division.

Deputy APRA Chair Helen Rowell described the approach APRA takes to enforcement in some detail, explaining that APRA's preferred approach is 'engagement' with industry as opposed to more 'formal action'.

Citing various examples of (alleged) misconduct, Mr Hodge questioned the effectiveness of this approach, both from the perspective of deterrence/prevention and from the perspective of ensuring trustees are acting in the best interests of members. He suggested that 'APRA is concerned with the stability of the system and the entities within the system as its primary focus' (as opposed to ensuring trustees are acting in the best interests of members). Ms Rowell denied this is the case, stating that regulator is also concerned ensuring that RSEs 'meet their promises and their obligations to members'. Mr Hodge went on to question the effectiveness of APRA's approach to ensuring compliance with the sole purpose test. Ms Rowell agreed that APRA has not required any trustee to enter into an enforceable undertaking over the last ten years and has never commenced a civil proceeding in relation to the sole purpose test. The Commission also heard that APRA is awaiting the conclusion of ASIC's work in relation to alleged fee for no service conduct, before investigating whether further action on the issue may be warranted – an approach that was questioned by Mr Hodge.

On the topic of commissions, and the transition of members to MySuper products, Mr Hodge queried whether APRA undertaken any project to evaluation whether RSE licensees acted in their own financial interests. Ms Rowell confirmed that no project has been undertaken and that 'there had not been concern internally at a general level' regarding the issue.

On the issue of extending the regulators' powers (eg permitting APRA to direct a trustee to merge the fund with another trustee'), Mr Hodge queried whether APRA would be likely to use them. Ms Rowell said: 'You couldn't rule it out. Yes, we would do that'.

Prudential standards: High level drafting makes establishing a breach 'very difficult'?

In his written submission to the Commission, Counsel Assisting Michael Hodge QC noted that under s 34C of the SIS Act, APRA has the power to determine prudential standards and that APRA takes a 'principles-based' approach to setting these standards. He added that the Commission heard that the approach is intended to enable entities to 'use a variety of approaches to comply with high-level principles, rather than APRA seeking to control a regulated entity through detailed prescription'. Mr Hodge noted that consequently, the standards are 'directed towards the development of policies and frameworks. To the extent they provide concrete guidance, that guidance tends to be expressed at a high level'.

Mr Hodge observed that 'whatever the other merits of this approach [principles based approach], such high level drafting means that establishing a breach of a standard — except in the most obvious way, such as failing to have a Fit and Proper Policy at all — is likely to be very difficult'.

Australian Securities and Investments Commission (ASIC) case study

The focus of questions in this case study was on the approach ASIC takes to enforcement and more particularly ASIC's (alleged) preference for entering into enforceable undertakings as opposed to going to court. In one example, the Commission heard that even where ASIC threatened, having completed its investigation, to take a financial institution (ANZ) to court, it failed to follow through agreeing instead to resolve the matter by way of an enforceable undertaking (the whole issue taking over three years to resolve). Asked why this approach was taken, ASIC witness Mr Mullaly said that 'the focus of this was to stop the conduct…We were able to achieve that without having to go to court'. Later, in questioning Deputy Chair Peter Kell, Mr Hodge asked whether, in circumstances where ASIC has identified conduct that it considers to be a breach of the law, it will commence a proceeding, Mr Kell said that it would be considered.

Asked whether, were the regulator granted stronger powers (eg in relation to commencing civil penalty proceedings for failure to comply with the best interests duty) the regulator would exercise those powers, Mr Kell said that the regulator would do so.

Commissioner Hayne asked Mr Kell 'Do you regard civil penalty proceedings as the best ultimate means of achieving public denunciation of misconduct?' to which Mr Kell responded: 'I think they can be a very effective means, but it will, Commissioner, it would depend on the circumstances. It might be that criminal proceedings are in some cases an appropriate tool. It might be that in other circumstances banning someone for life from the industry in which they're working sends a very, very powerful message as well. But certainly, I would say that civil penalty proceedings are a very important part of the – the deterrence tool kit'. Asked by the Commissioner whether ASIC had in the last five years 'given consideration to submitting a brief to Commonwealth DPP in respect of any aspect of the fees for no service matter?' Mr Kell responded in the affirmative.

