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Australia to require companies to address the gender pay gap with financial penalties attaching for non-compliance? Legislation aimed at addressing the gender pay gap: *Equal Pay Standard Bill (2018)* has been introduced by independent MP Andrew Wilkie

On 26 November, the *Equal Pay Standard Bill (2018) Cth* was introduced into the House of Representatives by independent MP Andrew Wilkie. Mr Wilkie said that the aim of the Bill is to address the gender pay gap in Australia (currently at 14.6%).

Some Key Points

The Bill proposes to establish a system, modelled on a similar equal pay certification scheme in Iceland (*Equal Status of Women and Men Act*) whereby companies of a certain size would be required to obtain independent, annual certification that they are paying men and women equally and in accordance with an 'equal pay standard' (to be developed by the minister) with financial penalties for non-compliance.

More particularly the Bill proposes to:

- **Establish an 'equal pay standard':** The Bill would require the minister to develop an equal pay standard against which companies will be assessed. In his second reading speech, Mr Wilkie said that there is 'some flexibility' as to what is in the standard and how it is assessed, but as a minimum, that it must include a requirement that, when individuals receive different wages, that decision is based on considerations that do not include gender.
- **Employers required to obtain certification that they comply with the equal pay standard:** The Bill would require certain eligible employers to obtain certification once the standard is in place. Mr Wilkie said that the Bill is intended to 'apply across the whole economy, public and private, and to all employers with a workforce of 25 people or greater. It also applies to the Commonwealth as a whole. The certification would be obtained from a certification body (a class of organisations determined by the minister under the act, and which might be, for example, an auditing body). Certification is only valid for 12 months. Mr Wilkie said that the requirement for annual certification would provide a further mechanism (in addition to the financial penalty/withdrawal of certification outlined below) to ensure that employers address, and continue to ensure, they are compliant with the equal pay standard.
- **Financial penalty for failure to comply:** The Bill allows the minister to give a direction to an employer to do 'whatever is necessary to comply with the equal pay standard and a time frame in which to do so' with fines attaching for failure to comply with the direction (up to $52,500), and the option of removing a company's certification if it fails to meet its obligations to pay women and men equally.
- **The Bill would operate in addition to all current statutory requirements**, including the *Workplace Gender Equality Act 2012* (Cth), the *Fair Work Act 2009* (Cth) and the *Sex Discrimination Act 1994* (Cth).

Proposed timeline for implementation: Phased approach

It's proposed that the requirement for employers to have certification certificates would be phased in over time for smaller businesses: employers with a workforce of over 250 would be required to obtain a certificate by 1 January 2020; between 150 and 249 by 1 January 2021; between 90 and 149 by 1 January 2022; and between 25 and 89 by 1 January 2023.

[Sources: Equal Pay Standard Bill 2018; Explanatory Memorandum; Second reading speech]

Shareholder Activism

Partial win for Third Point? The WSJ reports that Campbell Soup Co and activist Third Point (Daniel Loeb) have reached a settlement.

As previously reported in Governance News (see: Governance News 05/11/2018) activist Third Point LLC has been waging a campaign to install its own nominees on the board of Campbells Coup Co (Campbells) since September. Ahead of the AGM, a deal has reportedly been reached whereby:

- Campbells will expand its board to include two Third Point nominees (former Blue Buffalo CEO Kurt Schmidt and Comscore President Sarah Hofstetter);
- Third Point will be allowed some say in the appointment of a third director;
- Third Point will be allowed some say the selection of a new CEO;
- Third Point will also be invited to present at two board meetings and two meetings with the CEO within the next year.

In exchange, Third Point has agreed to withdraw its director slate (5 nominees, which had the backing of ISS) drop a lawsuit it had filed against the company and refrain from launching a proxy fight for 12 months.

The WSJ comments that the terms of the deal are similar to the offer made by Campbells to Mr Loeb earlier in the month (which was rejected by Mr Loeb at the time). The outcome, The WSJ suggests, highlights the difficulties for activists in targeting heavily family owned companies. Given the Campbell's founder's descendants hold such a sizeable stake, it is difficult for activists to secure sufficient shareholder support to succeed (even in this case with the support of one of the descendants).

[Sources: [registration required] The WSJ 26/11/2018; CNBC 27/11/2018]

Institutional Shareholders and Stewardship

In Brief | Geraldine Buckingham has been appointed as the new chair and head of BlackRock Asia Pacific. She will take up the role from February 2018. Ms Buckingham's appointment comes as BlackRock continues to consider Asia-Pacific one of its 'most critical priorities', according to chairman and CEO Larry Fink.

[Source: BusinessInsider 26/11/2018]

Meetings and Proxy Advisers

First strike at Harvey Norman Holdings Ltd AGM: 50.63% vote against at the adoption of the remuneration report.

At last year's AGM, 23.07% of the shareholder votes went against the adoption of Harvey Norman's remuneration report, falling shy of the 25% threshold for a first strike to be registered. This year, the remuneration report received a 50.63% 'against' vote.

The Australian reports that Mr Harvey appeared 'nonplussed' by the result, commenting 'Hopefully they will vote for us next time. I don't see why they voted this way. It could be not enough females or independent directors on the board.'

Little change to remuneration practices? Commenting ahead of the AGM, Glass Lewis noted that there has been little change in the company's remuneration practices, despite shareholder concern, in FY2018. According to Glass Lewis, the fixed components of the remuneration package of CEO, Kay Page (who is the wife of the Executive Chair, Gerry Harvey) is around 50% higher than the median for CEO's of Harvey Norman's index peers. Two other Executive Directors receive fixed remuneration comparable to the median for CEO's of Harvey Norman's index peers.

Other shareholder concerns contributed the result? Media reports suggest that other matters of shareholder concern may have contributed to the high 'against' vote. These include: the lack of board independence (5 of 9 board members are insiders, and the independence of the remaining four has been questioned given their long tenure and related party relationships); the lack of board diversity (the board has only one female representative); lack of board renewal (the board is unchanged since 2017); losses arising from non-core investments (eg investment in dairy farming), the accounting treatment of loans to franchisees and the company's financial performance more generally.

[Sources: Harvey Norman Holdings Ltd ASX Announcement: Results of Meeting 27/11/2018; [registration required] The AFR 28/11/2018; Glass Lewis blog 09/11/2018; News.com.au 27/11/2018; [registration required] The Australian 28/11/2018]

Setback for Premier's campaign for board change at Myer: Myer received a second strike, but the board spill motion was not carried

37.49% of shareholders voted against the remuneration report at the Myer AGM, giving the company a second 'strike' and triggering a board spill. However, the spill motion failed to be carried with only 35.93% support.

The result came in the context of long campaign by Myer's largest shareholder Premier Investments (Solomon Lew) for board change and for change in strategic direction at the company. In announcing the result, Myer Chair Garry Hounsell said that it demonstrated shareholders' support for the Myer board, for the strategic direction that the board have adopted and for CEO John King. He also said that by failing to support the spill motion, shareholders had ensured that 'anyone wishing to take over this Company will have to pay shareholders a control premium'.

Commenting specifically on the vote against the remuneration report Mr Hounsell said that the board is 'obviously disappointed….particularly given the support received from governance experts including all leading proxy advisors a well as the Australian Shareholders' Association' and that the company will consult with shareholders on any improvements or changes in approach for next year. He added that the board is 'in no doubt' that the results reflects 'broader issues'.

[Sources: Myer ASX Announcements: Chair's address 30/11/2018; Results of 2018 Annual General Meeting 30/11/2018; [registration required] The Australian 27/11/2018; 27/11/2018]

Markets and Exchanges

The ASX is consulting on a 'major package' of proposed changes to the ASX Listing Rules to 'simplify, clarify and enhance the integrity and efficiency' of the rules.

ASX Limited (ASX) has released a consultation paper: *Simplifying, clarifying and enhancing the integrity and efficiency of the ASX listing rules* seeking feedback from listed entities, investors, advisers and other stakeholders on what it describes as 'a major package of proposed listing rule amendments'.

Proposed Changes

Proposed changes include the following (among others).

