Governance News

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Diversity

United States | Going backwards on diversity: Fortune has released its annual Fortune 500 list which reveals among other things a 25% drop (since 2017) in the number of women CEOs, and a 50% drop in the number of African American CEOs (since 2012).

Fortune has released its annual Fortune 500 list on the 500 largest US companies. Among other things, Fortune found the following.

- There was a 25% drop in the number of women CEOs since last year with only 24 female CEOs on the list (or 5% of the list overall) as compared to 32 in 2017.
- Overall, female representation on boards improved slightly with the number of companies with zero female directors dropping to 12 companies (as compared with 42 companies with zero directors 5 years ago).
- In addition, Fortune found that representation of African Americans has worsened with only three African American CEOs on the list (down from 6 in 2012).

[Sources: Fortune 21/05/2018; 22/05/2018; [registration required] The WSJ 21/05/2018]

In Brief | Nine Australians in the list of the 100 most influential people in gender policy globally: Director of the Workplace Gender Equality Agency Libby Lyons, Minister for Revenue and Financial Services Kelly O'Dwyer and former Prime Minister and Chair of the Institute for Women's leadership Julia Gillard are among those to have been included in the list of 100 most influential people in gender policy released by apolitical this week.

[Sources: apolitical: Gender Equality Top 100 The most influential people in global policy; Workplace Gender Equality Agency media release 21/05/2018]

In Brief | The WSJ writes that Stacey Cunningham will be the New York Stock Exchange's CEO and the board's 67th president and the first female leader in the NYSE's 226 year history.

[Sources: Fortune 21/05/2018; 22/05/2018; [registration required] The WSJ 21/05/2018]

Remuneration

United Kingdom | Was the additional compensation awarded to an executive who stepped in to act as interim CEO excessive? 37.62% of shareholders voted against the remuneration report at Bovis Homes Group plc at the 23 May 2018 AGM despite the company's engagement efforts.

At the 23 May 2018 Bovis Homes Group plc AGM, all resolutions put to the meeting were passed by shareholders, but the company states that a 'significant minority' (37.62%) voted against the remuneration report.

Bovis Group's response to the protest vote against the remuneration report: The company states that circumstances over the past year were unusual and that remuneration decisions were shaped by unusual circumstances including: the departure of the CEO, the CFO stepping in to act as interim CEO, two unsolicited bids, the arrival of a new CEO and the launch of a challenging turnaround plan. The company notes that the Remuneration Committee consulted extensively with shareholders prior to the AGM on its approach to executive remuneration for 2017/18 and that this process 'helped shape the remuneration decisions that were taken'. The company goes on to explain that in reaching its decisions, the 'Committee's priorities were to ensure that the Directors' remuneration arrangements were fully aligned with the business and incentivised the successful delivery of the Company's challenging turnaround plan, whilst also ensuring that they were fair and reasonable both for the executives and shareholders, in what was an unusual year'. Bovis states that it is committed to ongoing engagement with shareholders on the issue.

High protest vote to be expected? Commenting prior to the meeting, Glass Lewis acknowledged that additional compensation for the interim CEO in the circumstances was arguably not unwarranted, but questioned whether the remuneration was excessive in this case – he was given a salary increase, an increase in bonus and a one off additional award. Glass Lewis also questions the decision to strip shareholders of the opportunity to vote on the one time award, to reset its relative TSR target range and the terms of a recruitment package for the new CEO.

[Sources: Bovis Homes Group PLC result of AGM 23/05/2018; Glass Lewis Proxy Insight 15/05/2018]

Other Shareholder News

The board and the CFO of Godfreys Group Ltd have resigned en masse and with immediate effect following the group's takeover by Arcade Finance Pty Ltd (the family company of Godfreys co-founder John Johnston).

Godfreys Group Ltd have announced that Arcade Finance Pty Ltd have acquired a relevant interest of 65% of Godfreys shares, giving it a controlling interest in the group, and that the board (including the Chair) and the chief financial officer had resigned. Grant Hancock, who is a director of Arcade, has been appointed as Director of the Godfreys board.

