Governance News

21 May 2018

Mark Standen
Partner

T +61 2 9921 4902 | **M** +61 412 104 902

Siobhan Doherty
Special Counsel

T +61 2 9921 4339 | **M** +61 413 187 544

Kate Hilder
Consultant

T +61 3 8608 2907 | **M** +61 411 418 172

For queries or to subscribe/unsubscribe to Governance News updates, please contact: kate.hilder@minterellison.com

Contents

Diversity

United States | EY Centre for Board Matters' annual analysis of independent director skills/qualifications has found boards are increasingly appointing younger directors, directors with no past CEO experience and directors with accounting and finance skills.

EY Center for Board Matters has released the results of its second report analysing the qualifications and characteristics of new independent directors ie directors who were elected to the boards of Fortune100 company for the first time in 2017.

About the research: The report is based on analysis of proxy statements filed by 83 companies on the 2017 Fortune 100 list. The report also compares the skills/qualifications of directors elected to the same companies in 2016 to provide a year on year comparison.

Key Findings

- **Rate of change on Fortune 100 boards:** 55% of companies added at least one director and of these, 30% added two or more.
- **72% of boards specifically identified gender and race/ethnicity as a consideration** when identifying director nominees. This is an increase from 64% in 2016. 23% of board included a board skills matrix, an increase of 3% on 2016.
- **Corporate finance and accounting skills** were the most common qualifications citied by companies in 2017 followed by: corporate finance, accounting; international business; government, public policy, regulatory; technology; marketing, business development. The majority of new directors were assigned to audit committees (44%) or compensation committees (24%).
- **40% of new independent directors appointed to Fortune 100 boards in 2017 were women**. This is unchanged from 2016. However, overall only 28% of directors in Fortune 100 companies are women (an increase of 1% on 2016). In 2016, international business qualifications were the most common.
- **54% of new independent directors served in other roles with non-CEO backgrounds** including other executive roles (40%) or non-corporate backgrounds (academia, scientific organisations, non-profits, government, military, etc) (14%). In 2016, 51% of new independent directors did not have CEO experience. Overall, 30% 'appear to be' joining a Fortune 100 public company board, having never previously served on a public company board, which is a similar proportion to 2016.
- **There appears to be a shift towards appointing younger directors**: For the second consecutive year, EY writes, over 50% of new independent directors appointed in 2017 were under the age of 60. The average age for new independent directors was 57 in 2017 as compared to 63 for incumbents and 68 for exiting directors. Of the new appointments 15% were under 50, (which is an increase from 9% on 2016). And, for the second consecutive

[Sources: EY Centre for Board Matters report: Independent directors: New Class of 2017 07/05/2018; Harvard Law School Forum on Corporate Governance and Financial Regulation 14/05/2018]

'Speak up' culture driving change? Amazon has reportedly committed to interviewing at least one woman or minority for every open position on the board going forward.

Fortune writes that less than a week after deciding to oppose a shareholder proposal aimed at increasing board diversity at Amazon, and under pressure from employees, shareholders and Congress, the Amazon board has agreed to adopt the 'Rooney Rule' which requires the board to interview at least one woman or minority for each opening.

Amazon reportedly confirmed the move in an Securities and Exchange Commission (SEC) filing on Monday, stating: 'The Amazon Board of Directors has adopted a policy that the Nominating and Corporate Governance Committee include a slate of diverse candidates, including women and minorities, for all director openings. This policy formalizes a practice already in place.'

Fortune comments that given Amazon has an all-white board of seven men and three women, 'the informal version of the rule "already in place" clearly needed a boost'. Fortune also observes that the change in policy is notable because it appears to have come about in part due to pressure brought by employees who challenged the company's comments on diversity and questioned the lack of tangible progress on the issue: 'We don't need more effort, we need COURAGE' one employee is quoted as stating.

[Source: Fortune 16/05/2018]

United States | Highly adept at conquering 'glass cliffs': How black female business leaders have overcome the barriers to advancement.

Harvard Business Review writes that black women continue to be underrepresented in leadership roles in corporate America. According to the article, though they make up 12.7% of the US population, they represent only 1.3% of senior management and executive roles of S&P 500 firms, 2.2% of Fortune 500 boards of directors and there is not a single black female CEO in the Fortune 500.

However, the article notes, a small number of black female executives have succeeded in overcoming barriers to advancement. To identify the barriers they faced and the strategies and tools they employed to overcome them, researchers conducted 59 in depth interviews with 59 black women executives who have occupied senior level positions (within four levels of the CEO) in US corporations over the period 2007 to 2014.

Key findings included the following.

- A primary driver of interviewee's success was their ability to navigate the challenge of simultaneously being highly visible but continually overlooked as a token member of an unrepresented group.
- Almost all of the executives interviewed spoke of having to adapt to this invisibility, and were observed to employ different strategies for doing so, based on their career stage.
    - Interviewees in their early careers described 'gaining self-awareness' of their invisibility and outsider status as an important step in overcoming barriers. The researchers found that some women actively tried to 'fit in' with their peers and superiors while others focused on 'balancing blending in and being their true selves'.
    - Interviewees at the mid-career stage were observed to deliberately take on risk assignments/roles ('glass cliff roles') in order to increase their visibility. Noting that prior research suggests that women and minorities are disproportionately represented in 'glass cliff' (highly risky) roles, the researchers write that in the case of most of the interviewees the roles in question were viewed as an opportunity to overcome 'their invisible outsider status and prove their worth as viable leaders'. The researchers also found that where interviewees avoided highly risky roles, their reason for doing so was usually not due to fear of failure (ie not because they felt unequal to the task) but either because they felt they lacked the organisational support to succeed in the role or because on moral grounds – because the role 'challenges their sense of self '.
    - Interviewees who had succeeded in becoming executives said that they focused more on making a meaningful impact in their organisations, their communities, and supporting junior employees. For example through taking on additional organisational roles such as managing diversity and inclusion efforts, joining boards of other (frequently non-profit) organisations, and mentoring young people.

Based on their findings, the researchers argue that given the 'challenges facing businesses today, corporate America is poised for change and new ways of thinking. Our research suggests that black women thrive in such challenging roles and are ready to answer the call'.

[Source: Harvard Business Review 10/05/2018]

In Brief | The federal government has outlined how it will spend $4.5 million to encourage more women and girls to pursue a career in STEM. Funding will go towards a 10 year plan, a new women in STEM ambassador and a toolkit for teachers and parents.

[Sources: Joint press release Minister for Women, Kelly O'Dwyer and Minister for Jobs and Innovation Michaelia Cash 16/05/2018]

In Brief | Nikkei Asian Review reports that Japan is moving to boost low female representation in politics by passing a law encouraging parties to voluntarily field more women candidates. The legislation has reportedly already cleared the lower house.

[Source: Nikkei Asian Review 17/05/2018]

Remuneration

United Kingdom | Evidence that UK shareholders are increasingly willing to vote against executive pay? The FT writes that a number of UK companies have faced 'shareholder revolts' over executive pay packages at recent AGMs.

According to a series of articles in The FT, a number of UK companies have faced 'shareholder revolts' over executive pay packages recently.

- **Melrose plc**: According to a statement issued by the company, almost a quarter (22.87%) of investors at Melrose plc rejected the company's remuneration report at the recent AGM. The FT attributes this to £40m bonuses recently paid to each of its four top executives.
- **Direct Line plc**: According to a statement issued by the company, more than 23% of votes at Direct Line plc were against approving the directors' remuneration report. This is in line, The FT notes, with recommendations from shareholder advisory groups Glass Lewis and Institutional Shareholder Services (ISS) recommendations not to support the resolution. In addition, The FT suggests that the high protest vote may be due to the fact that Penny James (who joined the company this year) as CFO has a salary of £657,000, which is 38% more than her predecessor and was also given a one-off award to compensate for the loss of bonuses from her previous job.

FTSE 100 groups including housebuilder Persimmon, British American Tobacco, Old Mutual and CRH have also suffered what the article describes as 'large-scale rebellions'.

[Sources: Direct Line Group Results of Annual General Meeting 10/05/2018; Melrose plc Results of Annual General Meeting 10/05/2018 [registration required] The FT 11/05/2018; 14/05/2018; 15/04/2018]

Shareholder Activism

Victory for activists Carl Icahn and Darwin Deason at Xerox: Xerox has reportedly agreed to call off the merger with Fujifilm, replace CEO Jeff Jacobson and appoint activist representatives to the board.

Xerox Corp has reportedly called off its planned $6.1 billion merger with Fujifilm Holdings Corp in a settlement with activist investors Carl Icahn and Darwin Deason who are respectively the largest and third largest shareholders in the company.

The settlement also reportedly includes an agreement that CEO Jeff Jacobson be replaced with IBM and Hewlett Packard executive John Visentin and the appointment of a number of activist representatives to the board, including Icahn Enterprises representative Keith Cozza as Chair. Mr Jacobson's position has reportedly already been terminated.