- **Measures intended to improve market disclosures and other market integrity measures:**
  - **changes to standardise the disclosure of voting results** at meetings of security holders
  - **expanding the 'good fame and character' requirement** in the conditions for admission as an ASX Listing (rule 1.1 condition 20) to cover an entity's CEO or proposed CEO as well as its directors and proposed directors
  - **new education requirements** for persons responsible for communication with ASX on listing rules issues (completion of a new 'approved listing rule compliance course')
  - **changes to quarterly reporting:** requiring rule 4.7B quarterly reporters to lodge quarterly activities reports and introducing new informational requirements for quarterly activity reports to help ensure entities are 'more accountable' for the 'use of funds' statements and expenditure programs included in their listing prospectuses and PDSs and to be more transparent about quarter-to-quarter differences in projected and actual cash outflows and about related party payments

- **changes to 'improve' and standardise the disclosure by listed investment companies and listed investment trusts of their net tangible asset backing**
- **introduction of a new requirement for listed entities to disclose the closing date for the receipt of director nominations to the market**
- **amending various rules to achieve consistent disclosure of the key features of underwriting agreements**

- **Measures intended to make rules simpler and easier to follow:**
  - **Announcing issues of securities and seeking their quotation:** 'simplifying and rationalising' the current process for announcing issues of securities and applying for their quotation.
  - **Working capital:** 'clarifying' the working capital requirement for assets test listings by adding a definition of 'working capital' in rule 19.12 and amending the 'working capital test' in rule 1.3.3 to make it clearer and easier to apply. ASX writes that the changes make 'explicit what is currently implicit in rule 1.3.3 that an entity must set out in its listing prospectus, PDS or information memorandum the objectives it is hoping to achieve from its capital raising and listing, so that it can then confirm it has adequate working capital to achieve those objectives'.
- **Measures to enhance ASX's powers to operate the market and to monitor and enforce compliance with the listing rules** including for example: adding a new rule 18.8A giving ASX the power to 'formally censure a listed entity that breaches the listing rules, or a condition imposed under the listing rules, and to publish the censure and the reasons for it to the market' and adding a new rule 18.5A to make it clear that ASX can 'exercise, or decide not to exercise, any power or discretion conferred under the listing rules in relation to an entity in its absolute discretion. The new rule will also make it clear that ASX may do so on conditions and, if it does, the entity must comply with the conditions'.
- **Various measures intended to make aspects of the listing process and ongoing compliance with the listing rules more efficient for issuers and for ASX**
- **Changes to the timetable for corporate actions**
- **Various changes to correct gaps or errors in the listing rules and make general drafting improvements** (including removing redundant rules) as well as to provide 'more and better guidance'.

Timeline: The deadline for submissions on the proposed reforms is 1 March 2019. ASX will then consider all submissions it receives in response to this consultation before finalising the proposed rule amendments and related guidance. Subject to the receipt of the necessary regulatory approvals, ASX plans that the final rule amendments and amended guidance will be released in May 2019 and will take effect on 1 July 2019.

[Sources: ASX media release 28/11/2018; Consultation Paper: Simplifying, Clarifying and Enhancing the integrity and efficiency of the ASX listing Rules 28/11/2018; Proposed Changes to the ASX Listing Rules (in markup)]

Regulators

Australian Securities and Investments Commission (ASIC)

Treasury is consulting on possible changes to ASIC registry fees (as part of the broader modernisation of business registers)

Treasury has released a discussion paper seeking feedback on the way in which to certain Australian Securities and Investment Commission's (ASIC's) registry fees could be simplified, streamlined and made more equitable. Treasury writes that the reforms being introduced as part of the 'Modernising Business Registers Program' (and in particular changes associated with moving ASIC administered registers onto a new and more modern platform administered by the ABR within the Australian Taxation office) provides both an opportunity to review both the quantum and nature of certain fees as well as a chance to ensure the business registers are funded sustainably into the future.

[Note: The government recently consulted on draft legislation, the *Commonwealth Registers Bill 2018* which proposes to create a new Commonwealth business registry regime. The draft legislation proposes to move certain existing legal registers administered by ASIC onto a single platform to be administered by the Australian Business Registrar (ABR) within the ATO. This includes the registers for companies, business names, ABNs and others. While ASIC's registry functions will be shifted to the ABR, ASIC will continue to administer all of its regulatory functions under the current ASIC laws. See: Governance News 05/11/2018]

ASIC registry fees in scope: The consultation is limited to the imposition of certain fees. These include: fees for annual review, registration application, late lodgement, review and payment, business name registration and renewal and search fees are in scope of the consultation. ASIC states that the review is not considering the levies and fees for service associated with the ASIC Industry Funding Model (IFM) IFM or possible fees for director identification numbers or an ABN.

Options for reform outlined in the discussion paper include:

- **Reforming registration and review fees to better account for entity size:** This could include charging different fees for large and small businesses.
- **Simplifying late fees:** Options could include replacing late payment fees with an interest charge to apply after 30 days have elapsed or increasing the penalty fees for late lodgement of annual review information (keeping the register up to date) and to lower fees associated with late payments of money from the annual review process.
- **Simplifying or removing search fees for digital interactions:** This could include abolishing fees for searches of publicly available electronic information held on the modernised business register. Treasury suggests that some search fees may be maintained in a modernised register as older data may continue to be stored in out of date paper-based methods. Due to the overhead of managing paper-based data, search fees could be maintained on a small range of activities that cannot be provided through an automated data process.
- **Introducing an infrastructure fee for users of the modernised registry services:** An infrastructure fee is being considered as a charge on the use of an API or comparable technology. An infrastructure fee could be structured based on the existing Department of Home Affairs Document Verification System model and comprise a one-off entry fee and a transaction fee (where the rate per transaction falls as the number of transactions increases). Other options could include the introduction data-usage based fees such as those that currently apply to phone or internet data plans.

Deadline for submissions: The closing date for submissions is 21 December 2018.

Proposed timeline for fee changes? Treasury writes that the consultation will feed into the Modernising Business Registers Program business case for Government consideration in 2019. Any changes to the current fee regime will be implemented 'over the longer term' as part of the Modernising Business Registers Program (which includes the following reforms: Australian Business Number system, introducing director identification numbers, reducing phoenixing activity, implementing a digital identity framework). Any changes to fees will also need to factor in the 'state of the ASIC mainframe' Treasury writes.

[Sources: Assistant Treasurer Stuart Robert media release: 28/11/2018; Treasury media release 28/11/2018; Discussion paper: Modernising Business Registers Program Review of Registry Fees 28/11/2018]

Australian Prudential Regulation Authority (APRA)

Further consultation on the introduction of leverage requirements for ADIs: In response to industry feedback APRA proposes to lower leverage ratio requirements and give ADIs more time to comply.

The Australian Prudential Regulation Authority (APRA) has released its response to submissions on the introduction of a leverage ratio requirement for authorised deposit-taking institutions (ADIs) and has released a revised draft *Prudential Standard APS 110 Capital Adequacy* for consultation.

Timeline: The deadline for submissions is 22 February 2019.

Changes made in response to feedback

The ratio, which measures the proportion of an ADI's assets that is funded through equity rather than debt is designed to supplement risk-based capital requirements by providing stakeholders with an alternative perspective on ADI's capital strength. According to APRA, the majority of submissions received were broadly supportive of the introduction of a minimum leverage ratio, but a number of submissions raised concerns about the minimum requirement and calculation methodology.

In response, APRA has proposed to:

- set the minimum leverage ratio requirement for larger ADIs (ADIs using the internal ratings based approach (IRB ADIs) at 3.5%, rather than its initially proposed 4%.
- keep the leverage ratio for ADIs that use the standardised approach to determine capital adequacy (standardised ADIs) at 3%;
- allow standardised ADIs to use Australian accounting standards, rather than the more complex Basel III methodology, to calculate certain parts of the ratio; and
- require IRB ADIs to largely follow the Basel III methodology to calculate their leverage ratios.

Small ADIs that qualify for the simplified prudential framework will be exempt from the leverage ratio requirements. Although still consulting on its final design, APRA is considering an eligibility threshold for the simplified framework of $15 billion in total assets, which will be complemented by other qualitative measures. Small ADIs will still be required to report to APRA under the new reporting standard ARS 110.1 *Leverage Ratio.*

Extended timeline for implementation: APRA also announced that it is proposing to extend the timeline for implementation of a range of revisions to the capital framework for ADIs (including the proposed leverage ratio) for twelve months (ie the proposed implementation date has been moved from 1 January 2021 to 1 January 2022). This will align the implementation of the leverage ratio with the broader revisions to the risk-based capital framework.

[Sources: APRA media release 27/11/2018; Response to submissions: Leverage ratio requirement for ADIs; Draft Prudential Standard APS 110 Capital Adequacy (changes marked); Draft reporting standard ARS 110.1 Leverage Ratio]

Corporate Social Responsibility and Sustainability

UN calls for banks to align themselves with the SDGs and the Paris Climate Agreement to rebuild trust: UN Principles for Responsible Banking have been released for a six-month public consultation period

The United Nations Environment Protection (UNEP) Principles for Responsible Banking (Principles) were released for a six month public consultation period on 26 November. UNEP writes that community trust in banks lost during the global financial crisis is yet to be rebuilt, and in the face of society's changing needs, demands and expectations banks should act to align themselves with community's 'shared direction' as expressed in the Sustainable Development Goals and The Paris Climate Agreement.

Development of the Principles: The Principles were developed by 28 banks jointly representing more than USD 17 trillion in assets continents (including Australian banks Westpac and NAB), and on behalf of the wider UNEP FI membership. 12 civil society organizations, including Oxfam International, 2 Degrees Investing Initiative and WWF, also assisted in the development of the Principles.