Reasons for 'so little action' are unclear?

In written submissions to the Commission, Mr Hodge outlined Mr Kell's evidence with respect to ASIC's preferred enforcement approach. Mr Hodge commented that 'On the evidence, it is not clear why so little action [court action] has been taken. Nevertheless, Mr Kell told the Commission that if ASIC were to have a greater role as conduct regulator of RSE licensees, it would require expanded powers to match. Mr Kell asserted that, notwithstanding its failure to bring proceedings against trustees to date, if ASIC were responsible for commencing proceedings for a failure to comply with the sole purpose test it might do so.'

[Sources: Round 5 closing submissions - 24 August 2018; 17 August 2018 – Final Transcript for Day 49; 16 August 2018 – Final Transcript for Day 48]

Possible reforms arising from the Financial Services Royal Commission? University of Wollongong's Professor David Gallagher suggests that (among other things) stronger powers for the financial regulators may be one of the recommendations likely to come out of the Commission.

Writing in The AFR, former CEO of the Commonwealth Government's Centre of Excellence in International Finance and Regulation (CIFR), now senior professor of Finance at the University of Wollongong Business School David R Gallagher, has outlined possible 'reforms' and 'lessons' that have emerged from the Financial Services Royal Commission hearings to date. These include the following.

- **Vertical integration** in the banking system appears to have led to 'very serious problems of misalignment between the customer and the bank' he observes.

[Note: Submissions on the issue of vertical integration appear to express a diversity of views. For example, ASIC's submission to the Royal Commission following Round 2 hearings, expressed the view among other things that the grandfathering of commissions should cease as soon as is reasonably practicable and also outlined the regulator's view on the vertical integration model. See: Governance News 14/05/2018. Separately, Treasury has submitted to the Commission that structural reform is unwarranted at this time. See: Governance News 30/07/2018.]

- **Stronger powers for the financial regulators?** The existing powers of the Australian Securities and Investments Commission (ASIC) appear to have been, in his view, 'less than effective in preventing patterns of illegal behaviour, and worse still, to remedy breaches in law'. This suggests that stronger powers 'with real teeth, are needed to rebuild trust and confidence in the financial system'. Having said this, Professor Gallagher goes on to state that 'what we don't need is interference that is politically motivated, where our financial regulators are compelled to meddle in the minutiae of financial entrepreneurship'.
- **Changes in the financial advice industry? '**The financial advice industry has long had issues of educational standards and professional proficiency. The revenue model of firms operating in the financial planning industry needs to be better aligned to client outcomes. Improved disclosure, professionalism and 21st century principal-agent relationships are needed fast' he observes.

[Note: ASIC Chair James Shipton has made similar observations on the need for the industry to raise standard of professionalism in recent speeches. See for example: Governance News 18/05/2018.]

- Trust in our institutions 'must now be at all-time lows' and 'there is a very real risk that negative sentiment might spill out into the broader financial system'. The full extent of this 'won't be fully known until the Hayne royal commission reports to government' he writes.

[Note: 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. See: Governance News 20/08/2018.]

Professor Gallagher concludes: 'The banking royal commission still has a long way to run. It has already proven itself to be the most effective vehicle to bring about genuine reform. I have no doubt that these special powers entrusted to the royal commissioner, Kenneth Hayne, will be the much-needed catalyst for significant and genuine reform in financial services industry. My only fear, though, is in the politics in effecting such reforms. Let's hope our politicians don't ruin this important chance'.

[Source: [registration required] The AFR 22/08/2018]

In Brief | The Financial Services Royal Commission has announced that its online forum for public submissions will close on 28 September after which date the Commission will shift its attention from past experiences to proposals on what should be done in response to the issues raised or conduct uncovered within the banking, superannuation and financial services industry. Those wishing to share their stories about past experiences are encouraged to make their submissions as soon as possible.