[Sources: [registration required] The AFR 14/05/2018; [registration required] The FT 15/05/2018]

Institutional Shareholders and Stewardship

Top Story | ACSI has released the first Australian stewardship code for asset owners

The Australian Council of Superannuation Investors (ACSI) released The Australian Asset Owner Stewardship Code (the Code) on 17 May. The Code was developed by ACSI in consultation with its members and other stakeholders with the aim of increasing the transparency and accountability of stewardship activities in Australia. The voluntary Code is open to all asset owners (including super funds, endowments and sovereign wealth funds), not just ACSI members. Signatories will be required to publish a Stewardship Statement for the period 1 July 2018 to 30 June 2019 by (or before) 30 September 2019.

Six Principles

The Code sets out six principles which signatories must commit to on an 'if not, why not' basis with accompanying guidance on each principle.

The principles-based approach, ACSI writes, is intended to allow 'asset owners to pursue their stewardship approach in a manner that is consistent with the spirit of the principles rather than reporting specifically against the guidance. Guidance has been provided for each of the principles by way of example. These are suggestions only and should not be regarded as mandatory'.

A high level overview of the six principles and the accompanying guidance is below.

1. **Publicly disclose how they approach their stewardship responsibilities**: The guidance on principle 1 states that for asset owners stewardship activities include voting, engagement (with companies in which asset owners are invested), policy advocacy and consideration of stewardship capabilities in the selection, appointment and monitoring of external asset managers and that these activities may be undertaken 'directly collaboratively, outsourced to asset managers or third party service providers or a combination of these'. ACSI states that disclosure can be made in a variety of ways eg in a separate stewardship policy, responsibility or sustainable investment policy, in a standalone stewardship statement, or on a separate section of the asset owner's website. ACSI emphasises that however disclosure is made, the information should be' readily accessible by the asset owner's beneficiaries and other stakeholders'.
2. **Publicly disclose their policy for voting at company meetings and voting activity**: The guidance on principle 2 suggests that asset owners go beyond the minimum regulatory reporting requirements as set out in s29QB of the *Superannuation Industry (Supervision) Act 1993* (Cth) and associated regulations and class orders, and in ASIC guidance: ASIC RG 252. The guidance includes a number of examples of disclosures that build on these requirements eg disclosing what principles guide voting decisions; whether and when the asset owner advises companies of a decision to cast a vote against or abstain from a resolution and the circumstances in which the asset owner will not vote (among others).
3. **Engage with companies either directly, indirectly (for example, via collective action or third-party providers) or both:** The Guidance on principle 3 outlines the various forms engagement may take, the importance of ensuring compliance with insider trading provisions and encourages companies to disclose the existence of escalation policies (where they have one). Disclosing the policy will both emphasise the role that engagement plays in the asset owner's investment activities and lead to greater accountability to beneficiaries and other stakeholders for asset owner engagement activities ACSI states. The guidance also outlines a number of examples of disclosures about engagement practices and states that where engagement activities are outsourced, the asset owner should monitor the quality of the delivery of those activities.
4. **Monitor asset managers' stewardship activities**: The Guidance on principle 4 states that 'Asset owners have an important and direct influence on asset manager behaviour through their investment mandates and agreements. Asset owners cannot delegate their stewardship responsibilities, even when they employ asset managers to act on their behalf. If an asset owner outsources any of their stewardship activities to asset managers, they will remain responsible for monitoring and assessing the quality of those activities'. The guidance outlines a number of examples of the how asset owners can fulfil their stewardship activities in circumstances where some or all of this activity is outsourced to asset managers including: incorporating stewardship capabilities, policies and strategies into their asset manager selection, appointment and monitoring processes; clearly communicating their policies and expectations about stewardship to asset managers; monitoring the consistency of the asset manager's engagement activities, voting decisions or recommendations against the asset owner's own principles; partnering with asset managers in relation to engagement activities; and articulating what stewardship reporting is expected and when. It's also suggested that asset owners

might consider an asset manager's performance in relation to stewardship activities as one measure of their asset manager's broader investment management performance.

5. **Encourage better alignment of the operation of the financial system and regulatory policy with the financial interests of long-term investors**: ACSI writes that as asset owners' holdings are impacted by the economy as a whole, in circumstances where asset owners have concerns regarding systemic, industry-wide policies, practices or disclosures, they can encourage policy makers to better align the operation of the financial system and regulatory policy with the interests of long-term investors through for example contributing to government, parliamentary committees and other relevant public-regulatory or policy forums. The guidance suggests that 'typical examples' of industry wide issues on which asset owners might advocate include changes to the Corporations Law, Listing Rules or government policy in relation to governance and shareholder rights, climate change and ESG disclosures.
6. **Report to beneficiaries about their stewardship activities'**. The guidance to principle 6 provides that disclosures should be 'readily accessible on an asset owner's website, unless they are confidential or commercially sensitive'. The guidance adds that 'Disclosures might include links to engagement, voting, responsible investment or sustainability reports, annual reports, or other voluntary disclosures'.

ACSI states that there will be variation in the way in which the code is implemented depending on the asset owner's particular circumstances.

Application

- ACSI writes that the Code is directed at Australian asset owners who have equity holdings in Australian-listed companies (regardless of whether the holding is passively or actively held) whether or not they are ACSI members.
- ACSI notes that as many assets owners will have exposures to international equity holdings and ownership rights in other asset classes they may wish to extend the application of the Code across their portfolio.
- ACSI also encourages other institutional investors to apply the code.

Signatory Requirements

- Signatories will be required to publish a Stewardship Statement describing how they apply the principles and if one or more of the principles have not been applied, why the signatory has not adopted those elements.
- Signatories are encouraged to review their own Stewardship Statement at least every two years and update it where necessary to reflect changes in stewardship practice. Signatories should notify ACSI if their statement is revised.
- ACSI will maintain a list of signatories on the ACSI website, including a link to their Stewardship Statement and contact details.

Timeframe

- Asset owners who adopt the Code must publish a Stewardship Statement on an 'if not, why not?' basis for the period 1 July 2018 to 30 June 2019 by or before 30 September 2019.
- ACSI comments that should signatories elect to adopt the code earlier than this that initial Stewardship Statements may be for an earlier period or part year.

ACSI CEO Louise Davidson said in a statement announcing the launch of the code: 'Australian asset owners have a long history of engaging with companies and voting their shareholdings to protect and enhance long-term value for their beneficiaries. Signing up is an opportunity for asset owners to demonstrate that their intentions are backed by meaningful action. This is a strong basis from which to build trust and to set the tone for stewardship in Australia.'

Professor Ian Ramsay is quoted as stating: 'I would like to congratulate ACSI on this important initiative. Australian asset owners play a fundamental role in our financial markets and it's good to see them take the lead in setting best practice standards for the disclosure and management of stewardship activities'.

Industry has reportedly welcomed the Code according to Financial Standard. The article adds that HESTA and AustralianSuper have already committed to adopting the code.

[Sources: Australian Council of Superannuation Investors media release 17/05/2018; Australian Asset Owner Stewardship Code 17/05/2018; Australian Financial Standard 17/05/2018]

'Akin to a dictatorship'? CalSTRS has called on Mark Zuckerberg to end Facebook's dual class share system or at least to nominate timeline to do so.

Writing in The FT, the California State Teachers' Retirement System (CalSTRS) has called on Facebook to end the dual class share system — or to at least nominate a time for the dual-class system to sunset — that enables Facebook founder, Mark Zuckerberg to maintain effective control over the company and the company's future strategy.

CalSTRS argues that the dual class system is contrary to the interests of shareholders because it inhibits the evolution of strong governance within the company. 'CalSTRS, with a portfolio of more than $220 billion, 54% of which is passively indexed, expects that when a company turns from being a private enterprise to one that is publicly traded, its governance should evolve in line with its status' wrote portfolio manager Aeisha Mastagni. She goes on to question why the dual class structure is still in place 'Why does Mr Zuckerberg need the entrenchment factor of a dual-class structure? Is it because he does not want governance to evolve with the rest of his company? If so, this American dream is now akin to a dictatorship.' she states. CalSTRS view is supported, she argues by a number of studies into the value of dual-class structures which have found that the value to shareholders lessens with time.

CalSTRS notes that The Council of Institutional Investors (CII), using an analysis of SEC filings, has listed 22 dual-class companies with time-based sunset provisions incorporated into their charters and urges Facebook to follow suit.

[Sources: [registration required] The FT 10/05/2018; Fortune 10/05/2018]

Do index providers have a role to play, and more particularly, does MSCI have a role to play in disincentivising dual-class structures? CII argues that it should.

As previously reported in governance news on 30/04/2018 Blackrock recently responded to MSCI's consultation on the treatment of unequal voting structures in the MSCI Equity Indexes. According to The FT, Blackrock was of the view that 'policymakers, not index providers, should set corporate governance standards' and that as such, index providers should not exclude companies with dual class share structures.

The Council of Institutional Investors (CII) have since released their response to the consultation on Harvard Law School Forum.