Some Key Points

- The six Principles are designed specifically for banks. They are:
    1. Alignment of business strategy with 'society's goals as expressed in the SDGs, Paris Climate Agreement' and other frameworks.
    2. Continuously increase positive impacts while reducing negative impacts.

3. Work responsibly with clients and customers to create shared prosperity for current and future generations
4. Consult, engage and partner with relevant stakeholders to achieve society's goals
5. Implement commitments through effective governance and setting targets
6. Commit to transparency and accountability (public reporting) of both positive and negative impacts, and contribution to society's goals

- Any bank, regardless of its starting point, context or size, can become a signatory.
- The Principles are intended to provide the banking industry with a single framework that 'embeds sustainability at the strategic, portfolio and transactional levels and across all business areas'.
- The primary objective of the principles, the UNEP writes, is to align banks community expectations as expressed in the Sustainable Development Goals (SDGs) and the Paris Climate Agreement. 'The Principles are intended to set the global benchmark for what it means to be a responsible bank, create value for both society and shareholders, help banks build trust with investors, customers, employees and society and provide 'actionable guidance' for how to achieve this' UNEP writes.
- Banks are required to set and publish targets in line with society's goals, as expressed in the SDGs, the Paris Climate Agreement and relevant national frameworks, in the areas where they have the most significant positive and negative impact and to engage with key stakeholders on their impacts.
- The Principles are supported by an Implementation Guidance, which provides details of the rationale for each Principle and practical guidance on how banks can approach the implementation of the Principles.

Do they go far enough? BankTrack has welcomed the release of the draft Principles, but has questioned whether they are sufficiently specific to achieve change and whether they go far enough.

Johan Frijns, BankTrack director said: 'We understand the scale of the challenge to develop principles that are applicable to a wide range of banks, from 'beginners' to banks further advanced in dealing with the societal impact of their business. But the current draft principles appear to be developed somewhere in a windowless basement with broken clocks: even a casual glance outside, with climate breakdown and other ecological catastrophes rapidly unfolding, and with so little time left to fix things, shows that more than lofty Principles, we need concrete and rapid commitments from all banks to abandon business sectors that contribute to climate breakdown and other ecological disasters.'

BankTrack has called on institutions who endorse the principles to make 'concrete commitments' to:

- immediately end all financial support for new fossil fuel projects and develop a phase-out plan for their existing fossil fuel portfolios and be;
- be prepared to sever business relationships with all clients whose activities 'wreak havoc on the planet, people and communities, and drastically increase their current commitments on transparency and accountability'

[Sources: BankTrack media release 26/11/2018; UNEP Finance Initiative media release 26/11/2018; Principles for Responsible Banking]

Westpac has launched a new green deposit scheme, certified by the Climate Bonds Initiative, for large wholesale investors who want to back environmentally friendly projects

Westpac has announced the launch of the 'world's first' green Tailored Deposit scheme for large investors who want to back environmentally-friendly projects.

- The scheme will only invest in projects certified by the internationally-recognised Climate Bonds Initiative. All asset classes invested in annually to ensure compliance with its standards.
- Projects might include renewable energy, low-carbon transport, low-carbon buildings, forestry and land rehabilitation as well as waste and water projects. According to The AFR, The City of Sydney Council is the first investor and has committed $10m over five years.

- The green-tailored deposit product is a medium to long term investment product (1-5 years) with a minimum transaction amount of AUD $1m.
- The scheme will be open initially to wholesale investors, but may be expanded to others in future. Reportedly Westpac has said that it expects the other big banks will offer similar schemes going forward.

[Sources: Westpac media release 26/11/2018; [registration required] The AFR 25/11/2018]

United States | Employees increasingly expect the organisations for whom they work to take a stand on social issues, and to be 'good corporate citizens'

HR Drive reports that an annual poll of United States employees, which tracks the increase in expectations that employees have of their organisations and the rewards employers gain from being 'good corporate citizens', has found that US workers want more social responsibility from their employers:

- 70% think their companies should address societal problems (up from 63% in 2017).
- 85% of respondents said good corporate citizenship is important where they work. Respondents also want their employers to make a difference in their community (76%) and the world (72%).
- 52% expect their employer to solve problem (an increase from last year's 41%).
- The poll also examined employees' loyalty when their work is aligned with their values.
    - Among employees whose companies reflect their values, 85% described themselves as loyal, and 54% said they're willing to go well beyond their work's scope.
    - For the 61% of employees who felt their companies were not aligned with their values, 44% described themselves as and 4% said that they're willing to go above and beyond.
- Trustworthy leadership was found to be the most critical factor in creating alignment, with 93% of respondents saying it's important.
- Overall, the study found that the concepts of 'corporate citizenship' and 'corporate social responsibility' are 'undergoing a revival' with millennials in particular believing organisations should be partly measures by their corporate citizenship.

[Source: HRDrive 28/11/2018]

Financial Services

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

Top Story | Financial Services Royal Commission Round 7 (Policy) hearings: Week 2 Part 1

Week 2 Round 7 hearings: Week 2, Monday 26 November – 30 November Part 1

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) seventh and final round of public hearings commenced on 19 November and ran until 30 November. The focus of the hearings was on the causes of misconduct and conduct falling below community standards and expectations by financial services entities (including culture, governance, remuneration and risk management practices), and on possible responses, including regulatory reform. In addition, the hearings considered the role of the regulators, the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) in supervising the actions of financial services entities, deterring misconduct by those entities, and taking action when misconduct may have occurred.

A high level overview of some of the issues explored in the course of questions to ASIC Chair James Shipton, NAB Chair Ken Henry, NAB CEO and Managing Director Andrew Thorburn and AMP Acting CEO Michael Wilkins is below.

[Note: For coverage of the some of the issues to arise in the first week of Round 7 hearings (see: Governance News 26/11/2018]

Australian Securities and Investments Commission (ASIC)

Counsel Assisting challenged various aspects of ASIC's enforcement approach including: ASIC's failure to take enforcement action or delay in doing so, ASIC's approach to determining the appropriate remedy for a breach, the efficacy of ASIC's use of negotiated outcomes rather than litigation to resolve issues (and civil or criminal action has not been pursued in some instances) and ASIC's method of evaluating its own performance in relation to enforcement. Counsel Assisting also questioned whether ASIC investigators are too close to the institutions they regulate. For example, the practice of allowing institutions to fact check media releases prior to their release was questioned, Commissioner Hayne stating that 'ASIC should know what it alleges'.

In addition, Counsel Assisting questioned whether the relationship between ASIC investigators and institutions under investigation was too close (citing emails showing that ASIC commissioners appeared to be discussing enforcement proposals directly with senior representatives of the institution under investigation).

ASIC Chair James Shipton said:

- **Delays unacceptable:** Mr Shipton said that the delays in taking action should not have occurred in the examples identified by Counsel Assisting, but also identified lack of resourcing as a factor in causing the delay.
- **Mr Shipton agreed that ASIC had 'over-utilised' and 'over-relied' on negotiated outcomes in the past,** and had also historically focused on customer remediation at the expense of enforcement.
- **Enforceable undertakings:** In relation to enforceable undertakings, and community benefit payments in particular, Mr Shipton said 'I've asked the team to look very seriously at the utility of community benefit payments, but more broadly, what I've asked the team to look at is the utility and the appropriateness of enforceable undertaking and similar arrangements, given the fact that it's very clear to me that we need to be more agile, willing and faster in applying court-based enforcement actions'. Mr Shipton maintained however, that enforceable undertakings have a place, and remain appropriate as part of ASIC's overall enforcement approach, citing a UNSW study indicating that enforceable undertakings do have some deterrent effect.

[Note: The study Mr Shipton referred to appears to be an ASIC commissioned study: *The general deterrence effects of enforceable undertakings on financial services and credit providers.* See: Governance News 29/10/2018.]

Mr Shipton also suggested that the lack of certainty of outcome (in relation to litigation), the financial cost and lack of resources to pursue litigation were also important factors to be taken into account, though he acknowledged that the consequences of breaching an enforceable undertaking (an expression of 'disappointment' by the regulator in the form of a media release) are not strong enough. He added that he expected enforceable undertakings will be utilised less in future, given that ASIC will have access to a 'more effective penalty regime for that fundamentally important provision of s912A' of the *Corporations Act 2001 (Cth)* and that when they are used that they should include a 'forthright and robust admission of wrongdoing and responsibility'.