The Australian comments that since listing in 2014 with an issue price of $2.75, Godfreys has performed poorly and the share price has steadily declined. According to the Australian Arcade intends to de-list Godfreys from the Australian Securities Exchange and operate it as a private company.

[Sources: [registration required] The Australian 23/05/2018; Godfreys ASX announcement 22/05/2018]

In Brief | Companies with dual class structures to continue to be included in MSCI indexes: MSCI proposes to continue to include securities with differential voting rights in equity indexes but with adjusted weights that reflect both free float and company-level listed voting power.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 22/05/2018]

Meetings and Proxy Advisers

CPA AGM | According to media reports, CPA Australia will move forward with all four of its board resolutions after they received sufficient backing in proxies (between 78 to 82% support) prior to the AGM.

According to media reports, CPA Australia will move forward with all four of its board resolutions after they received sufficient backing in proxies (between 78 to 82% support) prior to the AGM.

The passing of the resolutions will mean that the CPA will implement a number of changes including: abolishing the representative council in place of an appointments council; establishing a council of presidents; limiting the board to 10 directors and a minimum of two non-member directors; and capping director remuneration at $975,000 for 10 directors, and $900,000 for nine directors or less (removing the Auditor-General's salary as a benchmark of director pay).

According to media reports, members attending the meeting expressed frustration at what they viewed as a lack of substantive change. More particularly, the board reportedly faced questioning from members over the proxy result (and more particularly questions over alleged 'proxy harvesting' ahead of the AGM); over board remuneration; and over the failure to close CPA Australia Advice. The AFR reports that there were also calls for former CPA CEO Alex Malley to be stripped of life membership of the organisation.

The AFR reports that all ten member proposals, including proposals to remove Mr Wilson as chair, were defeated receiving around 30% support or less based on proxy votes received before the meeting. The article adds that Mr Wilson faced a protest vote of almost 19% based on proxy votes.

Jen Dalitz, a member described by The AFR as being 'heavily involved in last year's uprising' is quoted as commenting: 'The members that have put forward their resolutions have not been given a public forum through the body's mailing lists, to put their view forward while the board's view has been communicated through these shadowy means'.

According to the article, the CPA has said that it has done nothing wrong in encouraging members to exercise their right to vote ahead of the AGM, 'CPA Australia has been an international organisation for more than 60 years. Almost 30 per cent of members live overseas and the AGM affects all members' the AFR quotes a CPA spokesperson as stating.

[Sources: [registration required] The AFR 20/05/2018; 21/05/2018; 22/05/2018; Accountants Daily 23/05/2018]

Disclosure and Reporting

Time for banks to require corporate borrowers to disclose climate risk? Activist investor, TCI Fund Management has reportedly called on the BoE to introduce rules on how banks deal with the risks of climate change.

The FT reports that that activist investor Christopher Hohn (head of TCI Fund Management) has written to Bank of England (BoE) Governor, Mark Carney urging the BoE to introduce rules on how banks deal with the risks of climate change. According to The FT, Mr Hohn has called for banks to introduce a mandatory requirement for corporate borrowers to disclose the risks they face from climate change in line with the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations. Reportedly, Mr Hohn wrote that while UK banks are exposed to a wide range of 'serious climate-related risks' through their loan books, the current disclosure regime means there is inadequate information for investors. Mr Hohn reportedly cautioned that failure to act could potentially endanger the long-term stability of Britain's banking system.

Mr Hohn also reportedly suggested that because Royal Bank of Scotland is controlled by the government, its board should set an example and independently require this disclosure by its borrowers. The FT quotes RBS as stating that it is 'fully supportive' of initiatives such as the TCFD and would soon announce an updated policy on lending to high-carbon sectors to reduce its exposure to climate risks.

Noting recent support by fund managers for shareholder climate disclosure proposals, The FT suggests that the letter is the latest indication that fund managers are increasingly concerned about the risk climate changes poses to their investments. The article also notes that climate disclosure is emerging as a key shareholder concern at recent AGMs with many UK banks under 'particular pressure' from shareholders and environmental groups.