Unlike BlackRock, CII is broady supportive of MSCI's proposed approach (with some qualifications) on the basis that index providers have a 'legitimate and important role to play' in incentivising companies to adopt a one vote one share structure, especially given the 'void left by years of inaction from stock exchanges, regulators and global regulatory coordinators'. CII provides a number of justifications for this view, among them that 'Stock exchanges, regulators and global regulatory coordinators have not adequately responded to the growing separation of ownership and control. While various reasons explain this inaction, and fault cannot not be pinned on any one entity, what is ultimately most important is that for years, public equity has continued to slide down the path toward greater misalignment, and index providers are in position to do something substantive about it'.

Though supportive of MSCI's proposal, CII does suggest 'providing exemptive relief to prospective constituents and existing constituents that choose to adopt firm, reasonable, time-based sunset provisions in their governing documents'.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 16/05/2018]

Other Shareholder News

In Brief | Following the release of proposed changes to the ASX Corporate Governance Principles and Recommendations for consultation, the ASX will conduct a national road show in June to inform listed entities and other interested stakeholders about the changes, and foreshadowing important changes to the Listing Rules due to be released for consultation later in the year.

[Note: The proposed changes to the ASX Corporate Governance Principles and Recommendations were outlined in Governance News 04/05/2018. Consultation on the proposed changes will close on 27 July 2018.]

[Source: ASX Compliance update 04/18 11/05/2018]

In Brief | The Association of Chartered Certified Accountants (ACCA) has released a report: *Tenets of Good Corporate Governance* which highlights the link between strong governance practices and long term prosperity of both companies and the community.

[Source: ACCA report: The Tenets of Good Corporate Governance]

In Brief | The Norwegian Corporate Governance Board (NUES) is consulting on proposed changes to the Norwegian Code of Practice for Corporate Governance (Governance Code). The proposed changes stem from legislative and regulatory changes, international developments, and issues that have arisen through the Code's use. As further changes are expected to be made to Norway's legislation in areas including financial reporting, auditors, and shareholder rights as a result of EU legislation, the proposed changes have not been made in these areas, nor has change been made to the commentaries accompanying the code. Consultation closes on 11 June 2018.

[Source: NUES: Proposal for changes to the Norwegian Code of Practice for Corporate Governance [English translation] 22/05/2018]

Meetings and Proxy Advisers

United Kingdom | Proxy adviser Glass Lewis has advised shareholders against voting for the reelection of Chair Roberto Quarta at the upcoming WPP AGM.

The Guardian and The FT report that WPP shareholders are being urged by Glass Lewis, to vote against the reelection of the Chair and also against the remuneration report to protest against the way in which the departure of former CEO Martin Sorrell was handled.

More particularly Glass Lewis has questioned:

- The lack of transparency around the circumstances of Mr Sorrell's departure — which is being treated as a retirement by the company — and the decision not to publish the outcome of the investigation into his alleged personal misconduct, which ultimately prompted his resignation. This decision by the board classified Mr Sorrell as a 'good leaver' and ultimately enabled him to keep up to £20m in future share payouts intact.
- The way in which the nomination committee, which is chaired by Mr Quarta has handled the succession planning process, which in Glass Lewis' view 'has failed to adequately prepare for the replacement of Sir Martin Glass Lewis'.
- In addition, Glass Lewis has also raised concerns about Mr Quarta's increased workload due to a change in leadership at another company (Smith and Nephew) at which Mr Quarta is also Chair.

The Guardian quotes WPP as stating that a vote against Mr Quarta would not be in the interests of investors 'at such an important time when the business needs stability until such time as a new chief executive is appointed…The investors have shown support for WPP by the share price rising by 18% since Sir Martin Sorrell's retirement.'

According to The FT, Institutional Shareholder Services has not yet made a recommendation on either the pay report or the reelection of the Chair.

The AGM will be held on 13 June.

[Sources: The Guardian 14/05/2018; [registration required] The FT 15/05/2018]

United Kingdom | Unusual result: Shareholders have voted against the resolution to reelect the external auditors (Deloitte LLP) at the SIG plc AGM. Shareholders voted 108,962,143 (For); 395,827,122 (Against); and 371,198 (Withheld). The Times reports that the FRC is looking at Deloitte's role in the alleged accounting issues (eg exaggerated profits) at SIG and adds that it may open an investigation into the firm.

[Sources: SIG plc Results of AGM 10/05/2018; The Times 11/05/2018]

Regulators

Australian Securities and Investments Commission (ASIC)

Top Story | ASIC Chair James Shipton's address to the ACSI annual conference: ASIC to apply a new supervisory focus on the largest financial institutions and superannuation funds in light of the 'trust deficit' in the financial sector.

In a speech entitled 'Trust deficit in corporate Australia' given at the Australian Council of Superannuation Investors (ACSI) annual conference, Australian Securities and Investments Commission (ASIC) Chair James Shipton said that:

- The trust deficit in the financial sector is of the sector's own making and industry must commit to changing its approach to compliance to rectify it.
- Conflicts of interest in the sector are 'verging on a systemic issue' and urged industry to act to address it.
- ASIC's preferred approach in relation to conflicted payments in advice is to remove them all together and 'strongly suggest[ed]' that firms take this into account when considering how to deal with conflicts of interest arising from remuneration structures.
- ASIC intends to apply a new supervisory focus on Australia's largest financial institutions and superannuation funds. This will involve more 'intensive and dedicated supervision, together with increased cooperation with our fellow regulators especially APRA'. More specifically Mr Shipton said that ASIC plans to accelerate and expand the 'Wealth Management Project' (the series of investigations into advice in large financial institutions which he said had been the subject of many of the issues before the Financial Services Royal Commission).

A more detailed overview of the key points of Mr Shipton's address is below.

The 'trust deficit' and the need for industry to raise standards of professionalism

- Mr Shipton said that ' Australia's corporations, and the finance sector in particular, are suffering from a trust deficit. And this current predicament is of the sector's own making. And because it is largely of its own making, the sector must be held to account and must take responsibility for its repair.
- Need to 'embrace professionalism': Mr Shipton said there is a need for the people in finance to 'refocus on building a highly professional and ethical mindset…What I want to emphasise is that the industry, and the people within it, need to do more to support the proper functioning of the financial system and its regulation'.

[Note: Mr Shipton has spoken previously on the need to raise standards of professionalism to address the 'trust deficit'. Professionalism was the theme of his inaugural keynote address to the ASIC Annual Forum which also focussed on the 'trust deficit' in the financial sector, the risks this poses to the financial system and the need for higher levels of professionalism in the industry to address the issue. See: Governance News 23/03/2018.]

Conflicts of interest are 'verging on a systemic issue'

- **Despite the proliferation of conflicts of interest, industry has not acted to address the issue**: Mr Shipton said that there is a 'proliferation of conflicts of interest in parts of the financial sector' as has been highlighted by both recent ASIC actions and by the Royal Commission, and added that though these conflicts of interest are a 'perennial challenge for business' a 'number of institutions have not taken the management of conflicts of interest to heart with many financial firms 'turn[ing] a blind eye' to the risks, failing to have management systems in place to resolve conflicts and resisting attempts by ASIC to address conflicts or in some cases to recompense those harmed by them.
- **Need for cultural change**: Mr Shipton said that lack of action to address the issue was justified 'too often' on the basis that 'everyone else is doing it' and observed: 'A business culture that is blind to conflicts of interest is a business culture that does not have the best interests of its customer in mind. Moreover, it is one that is not observing the spirit as well as the letter of the law'.
- **Urged industry to take steps to address the issue (particularly conflicted payments):** Mr Shipton urged the sector to take steps to address the conflicts issue. Commenting specifically on the subject of conflicted payments in financial advice, Mr Shipton said: 'the best way to deal with some conflicts..[is] to remove them altogether. This is an option that ASIC favours in relation to conflicted payments in advice. There can be no ambiguity in this area. So, I would strongly suggest that all financial firms keep this in mind when considering how to deal with conflicts of interest arising from remuneration structures'.

The Regulatory System is 'not designed a police state'

- **Mr Shipton said that regulatory structure of the financial system is 'not designed as a police state'** but rather is designed on the basis that the '"first line" of compliance is the firms themselves'. He emphasised the necessity of firms taking responsibility for ensuring their own compliance and cooperating with regulators on this basis, 'if firms continue to fail to step up to their responsibilities, the integrity of our regulatory structure, and our financial system, is undermined' he said.
- **ASIC's active role in holding industry to account:** Commenting on the active role ASIC has taken to holding firms and people to account, Mr Shipton outlined the enforcement outcomes (bannings, criminal convictions and civil penalties) ASIC had secured since 2011. He stated: 'I am personally committed to using every inch of our powers and tools to get the outcomes that the community deserves'.

Adoption of new supervisory approaches with a focus on large financial institutions and superannuation funds

- **'Accelerate and expand' the Wealth Management Program**: Much of what we saw in the financial advice round of the Royal Commission hearings was based on the work of our Wealth Management Project. We intend to accelerate and expand this intense program. We are also looking at ways to build on our substantial enforcement outcomes. This could include making greater use of external expertise in our investigations and enforcement actions.
- **Focus on large financial institutions and superannuation funds**: Mr Shipton said that over the coming years ASIC will improve on existing work by adopting new supervisory approaches. More particularly Mr Shipton said that ASIC 'is looking to apply a new supervisory focus on Australia’s largest financial institutions and superannuation funds. This will involve more intensive, and dedicated, supervision, together with increased co-operation with our fellow regulators, especially APRA'.