- **Commitment to taking more 'court based action':** Counsel Assisting noted that ASIC's submission in response to the Commission's Interim Report accepted that 'the proper starting point of enforcing compliance with the law is litigation'. Mr Shipton agreed that this is the case. He went on to say that ASIC will be 'testing the limits of the law more' going forward. 'I want to make it crystal clear we will be undertaking more court based actions. We will be more adventurous as it were in pushing points of law. We will be taking more let's call it risks because we now have through my direct engagement with the government more funding to do exactly that' Mr Shipton said.
- **Extension of the Banking Executive Accountability Regime (BEAR):** Asked what additional powers (that are not 'pending') ASIC needs, Mr Shipton reiterated his support for the extension of the BEAR to cover conduct. 'I am a very strong advocate of the BEAR regime being extended

across to our areas of responsibility and jurisdiction. I mentioned earlier that I believe that we should be having far more deterrent effect on business leaders in financial institutions and to better enable the efficiency of that deterrent effect having a BEAR regime that would apply to them would make a direct linkage and make that wish more effective' he said. More specifically, Mr Shipton agreed that the accountability obligations imposed by BEAR should mirror the sorts of conduct obligations imposed under the UK Senior Managers Conduct Regime. Asked whether ASIC should apply the BEAR regime to itself (as the UK Financial Conduct Authority is required to do under the UK regime) Mr Shipton appeared to agree in principle: 'I think it's an excellent suggestion…And I think it provides a good governance framework for regulatory agencies' he said.

- **Efficacy of the close and continuous monitoring (embedding ASIC staff within large financial institutions) program:** Asked about the efficacy of ASIC's new supervisory approach in which ASIC staff are embedded into large financial institutions, Mr Shipton said that he believed the scheme will be effective (though it has only been in place for a short time). He added that it had already been effective in highlighting that in some instances, the 'raw message' from ASIC was not being relayed to senior decision makers.
- **Does ASIC need additional oversight?** Asked for his views on the 2014 Financial System Inquiry recommendation that a Regulatory Assessment Board be established to monitor regulators, Mr Shipton said that he would prefer improving the current system on the basis that he believes it capable of delivering the same benefits/level of oversight as a regulatory board could achieve. The Commissioner asked: 'What I suggest to you is that it all just becomes self-referential. ASIC determines the base, judges itself against the base. What I want to ask of you is where is the intellectual rigour in that process?' Mr Shipton disagreed that there was no rigour in the process, stating 'I would submit that the intellectual rigour is that that baseline [for behaviour in the financial services sector once established] would be for everybody to see… If we can see those baselines and we – and the world can see those baselines improving, then that must mean that both the financial institutions themselves are improving, and it also must mean that the regulator is improving, and that is, I believe, an objective assessment'.

NAB

Questions to NAB Chair Ken Henry and NAB CEO and Managing Director Andrew Thorburn included questions on the themes of cultural change, the scope of board accountability and accountability within the organisation more broadly, and remuneration.

Remuneration

- **Why pay variable remuneration?** Mr Thorburn said that the shift away from fixed pay in the industry is attributable to two causes: aligning and incentivising employees to act to optimise the short, term financial interests of shareholders, and the need to 'compete in the global talent pool'. Asked whether the implementation of the Sedgwick recommendations had decreased the bank's ability to compete in the global talent pool, Mr Thorburn said that it hadn't but that this was because the change was implemented Australia-wide, and because the talent pool for the retail part of the bank is largely drawn from Australia. Mr Thorburn said that for other roles such as technology roles, there was a need to be 'competitive' in the financial package offered to attract and retain talent. In addition, Mr Thorburn said that in his view, profit might drive good or bad behaviours (depending on the way in which it is structured) and that it was important to be able to reward employees for exceptional performance (though he did not agree that the primary motivator for employees is money).
- **Revised remuneration structure for frontline staff:** The Commission heard that frontline staff continue to be paid an element of variable remuneration, but that the way in which performance is assessed has been revised in line with the Sedgwick recommendations to include a greater focus on non-financial measures. The Commissioner asked 'what message' employees subject to the revised pay structure would 'take away from it' and what 'behaviours' Mr Thorburn regards 'this system as reinforcing'. Mr Thorburn said that the message employees would take away is 'firstly, achieving in a number of areas is very important. Second, those areas, at least 50 per cent of them are about the customer and their relationship and their engagement with us, not what we're selling them, to come back to that term. And thirdly, that the risk elements of a person's role must be very clear and it is

their own personal responsibility to understand them and to achieve them'. In terms of the behaviour he regards the system as reinforcing, Mr Thorburn said that he believes the plan reinforces 'our values' (a focus on building a relationship with the client, that the bank is winning more business and that risk is 'my responsibility'). Counsel Assisting suggested that the inclusion of some non-financial targets is not viewed by the lender as 'problematic' on the basis that there is a more holistic assessment of the employee's performance, that its expected that leaders will instil in employees the right type of culture (in terms of dealing with customers) and on the basis that the target is not a 'pure dollar value target' to which Mr Thorburn agreed. Asked whether the changes made to the remuneration structure in line with the Sedgwick recommendations had adversely impacted staff performance Mr Thorburn said he hadn't heard 'anything to that effect'.

- **Would NAB consider moving to a fixed pay structure for frontline staff?** Mr Thorburn said that NAB 'should consider it' but that it would need to be considered carefully. 'I would still be a bit worried if we did it – we would have to think through the unintended consequences but one of which would be – you know, you've got really good bankers, and I think being able to recognise them with an incentive payment – let's say they're at 10 per cent and you could give them 1.5 times that so they get 15 per cent, I think that's a – that's a good thing' he said.
- **Stop the practice of charging ongoing fees for advice?** Counsel Assisting asked a number of questions in relation to charging clients ongoing advice fees for provision of financial advice, suggesting that charging ongoing advice fees, is in effect 'rebranding' grandfathered commissions, 'traditionally you got paid a commission because you were part of a distribution network, and you didn't have to provide a service, and now it has been rebranded as a fee for service but you're still not providing a service' he said. Industry wide, Counsel said, there is an issue of services not being provided in exchange for the ongoing fee. He suggested that one way of addressing this would be to cease the practice. Mr Thorburn responded that this would 'be a dramatic way to fix it', adding that the issue was not the fee itself but rather the appropriateness of 'controls' to ensure the service is provided in exchange for the fee. 'I think having fees for certain services that you're clear with your client around and then are provided is a possible very legitimate commercial activity that a bank could do' he said. He added that he did not 'have a fundamental problem' with clients paying an ongoing fee for financial advice on a monthly or quarterly basis, 'if the fee is $12,000 a year that could be paid $1000 on a monthly basis' he said.
- **Would NAB consider moving to a fixed pay structure for executives?** Mr Thorburn said that he would have 'some concerns about abolishing it because I think it would make our sector – which is a very important one for Australia – less competitive and I don't think we would be able to retain and attract the talent we need to make our banking system really excellent'. Mr Thorburn also explained that 60% of executives' variable remuneration will now be deferred for 4 years and that the board retains discretion to withdraw it over that time.
- **Changes to executive remuneration:** Dr Henry was asked a number of questions in relation to changes made to the way in which NAB executives are remunerated, Counsel Assisting questioning the reasoning behind NAB's current approach (where the short term and long term variable reward schemes have been collapsed into a single form of variable remuneration), the transparency of the 'hurdles' involved and whether it incentivises the appropriate behaviour/the effectiveness of the scheme in holding executives accountable. Commenting on current remuneration scheme, Dr Henry said 'NABs view clearly today is that incentives should be aligned with customer experience – customer outcomes, to be clear…That instead of positioning the business in this way, that the purpose of the business should be to maximise shareholder returns subject to customer tolerance and subject to regulatory tolerance, that, rather, the purpose of the business should be about maximising the outcomes for customers subject to financial viability. And it is a rather profound distinction'. Dr Henry acknowledged that the new scheme had had a mixed response from shareholders, fund managers and proxy advisers some of whom had expressed support, and some of whom would prefer that no change had been made. Dr Henry also rejected the view that the scheme rewards short-term performance. Separately, Dr Henry was also asked whether the decision not to reduce executive bonuses in light of the issues identified, demonstrated 'intolerance' of issues, Dr Henry said that the decision not to do so was justified.

- **Operation of the two strikes rule:** Asked whether the two strikes rule 'requires boards to focus too much on financial measures in the design of their remuneration systems at the expense of measures that are directed to things like reducing the risk of misconduct or ensuring good outcomes for customers' Dr Henry said that he agreed. Asked what changes he would make to the rule, he said: 'boards have to accept that they have an accountability for matters which go beyond the financial performance of their business within a particular year, and the share price performance in a particular year. I think that – I think that that's the case. I do think that's the case. How that is operationalised in a way that has the relevant stakeholders holding the board accountable for its performance, I don't know. And that really is, in my view, your challenge, and I think it's really hard. I think it's really hard'.

Culture and the Role of the Board

A number of questions to NAB Chair Ken Henry focused on the issue of board accountability, the scope of board oversight/responsibility and the board's role in 'prescribing' the culture of an organisation.