[Source: [registration required] The FT 22/05/2018]

Markets and Exchanges

United States | The CFTC has issued guidance to exchanges and clearinghouses on listing cryptocurrency products.

The Commodity Futures Trading Commission's (CFTC) Division of Market Oversight (DMO) and Division of Clearing and Risk (DCR) has issued a joint staff advisory intended to give exchanges and clearinghouses registered with the CFTC guidance for listing virtual currency derivative products.

The advisory outlines 'certain key areas' which the CFTC 'require particular attention in the context of listing a new virtual currency derivatives contract' and clarifies the CFTC staffs' priorities and expectations in its review of new virtual currency derivatives to be listed on a designated contract market or swap execution facility, or to be cleared by a derivatives clearing organization. The 'key areas' highlighted in the guidance as requiring particular attention are:

- 'Enhanced market surveillance
- Close coordination with CFTC staff
- Large trader reporting
- Outreach to member and market participants
- Derivatives Clearing Organization risk management and governance'.

[Sources: Commodity Futures Trading Commission media release 21/05/2018; [registration required] The WSJ 21/05/2018; [registration required] The WSJ 21/05/2018]

In Brief | The Commodity Futures Trading Commission (CFTC) announced it has approved the Australian Securities Exchange Limited's (ASX 24) application to permit direct access for US customers to trade on its platform. Under the order, ASX 24 is registered with the CFTC and allowed to permit members and other participants in the US to trade by direct access on the exchange without having to trade through an intermediary.

[Sources: Commodity Futures Trading Commission media release 22/05/2018; ASX 24 Order of Registration]

Regulators

Australian Securities and Investments Commission (ASIC)

Second and final phase of industry funding model ASIC fees-for-services: Legislation introduced 24 May 2018.

The government introduced four Bills on 24 May to enact the second and final phase of the ASIC industry funding model – fees-for-service. The Bills propose changes to enable the Australian Securities and Investments Commission (ASIC) to charge entities a fee reflective of the actual (rather than then nominal) cost of providing specific services to them.

The Bills are:

1. *Corporations (Fees) Amendment (ASIC Fees) Bill* 2018.
2. *Superannuation Auditor Registration Imposition Amendment (ASIC Fees) Bill* 2018.
3. *Superannuation Industry (Supervision) Amendment (ASIC Fees) Bill* 2018.
4. *National Consumer Credit Protection (Fees) Amendment (ASIC Fees) Bill* 2018.

Minister O'Dwyer said that the proposed industry funding framework 'will ensure ASIC is transparent and held accountable throughout its periodic review in setting fee amounts by involving a public consultation process utilising a cost recovery implementation service. As an additional accountability mechanism, ASIC will include industry funding on the agenda of their external committees and panels for consideration'.

The Government will review the industry funding model accountability framework in three years. The new fee model is intended to commence from 1 July 2018.

[Sources: Corporations (Fees) Amendment (ASIC Fees) Bill 2018; Explanatory Memorandum; Superannuation Auditor Registration Imposition Amendment (ASIC Fees) Bill 2018; Explanatory Memorandum; Superannuation Industry (Supervision) Amendment (ASIC Fees) Bill 2018; Explanatory Memorandum; National Consumer Credit Protection (Fees) Amendment (ASIC Fees) Bill 2018; Explanatory Memorandum; Minister for Revenue and Financial Services Kelly O'Dwyer media release 24/05/2018]

The AAT has affirmed ASIC's decision to disqualify the director of 18 failed companies until 18 February 2019.

ASIC has announced that the Administrative Appeals Tribunal (AAT) has affirmed its decision to disqualify Mr Lubo Zivanoic from managing corporations until 18 February 2019.

- ASIC disqualified Mr Zivanovic on 18 February 2016, following his involvement in the management of 18 failed companies all of which were wound up in liquidation between 2008 and 2014.
- Liquidators reports were lodged for all 18 companies, alleging each company was insolvent and had failed to keep books and records. The total estimated deficiency by the liquidators was $26,855,268.
- The liquidators also lodged supplementary reports with ASIC alleging these companies failed due to Mr Zivanovic's poor management and control, the extremely large debts that were accrued, their failure to pay tax and lack of company records.