ASIC Resourcing

- **Discussing additional resourcing with government:** Commenting briefly on ASIC resourcing, Mr Shipton said 'As always, the extent that we can develop these initiatives will depend on our capability and level of resourcing. It is accordingly highly relevant that this is the first year that our funding will be sourced from industry'. He added that ASIC is in the process of discussing with government 'what additional support' is needed.

[Sources: Keynote address by ASIC Chair, James Shipton, Australian Council of Superannuation Investors Annual Conference, Sydney 17/05/2018; ABC 17/05/2018]

ASIC is consulting on its proposed approach to approving and overseeing compliance schemes for financial advisers.

From 1 January 2020, financial advisers, authorised to provide personal advice to retail clients about relevant financial products, are required to comply with a code of ethics being developed by the Financial Adviser Standards and Ethics Authority (FASEA) and be covered by a compliance scheme under which their compliance with the code of ethics will be monitored and enforced. Compliance schemes must be approved by ASIC.

Ahead of these new requirements, the Australian Securities and Investments Commission (ASIC) has released a consultation paper: *CP 300 Approval and oversight of compliance schemes for financial advisers* (CP 300) outlining its proposed approach to approving and overseeing compliance schemes for financial advisers.

The consultation paper outlines:

- The process for applying for approval of a compliance scheme.
- ASIC's expectations for the governance and administration, monitoring and enforcement processes, and ongoing operation of compliance schemes.
- How ASIC's proposes to exercise our powers to revoke the approval of a compliance scheme and to impose or vary conditions on the approval.
- ASIC's proposal to modify the law to ensure that monitoring bodies can gather the information from Australian Financial Services (AFS) licensees and authorised representatives that they need to carry out proactive monitoring activities.
- Draft guidance about the notifications that monitoring bodies must make to ASIC.
- how to apply for ASIC approval of a compliance scheme;
- ASIC's expectations for the governance and administration, monitoring and enforcement processes, and ongoing operation of compliance schemes;
- ASIC said it will also modify the law to ensure that monitoring bodies can gather the information from AFS licensees and authorised representatives that they need to carry out proactive monitoring activities.

Timeline: Consultation will close on 28 June 2018. ASIC intends to release a regulatory guide setting out the final policy by the end of September 2018.

[Note: The Financial Adviser Standards and Ethics Authority (FASEA) is currently consulting on a draft code of ethics for financial advisers. See: Governance News 26/03/2018.]

[Sources: 18-138MR ASIC consults on code of ethics compliance schemes for financial advisers; CP 300 Approval and oversight of compliance schemes for financial advisers; The IFA 15/05/2018]

ASIC is reviewing its regulatory approach to short selling: A number of proposals relating to short both naked and covered short selling have been released for consultation.

ASIC is consulting on a number of proposals relating to both naked and covered short selling. The paper covers a broad range of proposals including proposals to:

- grant legislative relief to allow market makers of certain exchange-traded products to naked short sell units in an exchange traded fund or a managed fund in the course of making a market in those products.
- grant legislative relief, in the context of corporate actions, to allow naked short sales of unissued products during a deferred settlement trading period.
- grant legislative relief to allow naked short sales in connection with initial public offering (IPO) selldowns made through a special purpose vehicle (where existing shareholders of a company sell

their shares through a special purpose on the condition that the company conducting the IPO is listed on the ASX).

- change the relevant time that short positions are calculated.
- remake a number of short selling class orders that are due to 'sunset'.

ASIC Commissioner Cathie Armour said, 'It is important that short selling continues to be regulated appropriately so that our market remains orderly and transparent. The proposals strike a balance between providing efficiency and certainty and reducing the burden of compliance for businesses, and managing the risks that short selling poses to market integrity.'

ASIC invites submissions on CP 299 by 20 June 2018, with a view to issuing a final consolidated instrument before 1 October 2018.

[Source: 18-135MR ASIC consults on short selling proposals]

Australian Prudential Regulation Authority (APRA)

Top Story | Outcomes of APRA thematic review of superannuation board governance practices released.

The Australian Prudential Regulation Authority (APRA) has written to registrable superannuation entities (RSEs) outlining the findings its thematic review of superannuation board governance practices. The review examined how well registrable superannuation entities (RSEs) were meeting the requirements of Prudential Standard SPS 510 Governance (SPS 510) with particular focus on board composition, board appointment and renewal, and approaches to board performance assessments. APRA makes observations and recommendations as to how these practices could be strengthened and specifically urges superannuation trustees to 'examine whether their board has the optimum mix of skills, capabilities and experience needed to effectively carry out its responsibilities'. APRA states that it expects all RSE licensee boards to review their existing governance arrangements against the practices outlined and to address any identified areas for improvement.

Scope of the Review

The review was undertaken over the period 2016-2017 and covered 29 licensees of various types, sizes, ownership models and board structures.

Key Points

The report includes the following recommendations.

- **Consider the optimal composition of their boards in the context of their business and strategic plans:**
  - 'That RSE licensees consider, determine, document and regularly review the optimal composition for the board and board committees in the context of the RSE licensee's business operations and strategic plan'.
- **Consider the extent to which the use of independent experts signals a skills deficiency their boards:**
  - **'**That RSE licensee boards consider the extent to which the use of independent experts signals a skills deficiency on the board that would be more appropriately addressed through appointment of a director with the requisite skills and experience.'
- **Consider whether board renewal and succession planning processes 'strike an appropriate balance between ensuring continuity and bringing in diversity and fresh perspectives':**
  - 'That RSE licensees have a director selection process that provides a clear role for the board (and not just nominating bodies) in the appointment of candidates, with a view to ensuring that candidates with the necessary skills and capabilities are appointed.

- 'That RSE licensees have sound renewal and succession planning processes that include policies in relation to tenure limits and reappointment that strike an appropriate balance between ensuring continuity and bringing diversity and fresh perspectives, where the criteria for any exceptions to tenure policy are clear and limited, and the policy is demonstrably implemented in practice.'

- **Consider whether board assessment processes are sufficiently objective and robust and measure the capability of the board as a whole as well as the individual:**

  - 'That RSE licensees have a robust and objective board assessment process that considers the performance of the board as a whole, as well as performance of individual directors, and identifies recommendations to improve performance that are effectively implemented'.

APRA Deputy Chairman Helen Rowell said 'The standard of RSE governance is improving, but boards have more work to do. The recommendations in this review provide a clear guide to industry better practice that licensees can review their governance arrangements against, and identify areas for improvement…Meeting the minimum requirements of APRA's prudential framework is not enough. APRA continues to encourage RSE licensees to change their mindset from one of legal compliance to aiming to deliver the best possible outcomes for their members'.

Further Detail: Overview of Key Observations

Board composition

- **Weaknesses in board composition policy**: APRA observed that very few boards had formally documented, or were able to articulate, what their optimal board (and committee) composition should be, and how this might change in the future in light of their strategic plan and objectives. In particular, APRA found there was limited documentation of aspects of board composition such as the target size, optimal skills mix, ideal number of independent directors, workload considerations, or the connection between director skills and experience and the RSE licensee's strategy and business plan.

- **Better practice is to take a holistic view of board skills and to link this to strategic planning:** APRA observed that better practice demonstrated by some boards was ensuring that the board as a whole (rather than individuals) possessed the requisite skills, capability and experience as part of their strategic planning process. 'This approach also provided these boards with appropriate diversity of perspectives, which APRA considers important to support better quality decision-making through appropriate review and challenge' APRA observes.

- **Weaknesses in committee composition policy**: ARPA observed 'a lack of clear criteria in both training and fit and proper policies in respect of the skill levels needed on committees' and more particularly that minimum collective skill requirements were often not present. APRA adds that examples of better practices included RSE licensees taking steps to ensure the 'alignment of skills of individual directors to the committee that best suited their expertise and also setting tenure limits for terms on committees, in addition to board tenure limits'.

- **Considerable use of independent experts may suggest a skills deficiency on the board**: APRA observed that over one third of the sample engaged at least one independent expert to support board committees. APRA states that 'Whilst the appointment of independent experts is standard practice across industry, APRA has observed through its supervisory activities that, in some situations, the appointment of independent experts to board committees has indicated a skills deficiency on the board'.

Board Appointment and Renewal

- **'Challenges in appointing quality candidates'**: APRA writes that the 'thematic review indicated that some boards had experienced challenges in appointing quality candidates with the necessary capabilities (particularly superannuation and financial expertise), in part due to the limitations imposed by constitutions'. APRA adds that better practice included boards 'developing strong collaborative relationships with their nominating bodies to ensure that these organisations had a good understanding of the board's strategic direction and plan, and the skills, capabilities and experience needed of potential candidates to effectively execute it.'