- **Can boards 'prescribe' culture?** Asked whether it's 'appropriate or even possible to prescribe a particular culture for financial services entities?' Dr Henry said that in his view it is not, but that regulators in Australia and overseas are increasingly taking 'a keen interest' in the culture of financial institutions. Dr Henry also questioned whether the board can 'ensure' a particular culture 'We have said consistently to APRA the word "ensure" is a bit strong. It's really difficult for a board to be held accountable for ensuring anything, just as it's rather difficult to hold APRA to that – to that standard of ensuring an appropriate risk culture' he said. He said that the board 'has the principal role to pay in respect of the development of the culture of the organisation' but that 'ensure is a bit of a strict standard'. 'Model, lead, encourage, those words are…more obvious than "ensure" he said.'
- **Role of the regulators in relation to culture?** Asked to comment on the role of regulators in this context, Dr Henry said that in the context of banking, culture is best overseen by APRA (rather than an ASIC) and that it is appropriate that the regulator take an interest in the form of questioning, challenging, nudging and through issuing prudential standards eg CPS 220 Risk Management (ensuring the board has formed a view of the risk culture within the organisation). Asked what more regulators could do, Dr Henry said that 'APRA has done more' for example requiring all banks to undertake a review of their own organisations following the release of the prudential review into the CBA. He added 'I think also through its leadership of the industry through its supervisory practices, APRA can influence the culture of institutions. And I think it is occupying that space'.
- **Assessing whether the desired culture had been achieved?** Asked how he will assess whether the desired culture has been embedded at NAB, Dr Henry said that he would assess it by reference to the information about various form of risk, in monthly risk reports from the Chief Risk Officer, through tracking improvement in the net promoter score, and decrease in the number of complaints and through directors visiting branches and talking to staff where there are instances of poor conduct. Asked how long it would take to embed the desired culture at the lender, Dr Henry said it would take up to 10 years. Counsel Assisting challenged whether these measures would be sufficient to monitor improvements.
- **Boards should be accountable to the community (rather than purely to shareholders):** Asked to whom boards should be ultimately accountable, Dr Henry said that they should be accountable to shareholders, to customers, and to the community 'now and our future community'. Asked how boards could 'achieve that accountability' Dr Henry said that it could be achieved through 'governance of the organisation' and more particularly, by boards accepting that they are accountable to the community rather than purely to shareholders.
- **Level of detail required in communications to the board:** Counsel Assisting asked a number of questions in relation to the level of detail provided to the NAB board and risk committee in relation to risk issues, Counsel alleging that there had been delay in the past (in the example under discussion) in escalating/reporting, and questioning whether the level of detail reported was sufficient given there was no explanation of the issue/background to the issue being reported or the business it related to, the root cause or details of possible contraventions of the law/possible penalties. Asked whether the 'inadequacy of information has been fixed in those reports' Dr Henry responded 'I certainly hope it has been fixed....there is always a risk that issues are not being elevated to the

board that the appropriate time and in the appropriate form.' He went on to say later, that 'there's an expectation…that management is doing it [reporting] in the interests of the corporations, and that what…management needs from the board is guidance on particular issues, but not every matter', as such there is an element of risk that 'not every matter gets presented to the board in a way that would alert the board to the importance of the question'.

- **Role of the board in challenging management:** Dr Henry was asked a number of questions in relation to the way in which particular matters were escalated and managed and more particularly, what the organisation, and the board could have done differently. A number of questions centred on whether the board could have stepped in earlier, to challenge the way in which management was addressing a particular issue. Dr Henry agreed that the board could have stepped in sooner in that instance, though he did not agree that the board had not challenged management. Counsel Assisting queried this, given (precise) details of the exchanges were not reflected in board minutes.
- **Clarification of the law is needed on when organisations should act?** The Commission heard that 'it has typically been the case' at NAB, that risk matters may not have been reported to the board/risk committee until after discussions with ASIC. Asked whether this practice (ie advising ASIC before the risk committee) should change, he agreed that it should. He added that 'I wonder whether it's necessary, in all occasions, to negotiate with ASIC at all, rather than simply notify and get on and fix it'. He went on to say that the 'habit' of negotiating an outcome with ASIC had 'contributed to an insufficient pace of remediation for customers'. Dr Henry suggested that in this context, clarification of the law would assist the organisation to be able to take action (without waiting for direction from ASIC): 'I have wondered whether in this case NAB should not have, years ago, funded some of our customers to take us to this place, to this Federal Court and get an outcome…The Commissioner of taxation behaves in this way quite a lot. He has a budget to fund lawsuits against himself, in that case to provide law clarification – clarification of the law'. The Commissioner asked whether clarification is necessary: 'The triplet which I never get in the right order in 912A is honest, efficient, fair? Those ideas are ideas of disarming simplicity. The board, above all else, will have its view, will it not, about efficient, fair and honest? And if what has happened contravenes that standard, does it not follow inexorably that something needs to be done about it?' Dr Henry responded, 'It seems simple when you say it. It's pretty challenging, really, for boards. It is pretty challenging. And maybe that's – maybe that's it. Maybe it's as simple as that'.

AMP

Questions to AMP's acting CEO Michael Wilkins included questions in relation to the issues of vertical integration, preventing fee for no service issues, the issue of fees more generally (ongoing advice fees and grandfathered commissions) and the possible extension of the Banking Executive Accountability Regime among others.

Extension of the Banking Executive Accountability Regime (BEAR) to insurance and superannuation?

The Commissioner asked Mr Wilkins, whether 'in respect of an organisation like AMP that engages in a number of different financial services, that there would be advantage in having an accountability regime that was not restricted to banking?'. Mr Wilkins agreed, adding that AMP has made the decision to implement some BEAR requirements (remuneration aspects) across 'the organisation, rather than just to the bank'. The Commissioner asked whether 'apart from the remuneration consequences which have their particularly important part to play in BEAR, just accountability mapping and accountability statements, are those steps that would have value in AMP in its activities beyond banking' (ie in superannuation and insurance) to which Mr Wilkins agreed, 'there would be benefit from that. And I think some of the overseas models where similar arrangements have been put in place apply to – to broader areas of conglomerates' he said.

Vertical integration

The Commission heard that AMP remains committed to the vertical integration model, 'we believe in vertical integration. We think it's – it's a – an appropriate structure that does have benefits for the consumer as well' Mr Wilkins said. Mr Hodge outlined a number of advantages the model has for customers including: affordability of advice 'because of the greater scale that's…afforded'; 'comfort and confidents' for customers in dealing with a 'large integrated organisation knowing that that organisation will stand behind the advice…and remedy any issues…that may emerge; and the benefit of advisers having access to the 'feedback loop' which allows them to 'feedback back into the product manufacturing component' feedback concerning the appropriateness of products. Counsel Assisting challenged this reasoning, and questioned more generally whether conflicts can be addressed within a vertically integrated model. Mr Wilkins said that 'advisers do have a best interest obligation, and I don't think that it naturally follows that they do not exercise that best interest obligation if they're in a vertically integrated group, or that the risk of them not doing that is any less if they are in an independent role'.

Fees

A number of questions to Mr Wilkins concerned the approach taken to identifying, reporting and addressing fee for no service issues, including in relation to how these issues can be prevented going forward.

Ongoing fees for financial advice

- Mr Wilkins acknowledged that in past, 'policies and procedures' to educate financial advisers on the need to ensure service was provided in exchange for ongoing advice fees were inadequate, and that it is a 'normal expectation' that where a fee is paid a service should be provided. Mr Wilkins detailed a number of changes implemented at the organisation to address the issue, and maintained that that there is now acceptance within the organisation that the conduct is unacceptable.
- A number of questions were asked in relation to ongoing advice fees generally including in relation to whether advice is necessary/has value and whether the fee is sufficiently transparent to customers. Mr Wilkins maintained that that ongoing advice has value stating that 'each customer is different, and their needs are different, and what we need to be able to do is to make sure that the product and service offerings that we have, particularly the service offering, caters to that need'.
- Asked about ongoing fees in relation to superannuation products, Mr Wilkins said that it would depend on the product, as to whether advice fees are justified. For MySuper products he said that there no ongoing advice fees should be paid, but for self-managed superannuation funds, it was appropriate.

Phasing out grandfathered submissions

Mr Wilkins was asked a number of questions in relation to AMP's submission to the Commission's Interim report which maintained that grandfathered commissions should not be banned. He explained that since the response was submitted, AMP has amended its position and are 'now saying that we favour a phased approach to the removal of grandfathered commissions'. Time would be needed, Mr Wilkins said 'for advisers to be able to go and make alternative arrangements with their customers to change the basis of their remuneration from their grandfathered commissions to a more contemporary fee for service type arrangement'. Asked how long would be needed, Mr Wilkins said that 'one year would be too short. Three years would probably be the maximum'.