- Mr Zivanovic appealed ASIC's disqualification decision to the AAT and obtained suppression orders that prevented ASIC from disclosing his disqualification.
- On 17 May 2018, the AAT upheld ASIC's decision to disqualify Mr Zivanovic. Mr Zivanovic is now disqualified from managing corporations until 18 February 2019.

[Source: 18-147MR AAT affirms ASIC's decision to disqualify director of 18 failed companies]

In Brief | Echoing many of the same themes as have featured in recent speeches by ASIC Chair James Shipton, ASIC Commissioner John Price has called on industry to embed 'a strong ethical perspective into your DNA' to rebuild trust and to seek to cooperate with the regulator. He also reiterated ASIC's focus on aligning conduct in a market-based system with investor and consumer trust and confidence flagging that there would be particular focus on gatekeeper confidence, professionalism, independence and ethical standards.

[Note: Mr Price's speech touches on many of the themes raised in ASIC Chair James Shipton's recent speeches including the address to the Australian Council of Superannuation Investors (ACSI) annual forum in which Mr Shipton called on industry to act to address the 'trust deficit'. See: Governance News 18/05/2018; and his inaugural keynote address to the ASIC Annual forum. See: Governance News 23/03/2018. Mr Price also called on industry to review the recently released APRA report into CBA culture (see: Governance News 04/05/2018) and to make use of available resources to assist in the process of cultural review. In particular, he referenced *Managing Culture: A good practice guide*. This publication was jointly released by The Governance Institute of Australia, The Ethics Centre, The Institute for Internal Auditors – Australia (IIA-A), and Chartered Accountants Australia New Zealand in December 2017. The guide argues that an ethical framework should sit at the heart of the governance framework of an organisation to drive good culture. In addition, the guide argues that internal and external audit, human resources and management as well as the board have a role to play in ensuring good conduct across the organisation. The guide provides high level guidance to these roles. See: Governance News 15/12/2018]

[Source: A speech by John Price, Commissioner, Australian Securities and Investments Commission Audit & Risk Committee Forum 2018 (Melbourne, Australia) 21/05/2018]

Australian Prudential Regulation Authority (APRA)

Additional Deputy Chair for APRA? New Bill proposed to enable the appointment of up to two Deputy Chairs.

Treasury Laws Amendment (APRA Governance) Bill 2018 (the Bill) was introduced into the House of Representatives on 24 May. The Bill amends the *Australian Prudential Regulation Authority Act* 1998 (APRA Act) to enable the Governor-General the discretion to appoint a second Deputy Chair of APRA.

Treasurer Scott Morrison issued a statement which said that the legislation 'will bolster the ability of the Australian Prudential Regulation Authority (APRA) to ensure stability and accountability in our critical financial sector through the appointment of a second Deputy Chair' and that the additional Deputy Chair would provide APRA with greater flexibility in the way it governed and allocated responsibilities helping to maximise the skills and capabilities available within its leadership.

Mr Morrison added that the government has already moved to appoint a second Deputy Chair at the Australian Securities and Investments Commission, and that it is appropriate that this also occurs for APRA.

[Sources: Treasury Laws Amendment (APRA Governance) Bill 2018; Explanatory Memorandum; Treasurer Scott Morrison media release 24/05/2018]

APRA is undertaking a comprehensive post-implementation review of the superannuation prudential framework to ensure it is meeting its objectives and remains fit for purpose. The review will be completed in three stages, and submissions will close 26 September 2018.

The Australian Prudential Regulation Authority (APRA) is undertaking a comprehensive post-implementation review of the superannuation prudential framework introduced in 2013.

Purpose of the review: APRA writes that the aim of the review is 'to ensure the prudential and reporting standards, and related guidance, have achieved their objectives and continue to remain fit for purpose…In conducting this post-implementation review, APRA's objective is neither to weaken nor strengthen the prudential framework. APRA will, however, consider changes to the prudential framework to address any gaps identified or issues raised during the review process to improve its effectiveness'.