[Source: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry news update 17/08/2018]

In Brief | Chair of Industry Super Australia, and independent director of Hostplus Peter Collins has reportedly called for a 'complete separation' between banking and superannuation funds following the

recent Royal Commission superannuation hearings The Australian writes. '(The inquiry) has the intellectual grunt and funding and forensic skill to really take significant corrective action and make recommendations to the government, which could improve a lot' he is quoted as stating.

[Source: [registration required] The Australian 21/08/2018]

Other Developments

Already taking action? The government has released its response to a 2016 senate committee report into improving women's retirement savings, largely outlining actions already on foot. The AIST has reportedly expressed criticism of the government's response.

The government has released its response to a 2016 Senate Economics Reference Committee report dealing with the insecurity faced by many Australian women in retirement entitled: *A husband is not a retirement plan.* The report found that women, particularly single women, are at a greater risk of experiencing homelessness, housing stress and poverty in retirement than men as women tend to retire with significantly less superannuation than men which the report attributes to a number of factors including the gender pay gap, career breaks for family/other reasons and women representing a higher proportion of the part time workforce. The report made 19 recommendations to increase women's participation in the workforce and improve their superannuation savings. These include, among others: strengthening the right to request flexible work under the *Fair Work Act 2009* (Cth); payment of the superannuation guarantee on the Commonwealth paid parental leave scheme, bringing forward the current schedule for increasing the superannuation guarantee to 12% and removing the exemption from paying the superannuation guarantee for employees who earn less than $450 per month.

The government response to the report, released two years after the senate report, largely outlines the work already on foot to address the gender pay gap in retirement income. The government 'notes' 13 of 19 recommendations, agreed/agreed in part to 4 recommendations and rejects two recommendations.

The government rejected recommendations to:

- Extend the discrimination ground of 'family responsibilities' under the Sex Discrimination Act to include indirect discrimination; and include a positive duty on employers to reasonably accommodate the needs of workers who are pregnant and/or have family responsibilities.
- The Australian Government revise the current schedule for the increase in the superannuation guarantee (SG) rate to 12%, and ensure the gradual increase in the SG rate is implemented earlier than the current timetable.

Disappointment in the response? Investor Daily reports that Australian Institute of Superannuation Trustees (AIST) CEO Eva Scheerlinck expressed disappointment in the government's response saying that: 'The government is spruiking a response that relies on individuals (husbands) fixing the super gender gap. This is absurd…The problem is not the fault of individual women and the government should not expect individual women (or their husbands, if they have them) to fix it.' Ms Scheerlinck reportedly went on to say 'Extending the spouse offset and allowing higher catch up contributions will do nothing to help ordinary working women who may not have the spare cash to put more into super, nor will it do anything to help divorced and single women who experience some of the poorest outcomes in retirement.' Ms Scheerlinck added that the recommendations that would have made the most difference to women would have been raising the super guarantee, removing the $450 threshold, and paying superannuation on all forms of parental leave.

[Sources: Senate Standing Committee on Economics Report: 'A husband is not a retirement plan' Achieving economic security for women in retirement 29/04/2016; Government response 16/08/2018; InvestorDaily 22/08/2018]

The government has released a New National Financial Capability Strategy to address poor levels of financial capability: ASIC modelling has found that there would be a $212 billion increase to consumer wealth and consumption if financial capability levels were lifted.

Minister for Revenue and Financial Services Kelly O'Dwyer has launched the latest 2018 National Financial Capability Strategy which she said will 'guide action across the government, business, community, education and research sectors to support enhanced financial capabilities in individuals, families and communities'.

The strategy is aimed particularly assisting people (especially women, young people, older Australians and Indigenous Australians) to improve their money management, decision-making and future-planning skills.

ASIC modelling has found that 1 in 3 Australians struggle to manage their money, and estimates that there would be a $212 billion increase to consumer wealth and consumption if financial capability levels were lifted marginally above current levels over the next 30 years. ASIC Chair James Shipton said, 'The financial sector as a financial community should be engaging in practices that promote fair consumer outcomes. In particular, we need to continue to encourage women to be more confident with money, young people to find the information they need when they need it, and support Indigenous Australians to access appropriate financial products and services.'