- **Weaknesses in tenure policy**: APRA observed that as required by SPS 510, boards across the sample included a tenure policy in their governance frameworks. However, APRA observed that 'the effectiveness of the policy was undermined in many cases by weaknesses in aspects of the policy, or in its implementation' for example by including overly long tenure limits; 'transition arrangements that appeared to unduly delay steps towards board renewal' and 'enabled exceptions which appeared designed to enshrine the current composition of the Board or enable some directors with long tenure to continue' and 'inconsistency between the constitution and the policy which impeded the policy's implementation'.

- **Ongoing board renewal:** APRA writes some boards were observed to recognise the importance of carefully considered succession planning as part of their tenure policy, and had in place an ongoing renewal planning process that considers the skills and experience that will be required as each director's term is likely to end. APRA welcomed the recent addition of cyber and digital skills to some boards as examples of this.

Board Assessment

- **Lack of objectivity in board assessment processes:** APRA observed that a number of assessments focused 'primarily or solely on relatively subjective assessment' of the skills and capabilities of individual directors with self assessment often the sole method for assessing board performance. Some weaker assessment processes involved collating individual director self-assessments while stronger assessment processes were observed to include greater depth of analysis eg interviews of individual directors by the chair and input from senior management. Better practice also included the use of external independent consultants to undertake external review of director performance. APRA adds that 'consideration of how to achieve sufficient objectivity in board performance assessments, as suggested in paragraph 47(b) of SPG 510, was not addressed by many of the sample population'.

- **Better practice is more frequent, external assessment:** APRA states that boards that demonstrated better practice undertook external assessments of the board and individual directors more often than the timeframes recommended as better practice in SPG 510.

Next Steps

- APRA states that it expects all RSE licensee boards to review their existing governance arrangements against the practices outlined and address any identified areas for improvement.

- As part of its post-implementation review of the superannuation prudential framework, APRA intends to review and amend the framework where appropriate to reflect the findings of this thematic review.

[Sources: APRA media release 17/05/2018; Letter to RSE Licensees — Board Governance Thematic Review 16/05/2018; [registration required] The Australian 18/05/2018]

APRA has released quarterly private health insurance statistics for March 2018.

[Source: APRA media release 17/05/2018]

The Australian Competition and Consumer Commission (ACCC)

Higher penalties for cartel conduct on the way? The Full Federal Court has ordered Japanese company Yazaki Corporation (Yazaki) to pay increased penalties of $46 million for cartel conduct (original penalty was $9.5m), following an appeal by the ACCC. The ACCC notes that this is the highest penalty ever handed down under the Competition and Consumer Act (2010).

The Full Federal Court has ordered Japanese company Yazaki Corporation (Yazaki) to pay an increased fine of $46m (increased from m $9.5 million) following an appeal from the Australian Competition and Consumer Commission (ACCC) against the initial penalty.

The fine is the highest ever penalty handed down under the *Competition and Consumer Act* 2010 (Cth).

ACCC Chair Rod Sims said: 'We appealed the penalties imposed by the trial judge because we considered that the original penalties of $9.5 million were insufficient to adequately deter Yazaki or other businesses from engaging in cartel conduct in the future'.

In an article commenting on the possible impact of the decision, The Age quotes Mr Sims as describing the decision as a 'game changer' and a ' a huge step towards getting our penalties up' on the basis that the court found that a company's entire turnover for Australia should be considered when assessing a penalty, rather than only that of the offending division.

[Note: The successful appeal follows the release of an OECD report: *Pecuniary Penalties for Competition Law Infringements in Australia* which found that average Australian penalties are significantly lower than those imposed in other comparable OECD jurisdictions and comments by ACCC Chair Rod Sims that the regulator would rethink its approach to penalties. See: Governance News 03/04/2018]

[Sources: Australian Competition and Consumer Commission media release 16/05/2018; Australian Competition and Consumer Commission v Yazaki Corporation [2018] FCAFC 73; [registration required] The Age 17/05/2018]

Other developments

United Kingdom | Climate change is a core financial risk and the transition to thinking about it in this light needs to be completed soon if larger risks are to be avoided according to the Bank of England (BoE) Executive Director, International Banks Supervision Sarah Breeden.

In her speech to the Green Financial Initiative and Green Finance Committee Climate, Bank of England (BoE) Executive Director, International Banks Supervision Sarah Breeden, has suggested that the transition from thinking about climate risk as a social responsibility issue to thinking about it as a core financial risk though only partially complete, must be accomplished soon if the larger risks associated with failing to properly manage climate risk are to be avoided. As such she argues that climate risk is a 'shared challenge' for the private sector and financial authorities.

A high level overview of some of the points she covered in her address is below.

- **'Climate change, and society's response to it, presents financial risks which impact the Bank's objectives'** Ms Breedon said. More particularly, she said that the physical effects of climate change (for example from more frequent or intense storms); and the impact of changes as the transition is made to the lower-carbon economy potentially 'affect the Bank's core responsibilities both for the safety and soundness of the firms we regulate and for the stability of the financial system if there is a late, abrupt and disorderly transition'.
- **Disclosure — support for the TCFD recommendations**: Ms Breedon said that the BoE has been supportive of the Task-force for Climate Related Financial Disclosures (TCFD) recommendations on the basis that they provide an 'excellent basis for firms to disclose their exposure to climate-related risks and opportunities and their related strategies, governance and risk management practices' are also of benefit to investors and ultimately in helping to ensure improvements in the management of climate risk.
- **'Mainstreaming' of Green Finance**: Ms Breedon commented briefly on the growing interest in green financing, of the difficulty of tracking it and more specifically on the continued rapid development of the green bond market which she said is 'forecast by some to pass $200bn this year overall'.
- **Need for international coordination:** Ms Green emphasised the necessity of international coordination. She said that this had been a significant element of the BoE's work and involved engaging with other financial regulators and central banks to help raise awareness of climate-related issues.
- **Change in mindset to thinking about climate risk as a financial risk issue**: Ms Breedon said that the transition from thinking about climate change as a social responsibility issue to thinking of it as a 'core financial risk at the heart of how companies manage their business' is only partially complete. She went on to say that the 'transition in thinking needs to lead soon to transition in action, if we are to reduce these financial risks in a timely manner and so avoid a late and abrupt transition to the low carbon economy to which governments have committed. To make this happen, we need to learn by doing, to identify decision-useful information that will support the necessary transition; and we need to identify the barriers to the mainstreaming of green finance so that the transition can be financed in practice'.

[Source: Speech given by Sarah Breeden, Executive Director, International Banks Supervision, Bank of England: The shared response to climate change: turning momentum into action 14/05/2018]

Ireland | The Charities Regulator has announced it will publish a governance code for charities later this year.

The Charities Regulator has issued a statement confirming that it will publish Ireland's first code of governance for charities later this year in line with the report recommendations of the Consultative Panel on the Governance of Charitable Organisations. It's hoped that the new code, will address the drop in public trust in the sector that has resulted from recent governance issues.

Further detail: The introduction of the code is in line with the recommendations of the Consultative Panel on the Governance of Charitable Organisations which has been researching an consulting on the issue since 2017. The Panel found:

- there is a need for a code of governance for charities;
- that the Charities Regulator should produce the code;
- the content of the new Governance Code should be developed in collaboration with the charity sector;
- the code should be principles-based and should operate on a 'comply or explain' basis by charities;
- the Charities Regulator should promote efforts to streamline compliance and reporting duplication between State bodies;
- the Charities Regulator should develop and issue guidance (where possible online and/or in digital/video format) to support prospective and current charity trustees; and
- the term of office of charity trustees should not be subject to a mandatory limit. However, the new Governance Code should include an advisory maximum limit on a 'comply or explain' basis.

All of panel's proposals have been accepted by the Charities Regulatory Authority.

CEO of the Charities Regulator, John Farrelly said that the publication of the Code of Governance would be a landmark in the development of Irish charities: 'For the first time there will be a code which will clearly set out what is expected from charity trustees. Good governance is the foundation stone of a well-managed charity. It needs to be proportionate to the size of the charity and the work that particular charities do. It is clear from our work to date that a one-size-fits-all approach will not work.'

[Sources: Charities Regulatory Authority media release 10/05/2018; Report of the Consultative Panel on the Governance of Charitable Organisations 05/04/2018]

Corporate Social Responsibilities and Sustainability

State Street Corporate Social Responsibility Report 2017 released: State Street has pledged to reduce its greenhouse emissions by 30% by 2025.

State Street Corporation released its 2017 Corporate Responsibility (CR) report on 14 May 2018. Among other things, the report highlighted State Street's commitment to environmental, diversity and social responsibility issues.

- **Environmental**
  - **State Street pledged to reduce its greenhouse gas emissions by 30%** (an increase over the 20% target achieved in 2017), reduce water consumption by 10% per full-time employee and achieve a recycling rate of 80% by 2025.
  - **State Street and its asset management business, State Street Global Advisors, joined the Task Force on Climate-related Financial Disclosures**, a global initiative aimed at improving the quality and consistency of corporate reporting on climate-related financial risk.

- **Engagement on CSR issues**: In 2017, State Street Global Advisors engaged a total of 610 global companies representing more than 45% of its total assets (12,291 in portfolio) on Environmental, Social and Governance (ESG) issues. Of those engagements, 271 were on environmental and social issues alone.