More specifically, APRA is seeking feedback on:

- the effectiveness of the current prudential and reporting standards and supporting guidance material;
- the practical impact of the framework for stakeholders;
- areas within the framework that could be reviewed to either enhance outcomes or reduce compliance costs; and
- the merits of potential changes to the framework to achieve this.

Scope of the review

- The post-implementation review covers all prudential and reporting standards (including guidance material) introduced or refined as a result of the Stronger Super changes.
- Subsequent changes to the prudential framework, such as, Prudential Standard CPS 226 Margining and risk mitigation for non-centrally cleared derivatives and Prudential Practice Guide SPG 227 Successor Funds Transfers and Wind-ups are outside the scope of the review.
- In total, the review will cover over 100 separate elements of the prudential framework including 13 prudential standards, 37 reporting standards and up to 58 guidance documents (practice guides, letters and information statements).
- To facilitate consideration of the various elements of the prudential framework, the review will be conducted under six broad topic areas starting with Governance and Risk management followed by Financial requirements, operational risk and outsourcing; Investments; Insurance; and Member flows and products.

Staged review: The consultation will be completed in 'three tranches'.

- **First tranche (released 23 May 2018)**: APRA has released the first of a series of consultation papers on aspects of the prudential framework:
  - **An 'overarching discussion paper'** outlining the purpose of the review and review process in more detail and seeking feedback on the superannuation prudential framework as a whole.
  - **Short topic paper — Governance** seeking feedback on the following prudential standards (and their related guidance material) and the following reporting standards: Prudential Standard SPS 510 Governance (SPS 510), Prudential Standard SPS 520 Fit and Proper (SPS 520), Prudential Standard SPS 521 Conflicts of Interest (SPS 521); Reporting Standard SRS 520.0; Responsible Persons Information (SRS 520.0); Reporting Standard SRS 600.0; Profile and Structure (RSE licensee) (SRS 600.0); and Reporting Standard SRS 601.0 Profile and Structure (RSE) (SRS 601.0).
  - **Short topic paper — Risk Management** seeking feedback on Prudential Standard SPS 220 Risk Management (SPS 220) and Prudential Standard SPS 310 Audit and Related Matters (SPS 310) and their related guidance material.
- **The second tranche** will comprise two short topic papers covering financial requirements, operational risk and outsourcing and investments.
- **The third and final tranche** will comprise the final two short topic papers covering insurance and member flows and products.

APRA will undertake a targeted public consultation on each tranche over a four week period, involving industry roundtables/workshops, bilateral meetings and calls for submissions.

Timeline: Submissions on all three tranches are requested by 26 September 2018. A final report on the superannuation post-implementation review is expected to be released by early 2019.

[Sources: APRA media release 23/05/2018; Discussion paper: Post Implementation Review of APRA's superannuation prudential framework 23/05/2018; Short topic paper one — Governance 23/05/2018; Short topic paper two — Risk Management 23/05/2018

Australian Transaction Reports and Analysis Centre (AUSTRAC)

In Brief | AUSTRAC is consulting on the proposed charging model for determining component amounts of the 2018-2019 industry contribution levy. Consultation closes 22 June 2018.

[Source: AUSTRAC media release 24/05/2018; AUSTRAC industry contribution 2018-19 – stakeholder consultation paper]

Other Developments

United Kingdom | Progress update on the 'root and branch' review of the Financial Reporting Council: Sir John Kingman has reportedly announced the members of the panel which will assist him in undertaking the review.

As previously reported in Governance News on 20/04/2018 on 17 April, the UK government announced the launch of an independent 'root and branch' review of the Financial Reporting Council (FRC) the regulator for auditors, accountants and actuaries. The announcement followed calls earlier in the year from Business Secretary Greg Clark (among others), for an independent review of the regulator, its independence and its enforcement powers, in the wake of the collapse of Carrillion plc. The purpose of the review according to the government's statement is to 'make the FRC the best in class for corporate governance and transparency, while helping it fulfil its role of safeguarding the UK's leading business environment'.