[Sources: 18-243MR The Hon Kelly O'Dwyer MP launches the 2018 National Financial Capability Strategy; 2018 National Financial Capability Strategy]

In Brief | Asia Region Funds Passport regulations made: *The Corporations Amendment (Asia Region Funds Passport) Regulations* 2018 were registered on the 20 August. The Asia Region Funds Passport (ARFP) is a multilateral agreement between Australia, Japan, Republic of Korea, New Zealand and Thailand to establish a common framework of coordinated regulatory oversight to facilitate cross border issuing of collective investment schemes.

[Source: Corporations Amendment (Asia Region Funds Passport) Regulations 2018]

Accounting and Audit

KPMG against breaking up the big four accounting firms and against 'naming and shaming' for poor audit quality? Following Deloitte CEO Richard Deutsch's calls for ASIC to name firms who fail to minimum quality thresholds, The AFR writes that KPMG Chair Alison Kitchen remains opposed to the idea.

The AFR reports that KPMG Chair Alison Kitchen 'remains opposed' to the proposal put forward by Deloitte CEO Richard Deutsch (see: Governance News 20/08/2018) that the Australian Securities and Investments Commission (ASIC) publish the names of firms who fail to meet minimum audit quality thresholds over a period of time.

Reportedly, Ms Kitchen opposes the change in approach as it would only lead to 'point scoring' and get in the way of 'shared learnings' across the big four accounting and consulting companies.

According to The AFR, Ms Kitchen also reaffirmed her view that the firms should not be broken up. She said the big multi-disciplinary accounting firms KPMG and rivals Deloitte, EY and PwC remained best-placed to audit large multinational listed firms.

[Source: [registration required] The AFR 21/08/2018]

In Brief | The AFR reports that, to counter controversy over government contract work, the big four accounting firms have expressed unanimous support for 'radical transparency' over government contract work ie for the government publishing details of every contract online with a description. Reportedly, the firms' view is that more transparency will help explain the value of the work they perform, clarify the type and scope of work they are doing across agencies and reduce the risk of disputes.

[Source: [registration required] The AFR 21/08/2018]

In Brief | The UK Financial Reporting Council has fined and reprimanded KPMG Audit Plc £3,000,000 (discounted for settlement to £2,100,000) and Senior Statutory Auditor and Audit Engagement Partner Michael Francis Barradell of £80,000 (reduced to £46,800 after adjustment for mitigating factors and a discount for settlement), following their admission of misconduct in relation to their audits of the financial statements of Ted Baker Plc and No Ordinary Designer Label Limited for the financial years ended 26 January 2013 and 25 January 2014. KPMG provided expert witnesses for Ted Baker in a court case, breaching independence guidelines. The watchdog added: 'In addition, there was a self-

interest threat arising from the fact that the fees for the expert engagement significantly exceeded the audit fees in the relevant years.'

[Source: FRC media release 20/08/2018]

Risk Management

Climate Risk

United States | Rolling back Obama era clean power plan: The EPA is consulting on a proposed new rule establishing emission guidelines for states to use when developing plans to limit GHGs. However, it's questionable whether the rule (if adopted) will have a significant impact either on halting the decline in coal production or on lowering power prices writes The FT.

Pursuant to President Trump's Executive Order 13873, which directed Federal agencies to review burdensome regulations, The US Environmental Protection Agency (EPA) has released a proposed new rule: The Affordable Clean Energy (ACE) Rule, for consultation.

ACE proposes to establish emission guidelines for states to use when developing plans to limit green house gases (GHGs) at their power plants, and would replace the Obama administration's 'overly prescriptive and burdensome Clean Power Plan (CPP).'

The EPA writes that ACE will work to reduce GHG emissions by:

- Defining the 'best system of emission reduction' (BSER) for existing power plants as on-site, heat-rate efficiency improvements.
- Providing states with a list of 'candidate technologies' that can be used to establish standards of performance and be incorporated into their state plans.
- Updating the New Source Review (NSR) permitting program to 'further encourage efficiency improvements at existing power plants'.
- Aligning regulations under CAA section 111(d) to give states adequate time and flexibility to develop their state plans.