Accountability and oversight of financial advisers

- **Adherence to Australian Banking Association protocols are sufficient:** The Commissioner asked Mr Wilkins for his view generally on how the industry, 'or the law generally should deal with the problem of the so-called rolling bad apple, that is, the adviser who is not sufficiently competent or engages in conduct of a kind that the advice licensee condemns, moves from business to business?' Mr Wilkins said the in his view 'there should be more protocols for that in place' adding that AMP was an 'early adopter' of the Australian Banking Association (ABA) 'protocols…And I think that that's an appropriate protocol'. Asked whether this is 'sufficient', Mr Wilkins said that it is, 'I think it is a sufficient step, but there also needs to be better monitoring of the activities of those advisers and a – a quicker consequence from organisations where those advisers are not meeting the appropriate standards' he said.
- **Individual licensing?** Asked for his view, by the Commissioner, on whether individual licensing is 'simply a bureaucratic step too far, or a useful step?' Mr Wilkins said 'I think that it probably would be an overly bureaucratic step to go with that'. Counsel Assisting challenged this, querying why if they're [advisers] to be professionals' like doctors, engineers, lawyers and accountants individual licensing would be inappropriate. Mr Wilkins maintained that it would be an 'overly bureaucratic step at this time.'

[Sources: 23 November 2018 - Draft Transcript for Day 64; 26 November 2018 - Draft Transcript for Day 65; 27 November 2018 - Draft Transcript for Day 66; 28 November 2018 - Draft Transcript for Day 67]

Other Developments

Top Story | ASIC's buy now pay later review: ASIC's first review of buy now pay later industry has raised questions about the adequacy of consumer protections and calls, among other things, for the extension of the (proposed) product intervention power to all credit facilities regulated under the ASIC Act

The Australian Securities and Investment Commission (ASIC) has released its first review of the buy now pay later industry: *Report 600 Review of buy now pay later arrangements.*

Scope of the review

The review commenced in January 2018 and examined six buy now pay later providers: Afterpay, Zippay, Certegy Ezi-Pay, Oxypay, BrightePay, and Openpay. The review was based on independent consumer research, consultation with a range of stakeholders (including other regulatory agencies, consumer advocates and the two ASIC approved external dispute resolution schemes and the time and industry associations) and on information provided to ASIC by the providers.

Some Key Findings

- **There has been rapid growth in the industry:** The number of consumers has risen from 400,000 in FY2016 to 2m in FY2018; transactions increased from 80,000 in June 2016 to 1.9m in June 2018, the number of merchants offering Zippay and Afterpay has increased 50-fold and 45-fold respectively, over two years; revenue of providers has increased from $32m in 2016 to $78m in Q2 2018.

- **User-profile:** 60% of users of the scheme are young (between 18-37), 2 in 5 earn under $40k and 40% are students or work part time. More than 4 in 5 users who used the scheme in the last 12 months plan to do so again.

- **In some cases, buy now pay later arrangements result in the price of goods being inflated:** ASIC found that though each provider reviewed, contractually prevents merchants from charging consumers higher prices for using a buy now pay later arrangement, there was 'anecdotal evidence' that some merchants may have charged consumers 'significantly higher prices' for using the scheme including for: higher value purchases (purchases over $2000), where the price of goods is less transparent and 'negotiable' (eg solar power products) or where consumers are acquiring services.

- **The scheme appears to have influenced spending habits, with over-commitment a risk for some consumers.** According to ASIC, 55% of users spend more than they would have otherwise due to the design and speed of the sales process 'which can influence consumers to make a purchase without careful consideration of the cost'. ASIC found the scheme can increase the amount of debt held by consumers and contribute to financial over-commitment. For example, ASIC found that one in six users (16%) has become overdrawn, delayed another bill payment or borrowed additional money.

- **Limitations of customer protections?** ASIC notes that the consumer protections under the *National Consumer Credit Protection Act 2009* (National Credit Act) do not apply to buy now pay later arrangements (providers are not required to hold an Australian credit licence (credit licence) or to comply with the responsible lending obligations.) This means that ASIC has limited jurisdiction to regulate conduct and to address lending risks to consumers when they use a buy now pay later arrangement.

- **Extension of the (proposed) product intervention power to all credit facilities regulated under the ASIC Act?** 'We consider that ASIC's proposed product intervention power should apply to all credit facilities regulated under the *Australian Securities and Investments Commission Act 2001* (ASIC Act), which includes buy now pay later arrangements. This would allow us to act quickly and effectively to address the causes of problems if we identify a significant detriment to consumers that cannot be resolved through other action' ASIC writes.

[Note: The *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* proposes to enable ASIC to issue a 'product intervention order' if it is satisfied that a financial product or a credit product 'has resulted in or will, or is likely to, result in significant detriment' to consumers. If enacted (without amendment), product intervention powers would come into force upon Royal Assent. The Bill has progressed to second reading stage in the House of Representatives and is yet to pass the Senate. The Senate Economics Legislation Committee report, recommended that the Bill be passed. Labor Senators said that they intend to introduce amendments to 'strengthen ASIC's remit so that conduct in the industry can be elevated, which will ensure that we have a sector that consumers can engage with and place their trust in'. This includes extending design and distribution obligations and product intervention powers to 'all financial products specified in the ASIC Act', potentially 'amending the bill such that design and distribution obligations apply to credit products defined in the National Consumer Credit Protection Act' and amending the Bill 'so that ASIC be given standing under the design and distribution obligation regime to seek compensation on behalf of affected consumers who are non-parties to the legal proceedings'.]

- **Area of focus for the regulator:** ASIC states that it will take regulatory action to address misconduct and monitor industry and risks to consumers.
  - **'ASIC states that it is 'considering the legal position' of scenarios where a merchant inflates the cost** of the underlying goods if a consumer uses a buy now pay later arrangement. 'We have taken action against credit providers for attempting to avoid the National Credit Code by creating artificial business models and for engaging in credit activities without a licence' ASIC writes.
  - **ASIC writes that it is also 'monitoring' the issue of consumers becoming increasingly indebted** due to the ability to access an alternate providers where they have missed payments. According to ASIC, each provider reviewed takes some steps to refuse some credit applications eg if a consumer misses a scheduled repayment, five of the six providers suspend that consumer's ability to make additional purchases until they have remedied the missed payment. However, only one out of six providers in the review examined the income and existing debts held by consumers before providing their services. ASIC also received reports of instances where consumers were allowed to the service despite having limited or no income and substantial existing debt.
- **ASIC expectations of providers:** ASIC states that it expects providers to ensure that: (a) consumers adequately understand the terms of their arrangement; (b) a complaints process is visible and accessible for consumers; (c) consumers understand that they can request financial hardship assistance from their provider; and (d) merchants act consistently with guidelines supplied by the provider which limit how these arrangements may be promoted and provided to consumers. ASIC writes that 'while we identified instances where providers could have done more, each provider demonstrated a readiness to work with ASIC by improving their practices in response to our recommendations' and that some have already implemented 'several improvements'.

[Sources: ASIC Report: Report 600 Review of buy now pay later arrangements; ASIC media release 28/11/2018; ABC 28/11/2018; The SMH 28/11/2018; [registration required] The AFR 28/11/2018]

Consultation on draft legislation intended to provide eligible mutual entities with access to a broader range of capital raising and investment options (without risking their mutual structure or status)

Treasury has released draft legislation for consultation: (Exposure draft) *Treasury Laws Amendment (Measures for a Later Sitting) Bill 2018: Mutual Entities (Tranche 2)* which proposes to enable mutual entities, registered under the *Corporations Act 2001 (Cth)* (*Corporations Act*) to issue mutual capital instruments (MCIs) — a new type of bespoke share for the mutual sector — without risking their mutual structure or status.

Key Changes Proposed

- **The draft Bill proposes to introduce a new bespoke capital instrument** in the *Corporations Act* for all 'eligible mutual entities'. Eligible mutual entities are companies limited by shares, companies limited by guarantee and companies limited by shares and guarantee.

- **Enable eligible mutual entities to issue MCIs**. The draft Bill proposes to enable eligible mutual entities to issue MCIs without risking their mutual structure or status. This is intended, according to the explanatory memorandum, to provide mutuals with access to a broader range of capital raising and investment options.
- **Establish a standard process** to allow eligible mutual entities, to amend their constitutions to allow them to take advantage of the changes. It's proposed that the new process will only be available for a fixed period of three years (36 months) from the time the Bill receives Royal Assent and that a mutual entity can only try to make use of the process a total of three times. The ability to use the process up to three times has been included to provide for circumstances where a mutual entity comes close to, but does not get enough votes to make, the required constitutional changes.

Timeline: The deadline for submissions on the exposure draft of the legislation is 24 December 2018.