The FT writes that review Sir John Kingman has selected his panel of 11 prominent business leaders, to assist in undertaking the review. According to The FT the panel will include:

- Anne Richards (CEO of UK investment house M&G);
- Amelia Fawcett (Deputy Chair of Swedish investment firm Kinnevik and a non-executive director at HM Treasury);
- Mary Keegan (former chair of the Accounting Standards Board and former audit partner at PwC);
- Mark Burgess (CIO for Europe at Columbia Threadneedle);
- Simon Fraser (Chair of the F&C Investment Trust and of industry group the Investor Forum);
- Amelia Fletcher (professor of competition policy at the University of East Anglia and a non-executive director at three UK regulators — the Financial Conduct Authority, the Payment Systems Regulator and the Competition and Markets Authority).

The FT writes that the positions are voluntary and unpaid. The FT comments that no current executives from the Big Four accounting firms are included on the panel but despite this, some commentators have said that the panel is too close to the establishment and unlikely to recommend the 'radical changes they believe are needed'.

[Note: The UK BEIS and Commons Work and Pensions Committee recently released a report into the collapse of Carillion plc which found, among other things, that the Financial Reporting Council (FRC) and the Pensions Regulator (TPR), 'were united in their feebleness and timidity' and which recommended (among other things) stronger powers for the FRC. See: Governance News 21/05/2018]

[Source: [registration required] The FT 18/05/2018]

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

Top Story | Round 3 Hearings Week 1: The focus of the first week of hearings was on the provision of credit to SMEs with particular focus on the conduct of financial services entities in connection with applications for business loans and the approach of the entities to hardship.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) commenced its third round of public hearings on 21 May. This round of hearings, which will run until 1 June, will focus on bank lending practices, and more particularly, on the provision of credit to small and medium enterprises (SMEs). A high level overview of the issues to be explored during the hearings as highlighted by Counsel Assisting Michael Hodge QC in his opening statement to the Commission, and of the case studies considered in the first week of hearings is below.

Focus of the hearings overall: three overarching questions to be considered

Mr Hodge identified 'three overarching questions' for consideration over the course of the hearings:

1. What obligations in relation to responsible lending ought to apply to small businesses?
2. In what circumstances might the exercise by a bank of default based contractual rights become unfair, unconscionable, or below community standards, when the relevant loan is a small business loan or a business loan?
3. How have the banks and the regulators responded to calls for higher standards for dealings with small business and the introduction of legislative prohibitions on unfair terms in small business contracts?

Mr Hodge stipulated that this round of hearings would not include consideration of lending to farmers as this would be the subject of the next round of hearings.

Case studies: Questions to be explored.

As previously, specific topics were explored/will be explored by reference to case studies. Mr Hodge said that the case studies in this round of hearings would collectively present an opportunity for the Commission to consider the following questions.

1. How 'small business' is defined in this context.
2. The rationale for distinguishing between small business loans and other business loans.
3. What meaningful difference in outcome would be expected if the requirements for lending to small businesses, as distinct from the bank’s compliance and application of existing requirements, was changed?
4. Whether the obligations with respect to SME loans should be adjusted to more closely reflect the obligations in relation to consumer loans, particularly where residential or other family assets are used to secure the loan.
5. Whether this change would result in any meaningful difference of outcome for small business customers or the guarantors.
6. What is the right balance between protecting SME borrowers through regulation and not creating barriers to business financing, and what does the community expect in this regard?
7. Whether the current policy setting for SME lending, whereby there is minimal regulatory oversight of banks in relation to SME lending and banks are effectively left to regulate in this space through the Code of Banking Practice, is correct.
8. The question of how significant power imbalances between the banks and SMEs in relation to lending affect the conditions for entry into and exit from these types of loans.
9. How sophisticated and well-resourced can SME customers be expected to be in their dealings with banks?
10. What is the right balance between banks being able to exercise their contractual rights to protect their interests and those of their shareholders and creditors and their promise to act fairly and reasonably towards an SME in a consistent and ethical manner?
11. Have banks responded effectively to relevant legislative changes, including the unfair contract terms provisions in the ASIC Act?
12. What has been the regulator’s role in implementing these changes?