In addition, ACE will deliver a number of benefits including:

- ACE would reduce the compliance burden by up to $400 million per year when compared to CPP.
- EPA projects that replacing the CPP with the proposal could provide $400 million in annual net benefits.
- ACE would reduce CO_2 emissions from their current level: EPA estimates that the ACE could reduce 2030 CO_2 emissions by up to 1.5% from projected levels without the CPP. The EPA adds that modelling suggests that when states have fully implemented the proposal, US power sector CO_2 emissions could be 33% to 34% below 2005 levels, higher than the projected CO_2 emissions reductions from the CPP.

'Restore the rule of law': The EPA goes on to state that 'many believed the CPP exceeded EPA's authority under the Clean Air Act, which is why 27 states, 24 trade associations, 37 rural electric co-ops, and three labor unions challenged the rule. Additionally, the Supreme Court issued an unprecedented stay of the rule'. As such, EPA Acting Administrator Andrew Wheeler said that the proposed rule would 'restore the rule of law and empower states to reduce greenhouse gas emissions and provide modern, reliable, and affordable energy for all Americans…Today's proposal provides the states and regulated community the certainty they need to continue environmental progress while fulfilling President Trump's goal of energy dominance.'

Assistant Administrator for the Office of Air and Radiation Bill Wehrum said that 'The ACE rule would fulfill this role in a manner consistent with the structure of the Clean Air Act while being equally respectful of its bounds.'

Consultation: The EPA will take comment on the proposal for 60 days after publication in the Federal Register and will hold a public hearing.

Minimal impact on declining coal production and minimal impact on prices? Commenting on the change in approach, The FT suggests that the rule (if adopted) is unlikely to arrest the 'steady decline' in coal production from today's levels. James Lucier of Capital Alpha Partners is quoted as stating that investors will pay little attention to the change in approach: 'The impact on public companies will be marginal to nil…The move away from coal-fired generation is driven by fundamental economics and not a regulatory mandate.'

The article goes on to suggest that the proposed changes are also unlikely to impact prices in any significant way with retail electricity prices projected to be at most only 0.4% lower by 2030, compared with the levels if the Obama administration's plans had gone into effect, and could be unchanged according to The FT.

[Sources: US Environmental Protection Agency media release 21/08/2018; Proposal: Affordable Clean Energy (ACE) Rule; ACE rule fact sheet; [registration required] The FT 22/08/2018; 20/08/2018;

In Brief | No emissions component in the National Energy Guarantee: the government announced it will not introduce legislation to ensure Australia meets its commitments to emission reductions under the Paris Agreement for lack of support. The AFR reports that business leaders have called on the government to reconsider on the basis that failure to do so will mean further uncertainty for business and for investors and have expressed disappointment at the change in direction. 'Theoretically it's still possible [for the states to continue with the NEG's reliability guarantee] but with potential leadership challenges, whatever happens we're going to start having mumblings, rumours of an election'.

[Sources: Business Insider 20/08/2018; [registration required] The AFR 20/08/2018; 22/08/2018]

Digital disruption and cybersecurity

Spending more on technology, prioritising cybersecurity but lacking in compliance oversight? The lack of IT risk strategies in mid-market companies is highlighted as a concern in a new Deloitte report into technology trends in mid market companies.

Deloitte has released a survey examining technology trends taking place in mid-market companies to determine the role that technology plays and how it influences business decisions. Among the findings, was that in 'many cases technology is augmenting workers rather than rendering them obsolete'.