- **Corporate Citizenship**
  - More than a fifth of State Street employees participated in community volunteer activities, devoting more than 123,000 hours of their time and talents to charitable causes.
  - State Street Foundation provided US$20.3 million in grants to charitable organisations worldwide.

- **Diversity and Inclusion**
  - **State Street signed the CEO Action for Diversity and Inclusion pledge** to welcome and respect diversity and inclusion, and share best practices with its peers.
  - **The company completed its second set of three-year diversity goals in 2017, achieving or exceeding those goals in five of eight categories**. For example, in 2014, 18% of our US workforce at vice president (VP) level were employees of colour; we set a goal of increasing this to 22% by 2017, this was then exceeded by 3% reaching 25% during this timeframe.
  - **Diversity targets**: State Street has now set new three and five year goals to increase the number of women and employees of colour in management roles.
  - **State Street received 100% on the Human Rights Campaign's Corporate Equality Index**, which benchmarks corporate policies and practices pertinent to LGBT+ employees.
  - **Gender equality efforts**: State Street was recognised for the representation of women on its board, receiving 'W' company certification from US national campaign group, '2020 Women on Boards'. Within the UK, it was also recognised by national newspaper, The Times as a 'Top 50 Employer for Women' for the fifth year in a row.

[Sources: State Street: 2017 Corporate Responsibility Report; BusinessWire 14/05/2018]

Financial Services

Top Story | First case brought by the FCA and PRA under the SM&CR: The regulators jointly fined Barclays CEO Mr James Staley £642,430 for breach of individual conduct rule 2 and Barclays has agreed to additional reporting requirements regarding whistleblowing systems and controls.

The first case brought by the Prudential Regulation Authority and Financial Conduct Authority under the Senior Managers and Certification Regime (SM&CR) has resulted in a finding that Barclays Group CEO Mr James Staley breached Individual Conduct Rule 2 (the requirement to act with due skill, care and diligence) in attempting to unmask a whistleblower. However, Mr Staley's conduct was not found to be breach of the requirement to act with integrity (Individual Conduct Rule 1). Though the PRA and FCA each imposed a financial penalty on Mr Staley, the fact that he has remained in his current role has been criticised by some commentators.

Facts

- On 21 June 2016, Barclays received an anonymous letter, purporting to be from a Barclays shareholder, containing various allegations (relating to recruitment practices at Barclays), including allegations against Mr Staley.
- Mr Staley considered that the letter fell outside of the firm's whistleblowing policy as its author did not purport to be an employee and further, that the allegations were false and submitted for malicious reasons (ie to undermine his hiring strategy).

- On 24 June, a second anonymous letter, purporting to be written by a Barclays employee, expressing similar concerns was received. Mr Staley recognised that this letter could fall within the scope of the whistleblowing policy as it purported to come from an employee and did not attempt to identify its author.
- Concerned that the letters were part of a campaign to undermine his hiring policy, on 28 June, Mr Staley instructed Security to try to identify the First Letter's author.
- On 29 June Mr Staley was informed that it might be treating the first letter as a whislteblow, and was advised not to attempt to identify the first letter's author which Mr Staley accepted.
- On 8 July, Mr Staley was informed that the allegations appeared to be unsubstantiated and that the investigation would shortly be concluded. Mr Staley mistakenly understood this to mean that the first letter was no longer being treated as a whislteblow and that he was therefore free to resume his attempts to unmask the first letter's author. However, he failed to confirm this expressly with Group Compliance and did not inform Group Compliance that he intended to resume his efforts to identify the first letter's author.
- Mr Staley then instructed Group Security to resume its efforts to identify the first letter's author.

Findings

The PRA and FCA determined that Mr Staley failed to comply with Individual Conduct Rule 2 (ICR2) which provides that he must act with due skill, care and diligence. However there was no finding Mr Staley breached his obligation to act with integrity (ICR1). More particularly, the regulators found that Mr Staley:

- Should have maintained an appropriate distance from the investigation into the allegations and the response to the allegations, given his conflict of interest (ie the fact that the allegations in part related to him).
- The regulators also found that Mr Staley should have recognised the possibility that the first letter fell within the scope of Barclays' whistleblowing policy and that the author was entitled to protections under the policy.
- The regulators found that given his lack of expertise in whistleblowing, Mr Staley should have explicitly consulted with those with whistleblowing expertise and responsibility and sought their express confirmation that what he wanted to do (ie identify the whistleblower) was permissible.

The FCA commented: 'Given the crucial role of the CEO, the standard required of Mr Staley under ICR2 is more exacting than for other employees. Where (as happened here) the CEO is faced with circumstances that undermine or risk undermining the impartiality of their judgement, they need to ensure that appropriate standards of governance (including independence of decision-making) are maintained. Further, whistleblowers play a vital role in exposing poor practice and misconduct in the financial services sector. It is critical that individuals who wish to raise concerns feel able to speak up anonymously and without fear of retaliation. Mr Staley's actions fell short of the standard of due skill, care and diligence expected of a CEO in a regulated firm: he risked compromising the value of an important resource by which the financial services industry and regulators can identify poor behaviours. That risk was exacerbated given the high profile of Mr Staley and Barclays within the financial services industry'.

Penalties

- **Penalty against Mr Staley**: The PRA and FCA each imposed penalties of £458,000 on Mr Staley with a 30% discount for early settlement, bringing the total combined penalty to £642,430. In addition, the regulators noted that Mr Staley is 'censured by the publication of the regulators' Final Notices'. Separately, Barclays announced that it had 'reduced the awarded value of Mr Staley's variable compensation for 2016 by £500,000'.
- **Penalty against Barclays**: Barclays has agreed to additional reporting requirements in relation to its whistleblowing systems including a requirement for Barclays' Whistleblowers' Champions — who are approved by the FCA and PRA under the Senior Managers Regime — to attest personally to the soundness of its whistleblowing systems and controls annually among others. The measures, which

apply to all cases until the end of 2020, are the first of their kind applied to a regulated firm in relation to whistleblowing the regulators note.

Barclays commented: In a statement welcoming the conclusion of the investigation, Barclays noted that 'There were no findings by the FCA or PRA that Mr Staley acted with a lack of integrity, nor any findings that he lacked the fitness and propriety to continue to perform his current role' and reiterated that Mr Staley continues to have the support of the board, and of shareholders based on the outcomes of the recent AGM. Mr Staley said: I have consistently acknowledged that my personal involvement in this matter was inappropriate, and I have apologised for mistakes which I made.'

Are the sanctions sufficient?

- Commenting on the finding, and acknowledging that Mr Staley (and Barclays) were sanctioned, The FT argues that the scale of the penalty is not in alignment with the importance of protecting whistleblower's anonymity (especially in the absence of incentives for whistleblowers to come forward): 'his [Mr Staley's] intervention served no purpose other than to root out and potentially intimidate a witness. In any system built on the principle of whistleblower protection, that cannot be a minor or technical offence' the FT writes.
- Forbes goes further arguing that the fact that Mr Staley was allowed to remain in his role 'sets an alarming precedent'.
- The WSJ quotes various commentators as suggesting that the penalty is insufficient to act as a deterrent to others. The article adds that the New York State Department of Financial Services is also still investigating the matter.

[Sources: Barclays media release 11/05/2018; Financial Conduct Authority Final Notice to Mr James Edward Staley 11/05/2018; Bank of England press release 11/05/2018; PRA written notice to Barclays Bank plc 09/05/2018; [registration requires] The WSJ 11/05/2018; [registration required] The FT 14/05/2018; Forbes 07/05/2018]

Hong Kong | The Securities and Futures exchange has issued an update on the implementation of the Manager-In-Charge regime (MIC) and highlighted areas on which it will focus when assessing the 'fitness and properness' of licensees and applicants.

The Hong Kong Securities and Futures Commission (SFC) has released the second issue *SFC Compliance Bulletin: Intermediaries* for 2018. The bulletin includes updates on the following points (among others).

- **Key trends noted in the SFC's licensing statistics**
  - The number of licensed corporations (LCs) and individuals increased at annual compound rates of 7% and 3% respectively over the past five years. As of 31 March 2018, the total number of licensees in Hong Kong reached a historical high of 44,238, up 3% from the previous year, while the number of LCs surpassed the 2,700 mark.
  - The bulletin highlights the trend towards Mainland Chinese entities choosing to establish or extend their financial services businesses in Hong Kong through setting up new LCs or acquiring existing ones, as evidence of greater financial market integration between the Mainland and Hong Kong. Approximately, 13% of all LCs are now controlled by Mainland-based corporate shareholders. In addition, after the November 2014 launch of Shanghai-Hong Kong Stock Connect, the number of stock exchange participants in Hong Kong has climbed steadily.
- **Provides examples of steps which licensed corporations have taken to strengthen corporate governance and senior management accountability following the introduction of the Manager in Charge (MIC) regime which** was fully implemented in October 2017. These include: instances of rectifying misalignments of executive responsibilities and licensing arrangements by, for example, analysing executive responsibilities and applying for the relevant licenses to reflect the appropriate level of responsibility; providing additional training to the executives where necessary; enhancing management and reporting structures to ensure the responsibilities and accountability of committees and individuals senior managers are clearly delineated across the organisation.