[Source: Treasury media release 26/11/2018; Exposure draft: Treasury Laws Amendment (Measures for a Later Sitting) bill 2018: Mutual Entities (Tranche 2); Explanatory Memorandum*]*

The Bill proposing to introduce increased civil penalties for white collar crime has passed the House of Representatives

Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 has passed the House of Representatives (with amendments) and will now move to the Senate.

Recap on the Bill: The Bill as introduced proposes to double the term of imprisonment from 5 years to 10 years for certain criminal offences. Civil penalties will also be increased 10-fold for corporations and 5-fold for individuals. The legislation will also expand the range of contraventions subject to civil penalties, and give the courts the power to seek additional remedies to strip wrongdoers of profits illegally obtained or losses avoided.

The amendments agreed are intended to clarify how the commencement of the strengthened penalty framework will operate with the commencement of certain legislation that is currently before Parliament or has recently passed Parliament; and to introduce or amend certain offences and civil penalty provisions. The amendments also make minor and technical amendments to ensure the infringement notice framework operates as intended.

Timeline: The increased penalties will apply to conduct that occurs wholly from the day after the day the Bill receives Royal Assent. The contingent amendments inserted into the Bill commence on the happening of certain events.

[Source: Supplementary Explanatory Memorandum]

Pressure building for more mergers in the superannuation sector? The Productivity Commission has found the case for 'economies of scale' in the superannuation sector is 'compelling'

Following the release of the draft report into the competitiveness and efficiency of the superannuation sector (see: Governance News 04/06/2018) in May, the Productivity Commission (PC) has released a supplementary paper: *Superannuation: assessing efficiency and competitiveness: supplementary paper - economies of scale* which has found that the case for economies of scale in the superannuation system 'is compelling'.

Some Key Points

- According PC estimates, annual cost savings of at least $1.8 billion could be realised if the 50 highest cost funds merged with the 10 lowest cost funds.
- Even 'modest economies' the PC writes can materially reduce costs. For example: a one basis point reduction in administration expense ratios for funds with more than $10 billion in assets would result in annual savings of around $130 million.
- Based on analysis of 70% of the system, the PC found 'little evidence' that scale benefits have been systematically passed through to members in the form of lower fees to date. Despite the realisation of economies of scale since 2004, the reduction in fees charged to members by the median fund did

not fall the PC writes. However, the PC suggests that some funds are likely to have passed through at least some of the scale gains in the form of member services, increases in reserves or the costs of new regulatory requirements. However, the PC notes that this cannot be tested nor established due to data constraints.

- Net returns were found to be positively related to size for not for profit funds, but no corresponding correlation was found for for-profit funds. The PC suggests that not for profit funds, on average, may have passed through some scale economies in higher returns (by investing more heavily in (higher cost) unlisted assets and securing higher returns as a result), but data limitations preclude a firm finding, the PC writes.

Commenting on the release of the PC paper, The Australian argues that it is evidence that the Australian Prudential Regulation Authority (APRA) should have done more to enforce best-interests duties across the sector by forcing mergers in the industry.

[Sources: Productivity Commission Supplementary Paper: Superannuation: Assessing efficiency and competitiveness: Economies of Scale; [registration required] The Australian 25/11/2018]

APRA quarterly superannuation statistics released

APRA has released its Quarterly Superannuation Performance publication and the Quarterly MySuper Statistics report for September 2018. As at 30 September 2018:

- Total superannuation assets totalled $2759.3bn (up 8.8% on September 2017)
- Total assets in MySuper Products totalled $695bn (up 13.9% on September 2017)
- Total self managed superannuation fund assets totalled $755.1bn (up 6.7% on 2017)

[Source: APRA media release 27/11/2018]

In Brief | Commitment to inclusive banking: The Australian Banking Association (ABA) has announced that banks have committed to new principles: *The Accessibility Principles for Banking Services* aimed at ensuring banking products are accessible for those living with a disability. The new principles cover all areas of banking, including general accessibility, digital channels such as websites and mobile banking, device design and use, telephone services, voice activated services or AI and specific areas related to customer authentication.

[Sources: The Accessibility Principles for Banking Services; ABA media release 30/11/2018]

In Brief | FASEA has released its policy on foreign qualifications as part of its revised standards for financial advisers for consultation. The deadline for submissions is 14 December 2018.

[Sources: FASEA media release: Foreign Qualifications Policy 29/11/2018; Draft policy statement]

Accounting and Audit

The government has agreed with the PJC recommendation to review the adequacy of auditor disciplinary functions

The Parliamentary Joint Committee on Corporations and Financial Services issued a Report on the 2016-2017 annual reports of bodies established under the ASIC Act on 16 July 2018. The Committee made one recommendation in its report: 'that the Government review the adequacy of auditor disciplinary function'. The government's response has now been released. The government has agreed with the recommendation stating, that 'A review of the avenues of auditor disciplinary functions will provide insights into these auditor disciplinary processes and may identify potential areas for improvement'.

No further details as to timeframe or details of the review were given.

[Source: Australian Government response to the Parliamentary Joint Committee on Corporations and Financial Services report: Report on the 2016-2017 annual reports of bodies established under the ASIC Act 30/11/2018]

United Kingdom | Increasing competition by challenging the 'big four' (or not)? Accounting firm BDO is reportedly set to become the largest firm outside the big four, assuming a merger with Moore Stephens goes through smoothly.

Accounting firm BDO and Moore Stephens are reportedly set to merge, which will make the enlarged firm the biggest in the sector outside the Big 4 (EY, PwC, Deloitte and KPMG) in the UK.

Head of BDO, Paul Eagland is quoted as stating that the merger will increase competition in the market — it 'creates a more powerful firm in the market to compete' he said. Mr Eagland also did not rule out future mergers stating 'we would love to talk to other firms who want to join the journey'.

The FT quotes academic Prem Sikka who is leading the Labour Party's review of the audit sector as questioning whether the new entity will be in a position to challenge the big four given it will only be about 30% as big as KPMG. Instead, he argues that restructuring the sector is the only way to address lack of competition.

[Sources: [registration required] The Times 26/11/2018; [registration required] The FT 26/11/2018]

Risk Management

Supply Chain Risk

Top Story | The Federal Modern Slavery Bill has passed both houses and will become law

The Federal *Modern Slavery Bill 2018* passed both houses, with amendments, on 28 November and will become law. An brief overview of the key changes and short recap of the Bill is below.

Recap: Mandatory Reporting requirements for large entities

As previously reported in Governance News (02/07/2018) the legislation will:

- **Introduce a Modern Slavery Reporting Requirement.** This will require businesses with annual consolidated revenue of more than $100m (including foreign entities carrying on a business in Australia), to publish annual statements on the steps they are taking to address modern slavery in their supply chains and operations. The Commonwealth is required to report on behalf of non-corporate Commonwealth entities, and the reporting requirements also apply to Commonwealth corporate entities.
- **Entities will be required to report on all modern slavery practices** criminalised under Commonwealth law (eg trafficking in persons; forced labour, forced marriage) in line with mandatory reporting criteria.
- **Reports will be kept by the Minister in a publicly accessible, online repository**, the Modern Slavery Statements Register.
- **Timeline:** The precise date at which reporting requirements commence will be fixed by proclamation to enable the government to align the requirements to commence at the beginning of either the Australian calendar year or the Australian financial year. This is also intended to allow entities time between passage and commencement of the legislation to identify whether they are a reporting entity and to become familiar with their obligations to comply with the Modern Slavery Reporting Requirement. The proclamation period is limited to a period of six months. If proclamation does not occur within six months after the Bill receives Royal Assent, the Bill will automatically commence the day after six months from Royal Assent.

Amendments: New compliance and oversight measures

The amendments are intended to establish 'an appropriate mechanism to address non-compliance'; strengthen parliamentary oversight of the implementation of the new reporting requirement, and to provide a 'clear pathway to future civil penalties if initial compliance rates are inadequate'.

- **Option for the Minister to name and shame non-compliant entities where there is 'serious non-compliance':** A new section (s16A) has been inserted which will empower the responsible

Minister to require suspected non-compliant entities to explain why they have not complied with the Modern Slavery Reporting Requirement and to undertake specified remedial action where the Minister requires it eg to provide a Modern Slavery Statement to the Minister or to revise a statement to address all the requirements set out in s13 or 14 of the legislation. Subsection 16A(4) provides that the Minister may publish the identity of the entity (and other details) on the Modern Slavery Statements Register 'or in any other way the Minister considers appropriate' if the entity fails to comply with the minister's request by either: failing to provide an explanation in relation to the Minister's request for an explanation; or failing to take remedial action in response to a request made by the minister to do so.

- **Annual reporting to parliament:** The Minister is required to report annually to the parliament about the implementation of the Modern Slavery Act including compliance trends. This is intended, according to the Supplementary Explanatory Memorandum to ensure there is 'ongoing monitory and evaluation' as well as to provide a mechanism to identify any amendments required before the three year review.
- **Review after three years to assess whether civil penalties are required:** the Legislation will be reviewed at the end of three years to consider the 'necessity and timing for future reviews and whether amendments are needed to include additional compliance mechanisms, such as civil penalties'.