Key points

- **Hiring trends:** 46% of the survey companies reported plans to hire more than they did before implementing new technologies. 26% indicated that they would require fewer people.
- **Reskilling workers to prepare for the impact of digital disruption was identified as an 'urgent need'** by survey companies, with a number of respondents indicating that the current skills shortage is an impediment to growth.
- **Broad based disruption — areas of greatest impact:** Survey companies identified the following as the area most likely to be impacted by digital disruption: operations (54%), customer service (46%), marketing and product development (each 41%) and sales 39%.
- **Majority of companies are spending more on technology:** 57% of respondents said that they are spending more on technology. 33% indicated that their company spends at least 5% of their revenue on technology and 45% said they spend between 1 and 5%.
- **Cybersecurity, operations and focus on customer interactions:** The questions private company leaders are grappling with include how to prioritise these investments, how to manage them, and how to ensure they are translating into growth. More particularly, some of the key priorities identified in the report are: efforts to bolster cyber defences (38% identified this as the top IT investment priority), bring down operational costs by leveraging new technologies and increasing focus on use of technology to enable new types of customer interactions/measure customer activities to drive 'competitive advantage'.

- **Lack of IT compliance oversight?** According to the report, despite increased involvement across businesses, 33% of respondents said that they have 'little to no formal strategy or processes in place to oversee the risks and opportunities attached to emerging technologies.' Asked why this was the case, respondents cited: lack of resources to build and develop appropriate protocols, the cost and a lack of understanding of the importance of IT governance within the C suite among other factors. The report states that this is problematic for a number of reasons, among them that lack of understanding (at board level) of the importance and potential impact of emerging technologies could both contribute to lack of organisational efficiency and leave opportunities untapped.

About the survey: The survey was conducted with 500 respondents from mid-market companies (companies with annual revenues ranging from $100 million to a little more than $1 billion) over the period 16 May to 4 June 2018. Half of the respondents were C-suite executives, while the remaining executives held other management roles. Eighty percent of the respondents represented companies that are privately held, while the remainder were publicly traded firms. Thirty-three percent of the respondents were from consumer and industrial products companies; 24 percent represented technology, media and telecommunications companies; and the remainder were divided among energy and resources, financial services, life sciences and health care, and other industries.

[Source: Deloitte: Technology in the mid-market embracing disruption August 2018]

Whistleblowing

In Brief | The UK, and other countries without whistleblower reward schemes, have it wrong? Whistleblowing is an effective tool in policing poor company behaviour yet remains career suicide according to FCPA blog. Given this, 'All countries need to set up whistleblower protection and reward schemes, that not only protect the source but will ultimately see them justifiably remunerated where an investigation concludes that there has been wrongdoing, and where the organization is on the receiving end of significant sanctions'.

[Source: FCPA blog 21/08/2018]

Other Developments

In Brief | Uber has reportedly settled harassment and hostile work environment claims: 56 current and former Uber Technologies Inc employees who filed sexual harassment claims will collect on average $33,928.57. In addition, 431 other female and minority engineers and other workers covered by a 207 class action lawsuit will receive an average of just under $11,000 for alleged pay disparities.

[Source: Bloomberg 22/08/2018]

Restructuring and Insolvency

ASIC has reported that two former company directors have been convicted in the NSW District Court for engaging in illegal phoenix activity and breaching their directors' duties.

The Australian Securities and Investments Commission (ASIC) has announced that that two former company directors have been convicted and sentenced in the NSW District Court for engaging in illegal phoenix activity and breaching their director's duties.

Mr Allan Raad plead guilty to dishonestly using his position as a director of a company to gain an advantage for himself by causing the sale of the assets of the company to his brother-in-law's newly-incorporated company for $20,000. Some of the same assets were later on-sold for $176,000.

The company was placed into voluntary liquidation soon after with an estimated deficiency of $1.1 million.

Mr Raad was sentenced to 18 months' imprisonment for using his position dishonestly to gain an advantage and for having fraudulently removed property. He was released on a recognisance order to be on good behaviour for two hears.

Mr Yousef Joseph Bazouni, (Mr Raad's brother-in-law) was convicted of complicity in that he aided, abetted, counselled or procured the commission of the offences by Mr Raad. No penalty imposed and ordered to be of good behaviour for 12 months.

As a result of the convictions, both men are automatically disqualified from managing companies for five years.

[Source: 18-246MR Two former company directors convicted for engaging in illegal phoenix activity]

Other News

National Scheme for Australian Charities and Not for Profits? Final report into the effectiveness of current regulatory arrangements released.