- **Highlights areas on which the SFC will focus when assessing the 'fitness and properness' of licensees and applicants** which include, failure to meet the SFC's fitness and properness requirements or to provide complete, true and accurate information to the SFC.
- **Flags SFC's intention to conduct a thematic review** of the structure and effectiveness of the management of licensed corporations, including board governance and the responsibilities of MICs.

SFC's Deputy Chief Executive Officer and Executive Director of Intermediaries Ms Julia Leung comments: 'With the number of SFC licensees reaching record highs and the industry landscape evolving rapidly, we are reviewing our process to ensure that our gatekeeping function continues to be carried out in a fair, efficient and transparent manner. Licensees have to remain fit and proper and in this connection, we are pleased to note that licensed corporations have strengthened their senior management accountability which in turn is driving proper behaviour.'

[Sources: SFC media release 16/05/2018; SFC Compliance Bulletin: Intermediaries Issue No 2 May 2018]

Consultation on phase 1 of the 'Retirement Income Framework': Progressing reforms announced in the 2018-2019 Federal Budget, the government in consulting on the principles the government proposes to implement in legislating the retirement income covenant.

Minister for Revenue and Financial Services Kelly O'Dwyer has released a position paper outlining the proposed principles underpinning a 'retirement income covenant' — which is proposed to be included in the Superannuation Industry (Supervision) Act 1993 (SIS Act) — as a first stage of the development of a retirement income framework.

The retirement income covenant proposes requiring trustees to develop a retirement income strategy for their members. More particularly, Treasury writes that the proposed changes will 'codify the requirements and obligations for superannuation trustees to consider the retirement income needs of their members, expanding individuals' choice of retirement income products and improving standards of living in retirement'. Minister O'Dwyer commented that this is intended to 'form the cornerstone of the new framework'.

It's also proposed that there will be supporting regulations requiring trustees to offer their members a comprehensive income product for retirement (CIPR) and to guide and support members to select the right retirement solution.

The position paper outlines the principles the government proposes to implement in the covenant and supporting regulatory structures.

Minister O'Dwyer states that the government is prioritising the retirement income covenant and supporting regulations as the first phase of the retirement income framework. She adds that that the government is currently developing disclosure requirements (metrics), which she describes as 'another crucial part of the framework to better inform consumers and aid comparison of retirement products' and anticipates consulting on a detailed proposal later in the year.

The closing date for comments is 15 June 2018.

[Source: Minister for Revenue and Financial Services Kelly O'Dwyer media release 17/05/2018; Retirement Income Covenant Position Paper 17/05/2018]

In Brief | KPMG's *Super Insights Report 2018* predicts that half of Australia's superannuation funds will merge with larger funds or exit the system in the next ten years and that funds will also evolve to provide banking, aged care and other services.

[Sources: KPMG Super insights report 2018: the impact of regulatory changes, scrutiny, evolving member expectations and technology in the sector; [registration required] The AFR 16/05/2018; Investment Magazine 15/05/2018]

In Brief | An IFA survey of 1,456 financial advisers has found that the majority of financial advisers (47.9%) view the approach taken by the Financial Services Royal Commission as 'too lenient', while 41.2% expressed the view that 'it has been fair'. Only 10.9% of respondents indicated that the commission has been 'too harsh'. The IFA concludes from this that despite the fact that the

commission may result in significant further reform of the financial advice model (with implications for financial advisers) most advisers are supportive of the line the commission is taking.

[Source: IFA 17/05/2018]

Accounting and Audit

United Kingdom | The Work and Pensions and BEIS Committees have released their report into the collapse of Carillion plc. Among other things the report recommends that KPMG, EY, PwC and Deloitte should be referred to the Competition Authority for possible break up.

The UK Commons Work and Pensions Committee has released a report into the collapse of Carillion plc which has recommended (among other things) that:

1. KPMG, EY, PwC and Deloitte should be referred to the competition authority for possible break up;
2. Stronger powers for The Financial Reporting Council; and
3. 'A more active and interventionist approach' in the forthcoming revision to the Stewardship Code.

Further detail: The report includes the following findings and recommendations (among others).

- **Time to review the UK audit market — The 'big four' firms should be referred to the Competition and Markets Authority for possible break up.**
  - The report states that Carillion exposed the UK's audit market as a 'cosy club incapable of providing the degree of independent challenge needed'.
  - The lack of competition in the audit market was found to create 'conflicts of interest at every turn': KPMG were external auditors, Deloitte were internal auditors and Ernst and Young were tasked with turning the company around. The committee writes 'PwC variously advised the company, its pension schemes and the Government on Carillion contracts, but was still the least conflicted of the Four, and as the Official Receiver searched for a company to take on the job of Special Manager in the insolvency, the oligopoly had become a monopoly and PwC could name its price'.
  - More particularly, the report found that KMPG (which acted as Carillion's auditor for 19 years) failed to exercise professional scepticism towards Carillion's accounting judgments over the course of its tenure, consistently signing off on the figures presented to it despite the fact that 'Carillion's accounts were systematically manipulated to make optimistic assessments of revenue, in defiance of internal controls'. Therefore, the report concludes, KPMG was 'complicit' in enabling the issues to continue.
  - In addition, the report found that other firms were also paid 'lucrative fees' by Carillion to provide 'badges of credibility'. The report provides various examples of this including payments to Deloitte (£10 million to review risk management and financial controls), EY (£10.8 million for 'turnaround advice); and PwC (ongoing fees).
  - Recommendation that the 'Big Four' accounting firms be referred to the Competition Markets Authority for possible break up: 'KPMG's audits of Carillion were not isolated failures, but symptomatic of a market which works for the Big Four firms but fails the wider economy. …Waiting for a more competitive market that promotes quality and trust in audits has failed. It is time for a radically different approach. We recommend that the Government refers the statutory audit market to the Competition and Markets Authority. The terms of reference of that review should explicitly include consideration of both breaking up the Big Four into more audit firms, and detaching audit arms from those providing other professional services'.
- **Failures of the Carillion Board:** The report is also highly critical of the Carillion board concluding that 'Carillion's board are both responsible and culpable for the company's failure'. The report states that 'Carillion's directors, both executive and non-executive, were optimistic until the very end of the

company. They had built a culture of ever-growing reward behind the façade of an ever-growing company, focused on their personal profit and success. Even after the company became insolvent, directors seemed surprised the business had not survived. Once the business had completely collapsed, Carillion's directors sought to blame everyone but themselves for the destruction they caused. Their expressions of regret offer no comfort for employees, former employees and suppliers who have suffered because of their failure of leadership.' The report singles out three board members, the former Finance Director, CEO and Chair for particular criticism.

- **Former Finance Director**: 'Richard Adam was Carillion's Finance Director for 10 years. He was the architect of Carillion's aggressive accounting policies and resolutely refused to make adequate contributions to the company's pension schemes, which he considered a 'waste of money'. His voluntary departure at the end of 2016 and subsequent sale of all his shares were the actions of a man who knew where the company was heading'.
- **Former CEO**: 'Richard Howson, Chief Executive from 2012 to 2017, was the figurehead for a business that careered progressively out of control under his misguidedly self-assured leadership'.
- **Chair**: 'Philip Green joined the board in 2011 and became Chairman in 2014. He was an unquestioning optimist when his role was to challenge. Remarkably, to the end he thought he was the man to head a "new leadership team"'.
- Breach of duty and possible disqualification? The report suggests that the Insolvency Service should 'carefully consider' whether Carillion's former directors breached their duties under the Companies Act or to recommend to the Secretary of State action for disqualification as a director.

▪ **Failure of internal and external controls**

- **The report found there was a failure by non-executive directors to scrutinise or challenge executives.** 'Non-executives are there to scrutinise executive management. They have a particularly vital role in challenging risk management and strategy and should act as a bulwark against reckless executives. Carillion's NEDs were, however, unable to provide any remotely convincing evidence of their effective impact' the report states.
- **The report found that key regulators, the Financial Reporting Council (FRC) and the Pensions Regulator (TPR), 'were united in their feebleness and timidity'** and need to be more proactive in using the powers they do have to prevent future issues**.** The report states: 'This case is a test of the regulatory system. The Carillion collapse has exposed the toothlessness of the Financial Reporting Council and its reluctance to use aggressively the powers that it does have. There are four different regulators engaged, potentially pursuing action against different directors for related failings in discharging their duties. We have no confidence in the ability of these regulators, even with a new Memorandum of Understanding, to work together in a joined-up, rapid and coherent manner, to apportion blame and impose sanctions in high profile cases'.
- **Stronger powers for the FRC**: The report welcomes the government's review of the FRC's powers and effectiveness and calls on the government to 'provide the FRC with the necessary powers to be a much more aggressive and proactive regulator: one that can publicly question companies about dubious reporting, investigate allegations of poor practice from whistle-blowers and others, and can, through the judicious exercise of new powers, provide a sufficient deterrent against poor boardroom behaviour to drive up confidence in UK business standards over the long term'.
- **The report also calls for a more visible role for regulators in revisions to the Stewardship Code (to be undertaken this year):** 'The current Stewardship Code is insufficiently detailed to be effective and, as it exists on a comply or explain basis, completely unenforceable. It needs some teeth…A more active and interventionist approach is needed in the forthcoming revision of the Stewardship Code, including a more visible role for the regulators, principally the Financial Reporting Council'.