Impact?

Commenting on the Bill, MinterEllison Partner Geraldine Johns-Putra, said that the passage of the legislation, and the inclusion of stronger oversight and compliance mechanisms in the legislation, reflects the huge support for modern slavery reporting politically and in the community. However, she noted that 'right up to the passage of the Bill, the question of including penalties in the legislation has arisen. Given the amendments to the bill, that debate continues notwithstanding passage of the Bill' she said. She added that companies should make full use of the three year period prior to review of the Act. 'Overseas experience has shown that although many companies take their obligations seriously, they do use the first year report as a learning opportunity and sometimes adjust their approach in the second year.'

Response

The Bill appears to have been broadly welcomed, but there appears to be strong support for both the introduction of civil penalties and the appointment of an Anti-Slavery Commissioner from some organisations.

- **Statement from the Business Council:** The Business Council issued a statement welcoming the passage of the legislation. Business Council CEO Jennifer Westacott said 'We congratulate the Parliament in establishing this important piece of legislation, which the Business Council has long supported. Modern slavery is abhorrent and business looks forward to continuing to work with the government on implementing the legislation…We believe greater transparency of supply chains will drive better practice and reveal which companies are working to maintain clean supply chains.'
- **Stop the Traffik** issued a media release welcoming the passage of the Bill as an important 'first step' but cautioning that 'it is only a start'. In particular, the organisation would like to see the appointment of an Anti-Slavery Commissioner and for other matters raised in the 'Hidden in Plain Sight' report to be addressed going forward.

[Note: For an overview of the issues raised in the Hidden in Plain Sight report see: *Modern slavery & global supply chain reporting: Gearing Up for Compliance* 18/06/2018]

- **Law Council of Australia President**, Morry Bailes has reportedly welcomed the passage of the Bill as an important step in eliminating slavery but has said that he would like to see the appointment of an Anti-Slavery Commissioner and a penalty regime to ensure accountability.
- **The Australian Council of Trade Unions** reportedly said that an Anti-Slavery Commissioner should have been appointed and expressed disappointment that civil penalties were not included.

[Sources: Schedule of Amendments; Modern Slavery Bill Supplementary Explanatory Memorandum; Business Council of Australia media release 29/11/2018; SBS 30/11/2018; Stop the Traffik media release 29/11/2018]

Cybersecurity

United Kingdom | Facebook confidential documents seized by the UK government as part of an investigation into Facebook's work with third party data providers

Reportedly, the UK parliament has seized Facebook documents that they believe will aid them in their Cambridge Analytica inquiry. The documents (which were reportedly obtained from a US businessmen whose company Six4Three is suing Facebook in the US) are believed according to media reports, to demonstrate that Facebook misled the US Congress about its role in the Cambridge Analytica incident (which revolved around the misuse of people's personal data).

Fortune reports that Facebook has complained to UK MP Damian Collins (culture and media chair) on the basis that the documents were supposed to be under seal, per US law. Mr Collins has reportedly responded that he has 'reviewed [the documents] and the committee will discuss how we will proceed early next week. Under UK law and parliamentary privilege we can publish papers if we choose to as part of our inquiry'.

The move to seize the documents follows Facebook CEO Mark Zuckerberg's repeated refusals to answer UK MP's questions. The Guardian comments that it is the latest in a 'struggle' to hold Facebook to account, and has raised concerns about the limits of UK authority over international companies like Facebook that now play a role in the democratic process.

Following the seizure of Facebook documents, Facebook's head of policy in Europe (and a former member of UK Parliament) Richard Allan appeared before an international 7 country committee (with representatives from the UK, Brazil, Ireland, Canada, Latvia, Argentina and Singapore) to answer questions in relation to disinformation on the social network after Facebook CEO Mark Zuckerberg refused to appear. Mr Allan reportedly faced a 'gruelling session' of questioning around the way in which Facebook handles user data and privacy. A seat at the meeting was reportedly left vacant with a card reading Facebook CEO Mark Zuckerberg's name, highlighting, CNBC suggests, the visible frustration with the company in the way it engages with lawmakers.

[Sources: The Washington Post 23/11/2018; The Guardian 25/11/2018; Fortune 26/11/2018; CNBC 27/11/2018]

United States | USPS data breach has reportedly exposed the data of 60m users

A flaw in a US Postal Service (USPS) API Informed Delivery (which enables users to track their deliveries) reportedly allowed a researcher to access millions of rows of user data by sending 'wildcard requests' to the server, exposing 60 million users' data. The specific flaw has since been addressed by USPS but TechCrunch queries what other vulnerabilities may 'crop up' in the API.

[Source: TechCrunch 26/11/2018]

Climate Risk

UN Climate risk report has found that existing current climate measures are inadequate to meet Paris Agreement targets

Global efforts to tackle climate change are falling short according to the latest *United Nations Emissions Gap Report*. The report assesses the latest scientific studies on current and estimated future greenhouse gas emissions (GHG emissions) and compares these with the emission levels permissible to achieve the goals set at the Paris Climate Agreement.

Some Key Findings

- **Current commitments expressed in the Nationally Determined Contributions (NDCs) are 'inadequate' to meet the Paris Climate agreement target.** If NDC 'ambitions' are not increased before 2030, exceeding the 1.5 degree goal can no longer be avoided, the report cautions.
- **Global greenhouse gas emissions show no signs of peaking.** Global CO2 emissions from energy and industry increased in 2017 following a three year period of no change and total annual GHG emissions including from land-use change, reached a record high.

- **Need for urgent action:** Global CO2 emissions increased in 2017 (after three years of no change), indicating that there is a need for countries to move rapidly on the implementation of their current NDCs and at the same time to be more 'ambitious' — there is a need for 'unprecedented and urgent action' to address the issue, the report argues.

Context: Paris Climate Agreement

The goal of the Paris Agreement on climate change is to keep global temperature rise this century to well below 2 degrees celsius above pre-industrial levels. It also calls for efforts to limit the temperature increase even further to 1.5 degrees celsius.

Scope of the report

The annual Emissions Gap Report includes an assessment of the emissions associated with the Nationally Determined Contributions and current policies of each of the G20 members, including the European Union. This is in addition to presenting an update on GHG emissions and national actions to meet the earlier Cancun pledges. The annual UN Environment Emissions Gap Report presents an assessment of current national mitigation efforts and the ambitions countries have presented in their Nationally Determined Contributions, which form the foundation of the Paris Agreement.

[Sources: The New Daily 28/11/2018; UN Emissions Gap Report 2018]

United States | The Trump administration has released a congressionally-mandated report on the effects of climate change in the US which has found that extreme weather events are set to worsen, and that existing inequalities between low income and higher income communities are set to widen, due to lack of action to address the issue. Reportedly President Trump has dismissed the report, saying 'I don't believe it'.

[Sources: Fourth National Climate Assessment Volume ii: Impacts, Risks and Adaption in the United States November 2018; CNBC 26/11/2018; CNN 27/11/2018; The Guardian 27/11/2018]

In Brief | Rio Tinto Chair Simon Thompson has identified failure to take action on climate change as a 'the greatest long term threat to Rio Tinto': 'Rio has been a pioneer in setting high environmental and social standards, and engaging with stakeholders. And it has been a pioneer, not just because it is the right thing to do, but because failure to do so would undermine our business model' he said.

[Sources: Speech by Rio Tinto Chair, Simon Thompson at the Sydney Investor Seminar, ESG Roundtable, Delivering value and resilience through sustainability, 26/11/2018; The SMH 26/11/2018; [registration required] The Australian 27/11/2018]

In Brief | A majority of Australians support putting a price on pollution? 63% of Australians support putting a price on pollution to reduce GHG emissions, and only 25% are opposed to it according to research conducted by the Australia Institute (TAI).

[Source: The Australia Institute media release 25/11/2018]

Other News

The 2019-2020 Federal Budget will be held 2 April 2019 ahead of the Federal election (expected to be held in May).

The Prime Minister announced on 27 November, that the 2019-20 Federal Budget will be held on 2 April 2019, ahead of the Federal election which is expected to be held in May 2019. The Prime Minister said that 'it will be a surplus budget'.

Treasurer, Josh Frydenberg, also announced that the Mid-Year Economic and Fiscal Outlook (MYEFO) will be released on 17 December 2018.

[Source: Transcript: Press conference with the Prime Minister and Treasurer 27/11/2018]

In Brief | One step closer to a Federal ICAC? *The National Integrity Commission Bill 2018* was introduced into the House of Representatives on 26 November and has been referred to the Senate Legal and Constitutional Affairs Legislation Committee for report by 5 April 2019.

[Source: National Integrity Commission Bill 2018; Explanatory Memorandum]