The final report into the effectiveness of the *Australian Charities and Not for Profits Commission Act 2012* (Cth) and the *Not for profits Commission (Consequential and Transitional Act) 2012* (Cth) (ACNC Acts), was tabled on 22 August.

The report makes 30 recommendations, among them the establishment of a national scheme for the sector. 'The Panel is strongly of the view that a national scheme is the best option for the sector going forward, especially in areas such as governance, fundraising and registration. In the absence of a national scheme, the sector will continue to be subject to an unacceptable level of unnecessary red tape' the report states.

Among other changes, the report recommends:

- In respect of the ACNC governance standards, the Panel recommends no changes to *Standard 1: Purposes and not for profit nature*, *Standard 2: Accountability to members* or *Standard 4: Suitability of Responsible Persons*. However, the Panel recommends that *Standard 3: Compliance with Australian Laws* be repealed. The Panel recommends that *Standard 5: Duties of Responsible Persons* should be retained but the regulation should be amended to remove the word 'perceived' with respect to conflicts of interest.
- To reduce red tape, the Panel recommends that a registered entity should be presumed to be in compliance with the ACNC governance standards if it already applies a separate set of comparable governance requirements. The registered entity should be able to self-assess that it is compliant with such governance requirements and make a declaration in the Annual Information Statement.
- Directors' duties and other provisions 'turned off' under the *Corporations Act 2001 (*Cth) should be 'turned on'. 'This will resolve ambiguity and address other concerns raised in the course of the review' the report states.

ProBono news reports that the charity sector has welcomed the release of report and the review recommendations including the establishment of a single national scheme and fundraising reform to combat an 'unacceptable level of unnecessary red tape'.

[Sources: Treasury media release 22/08/2018; Final Report: Strengthening for purpose: Australian Charities and Not for profits Commission Legislation Review Report and Recommendations; ProBono News 23/08/2018]

Treasury has released a consultation paper setting out a proposed package of reforms for the administration and oversight of organisations with Deductible Gift Recipient (DGR) status.

Treasury has released a consultation paper setting out a proposed package of reforms for the administration and oversight of organisations with Deductible Gift Recipient (DGR) status.

Feedback is sought on the following reforms:

- 'the requirement for non-government organisations with DGR status to register as a charity with the ACNC from 1 July 2019
- transition arrangements to support existing organisations with DGR status to register as a charity with the ACNC

- the Commissioner of Taxation's discretion to exempt organisations with DGR status from the requirement to register as a charity in limited circumstances
- the abolishment of certain public fund requirements'.

Treasury states that The Australian Taxation Office and the ACNC will release guidance materials on the practical application of the proposed implementation of the DGR reforms in due course.

Commenting on the proposed reforms, Minister for Revenue and Financial Services Kelly O'Dwyer said: 'These sensible reforms will enhance the role of the Australian Charities and Not-for-profits Commission (ACNC), strengthen governance arrangements, reduce administrative complexity, and ensure continued trust and confidence in the sector'.

Timeline: Submissions will close on 21 September 2018.

[Sources: Minister for Revenue and Financial Services Kelly O'Dwyer 22/08/2018; Treasury media release 22/08/2018; Consultation paper; Deductible gift recipient reforms FAQs]

The AFR reports that the Australian dollar has rebounded after Scott Morrison was voted in as leader of the Liberal Party, Moody's Investor Service has reportedly said assuming 'the absence of significant changes in the nature and implementation of policies' there are 'no implications for Australia's sovereign credit profile.

[Source: [registration required]The AFR 24/08/2018]

In Brief | Consequences of a 'no-deal' Brexit? The UK Government has released a series of technical notices providing guidance on preparing for a no-deal Brexit. The FT reports that Dominic Raab, the Brexit secretary, conceded that there would be 'some extra regulatory' changes, but these would be offset by the opportunities for companies looking beyond the EU, though he is confident that a deal is in sight. In the meantime the EU has released a number of 'preparedness' notices of its own.

[Sources: The Guardian 23/08/2018; [registration required] The FT 23/08/2018; European Commission: Policies information and services: Communications Networks, Content and Technology]