- **Carillion could happen again**: The report concludes that: 'Most companies are not run with Carillion's reckless short-termism, and most company directors are far more concerned by the wider consequences of their actions than the Carillion board. But that should not obscure the fact that Carillion became a giant and unsustainable corporate time bomb in a regulatory and legal environment still in existence today. The individuals who failed in their responsibilities, in running Carillion and in challenging, advising or regulating it, were often acting entirely in line with their personal incentives. Carillion could happen again, and soon'.

[Sources: [registration required] The AFR 16/05/2018; 16/05/2018; [registration required] The FT 16/05/2018; 16/05/2018;13/05/2018; 17/05/2018; Work and Pensions Committee: Carillion joint inquiry 2nd report 16/05/2018]

Update: FRC investigation

As previously reported in Governance News on 26/03/2018, The FRC is conducting an investigation into the Carillion collapse.

Due to the high level of public interest in the issue, The FRC released an update on the progress of its investigation on 16 May in which it confirmed that the main areas of focus for the investigations of KPMG's audit of Carillion (2014 – 2017) and of two finance directors Richard Adam and Zafar Khan are: contract accounting; reverse factoring; pensions; goodwill and going concern. The FRC said that it is currently undertaking a review of audit files and other relevant materials and that it expects to 'review tens of thousands of documents and emails in order to establish how and why audit and accounting decisions were reached'. The FRC also states that it is collaborating with the OR (Insolvency Service), the FCA and the Pensions Regulator. It has also commenced the first of many detailed and recorded interviews and meetings with those under investigation, a process which can take several months.

The FRC states that it will complete the work relating to Carillion as quickly as possible but provides no specific timeframe.

[Source: Financial Reporting Council media release 16/05/2018]

New code of ethics: The Accounting Professional and Ethical Standards Board (APESB) has released a proposed update to the code of ethics following changes in international standards.

The Accounting Professional and Ethical Standards Board (APESB) is consulting on a proposed update to *APES 110 Code of Ethics for Professional Accountants* to incorporate changes resulting from the issue by the International Ethics Standards Board for Accountants (IESBA) of a restructured and renamed International Code of Ethics for Professional Accountants (including International Independence Standards).

The Exposure Draft proposes substantial revisions including:

- Structural and drafting enhancements developed under the IESBA's Structure of the Code project;
- Revisions to the provisions pertaining to safeguards in the Code, developed under the IESBA's Safeguards project;
- New requirements and application material relating to pressure to breach the fundamental principles, developed under the IESBA's Review of Part C project (Section 270);
- Revisions to clarify the responsibilities of Members in Business when preparing and reporting financial information, developed under the IESBA's Review of Part C project (Section 220);
- Revisions to clarify the applicability of the provisions in Part C of the extant Code to Members in Public Practice, developed under the IESBA's Review of Part C project (paragraphs R120.4, R300.5 and 300.5 A1); and
- New application material relating to professional scepticism and professional judgement, developed under the IESBA's Professional Scepticism (short-term) project (paragraphs 120.5 A1, 120.5 A2, 120.5 A3, 120.13 A1 and 120.13 A2).

Timeline: Consultation on the proposed changes will close 31 July 2018. The proposed effective date for the changes (once finalised) is 1 January 2020 (though 'earlier adoption of these provisions will be permitted').

[Sources: APESB media release 11/05/2018; Proposed Standard: APES 110 Code of Ethics for Professional Accountants May 2018; (including Independence Standards); Explanatory Memorandum; Accountants Daily 14/05/2018]

Risk Management

Cybersecurity

Greater impact than initially disclosed? The Equifax data breach reportedly impacted more customers than initially disclosed.

Fortune writes that Equifax Inc has reportedly said that tens of thousands of more consumers records were compromised in its 2017 data breach in a Securities and Exchange Commission (SEC) filing. According to the report, hackers accessed:

- Dates of birth of 146.6m US consumers;
- Social Security Numbers of 145.5m US consumers;
- Address information for 99m US consumers;
- Phone numbers for 20.3m consumers;
- Tax ID for 97,500 US consumers;
- Drivers Licence information for 17.6m consumers; in addition to gender, phone number and email addresses.

According to Fortune, many companies have yet to alter their systems and processes to avoid similar breaches occurring with many introducing the same security holes into their computer networks as were present at Equifax.

[Source: [registration required] The WSJ 08/05/2018]

In Brief | Facebook has reportedly suspended 200 apps as the investigation into data misuse following the Cambridge Analytica continues. It has not yet been established that the apps in question actually abused the data.

[Sources: City AM 14/08/2018]

Other developments

In Brief | The Hong Kong Securities and Futures Commission (SFC) has announced it has 'reprimanded and fined' Citigroup Global Markets Asia Limited (Citi) $57 million after resolving concerns with Citi over its discharge of duties as a sponsor in relation to the listing application of Real Gold Mining Limited (Real Gold).

[Sources: Hong Kong Securities and Futures Commission media release 17/05/2018; [registration required] The WSJ 17/05/2018]

In Brief | United Kingdom: An ad hoc post-legislative scrutiny committee, to be chaired by former Supreme Court Justice Lord Saville of Newdigate has been set by the House of Lords to consider the Bribery Act 2010 UK. The committee will explore whether the Act has achieved its objectives in terms of convictions and awareness of the Act among small and medium sized enterprises. The Committee will report by 31 March 2019.

[Sources: Bribery Act 2010 Committee membership 17/05/2018; Report: New ad hoc committees in 2018-2019 09/05/2018)

Restructuring and Insolvency

Do the proposed insolvency reforms go too far? Holding directors personally liable for company GST debt is asking directors to take on too much risk, The Australian argues.

Commenting on the possible impact of the proposed anti-phoenixing reforms announced in the 2018-2019 Federal Budget, and more particularly on the proposal to extend the Director Penalty Regime to GST, luxury car tax and wine equalisation tax which will make directors personally liable for the company's debts (see: Governance News 11/05/2018),The Australian argues that due to the added risk for directors the reforms are likely to:

- make it more difficult for entrepreneurial companies to attract expertise to their boards;
- make it more difficult for companies to obtain risk capital; and
- see a number of 'undercapitalised companies' in high risk industries go into administration.

'We need to stop bad practices but surely there is a better way than curbing honest entrepreneurship and employment by making directors stake their family home,' The Australian argues.

[Source: [registration required] The Australian 15/05/2018]

Other News

The Joint Standing Committee on Electoral Matters has recommended a referendum on s44 though according to media reports, the government has ruled out this option.

The Joint Standing Committee on Electoral Matters has today released its report into matters related to Section 44 of *The Australian Constitution.*

The committee makes four recommendations:

1. 'That the Australian Government prepare a proposed referendum question to either repeal sections 44 and 45 of the Constitution or insert into sections 44 and 45 the words: 'Until the Parliament otherwise provides…'
2. If the referendum passes, the Committee further recommends that the Australian Government further engages with the Australian community to determine contemporary expectations of standards in order to address all matters of qualification and disqualification for Parliament through legislation under section 34 of the Constitution.
3. In the event that a referendum does not proceed or does not pass, that the Australian Government consider strategies to mitigate the impact of section 44 as outlined in this report.
4. The Committee recommends that the Government consider the implications of this report in the context of the upcoming by-elections, in particular the options outlined in Chapter 4'.

In a statement, Committee Chair Senator Linda Reynolds said 'The question of whether or not the application of these rules meets contemporary Australian expectations' is an issue for the nation to determine and that the matter should be considered in the context of a wider 'debate on qualities we want in our candidates when they stand for election and for those who are elected to Parliament'.

Commenting specifically on the committee's recommendation that the question should be put to a referendum, Senator Reynolds said while the Committee had 'recommended a referendum to permanently fix the problems with s 44, the Committee acknowledged the preconditions for a successful referendum do not yet exist and may take time to achieve. Until such time a referendum is successful in providing Australians or their elected representatives the ability to change disqualifications, the committee has recommended the Federal Government consider implementing a range of mitigation strategies' she said.

Various media reports have said that the government has ruled out holding a referendum on the issue.

[Sources: Joint standing committee on electoral matters media release 17/05/2018; Report into matters relating to section 44 of the Constitution 17/05/2018; [registration required] The Australian 18/05/2018; 18/05/2018; [registration required] The SMH 11/05/2018; [registration required] The Courier Mail 18/05/2018]

In Brief | The government is consulting on plans to strengthen commonwealth procurement processes in line with the 2018-2019 Federal Budget announcement and building on the recommendations of the Black Economy Taskforce. Consultation on the proposed process will close on 15 June.

[Sources: Consultation paper: Increasing the integrity of the commonwealth procurement process 15/05/2018; Minister for Revenue and Financial Services Kelly O'Dwyer media release 15/05/2018]