13. Are SMEs able to obtain efficient and cost-effective redress in their dispute with lenders?

[Source: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Transcript 21 May 2018 – Draft Transcript for Day 20]

Focus of the first week of hearings: 21 May – 25 May

Mr Hodge said that the first week of hearings would focus predominantly on the conduct of financial services entities in connection with applications for business loans and the approach of the entities to hardship (broadly speaking, Topics 1 and 2 as identified in the schedule of Topics and Case studies to be considered in this round of hearings). In particular, he said there would be a focus on how banks assessed such loans, whether such practices met community standards and expectations, and the circumstances where financial abuse was apparent, including where spouses or family members find themselves as co-debtors or guarantors.

Parental guarantee and mortgage case study

This case study concerned Ms Carolyn Flanagan who provided a personal guarantee and mortgage to Westpac in relation to a business loan taken out by her daughter and daughter's partner. The Commission heard that Ms Flanagan, who suffers from glaucoma and is legally blind as well suffering from a number of other health conditions, was approved (by Westpac) to guarantee the loan. After the borrowers defaulted on the loan, Westpac sought to repossess Ms Flanagan's home (though later agreed to allow her to remain in it until her death), and an FOS complaint was lodged.

Ms Flanagan and her Legal Aid solicitor each gave evidence about the taking of the guarantee and security from Ms Flanagan. The Commission heard that Ms Flanagan's recollection of the loan approval process was unclear and that she appears not to have sought independent legal advice before providing the guarantee. The Commission also heard that Ms Flanagan's understanding of the loan amount may have been incorrect (she may have understood it was for a lesser amount that was actually the case) and questioned were asked around whether Ms Flanagan fully understood the import of providing the guarantee. Dana Beiglari (Legal Aid NSW) also gave evidence of the experience of legal aid clients more generally. She said many elderly clients felt obligated to provide similar guarantees to their children/family members and in these circumstances, were less likely to seek independent legal advice.

Asked whether Westpac should have accepted a guarantee from Ms Flanagan and whether Ms Flanagan's case was indicative of 'a problem' with the process for taking a guarantee general manager for commercial banking at the Westpac group Mr Alastair Welsh said that though it had a 'sad result' in the particular case, there was not a problem with the practice more generally. Mr Welsh also denied that there was any failure to exercise due care and skill as a banker in the particular case. Mr Welsh said: 'In my view of the situation is we allowed a mother to back her – back her child. And that's…a big part of backing small businesses, where parents support their children, as we heard from Ms Flanagan yesterday. And in this situation it has turned out in a very sad way'.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Transcript 21 May 2018 – Draft Transcript for Day 20; 22 May 2018 – Draft Transcript for Day 21]

Entry into loans for the purposes of purchasing franchise businesses — Three case studies.

The three case studies each concerned the provision of a loan for the purpose of purchasing a franchise which, in each instance, subsequently failed. In each case, the process by which the loans were approved by the lenders, the approach of the banks to monitoring and enforcing the loan and their approaches to dealing with the Financial Ombudsman Service (FOS) complaints was explored.

1. **Gelato franchise case study:** The case study concerned business credit facilities provided by ANZ in relation to the purchase of a gelato franchise by a husband and wife which, when the franchise failed, became the subject of a Financial Ombudsman Service (FOS) complaint. The loan was approved on the basis of the bank's assessment of a business plan containing 'optimistic' revenue forecasts.

   The FOS complaint alleged that ANZ should not have approved the loan because it should have determined that the company would be unable to service it. The FOS issued a recommendation, and later a formal determination, in favour of the customer (which ANZ has complied with though it disagreed with the FOS determination) which found that ANZ did not exercise the care and skill of a diligent and prudent banker in selecting and applying credit assessment methods and in forming an opinion about the customer's ability to repay the credit facility before giving or increasing such a facility (in accordance with clause 27 of the Banking Code of Conduct).

The Commission heard evidence from general manager home lending at the ANZ Bank Kate Gibson about the process ANZ follows to assess customer's capacity to service business loans of this kind. Mr Hodge QC questioned whether ANZ bankers had met the requirements of the banking industry code, to act with the 'care and skill of a diligent and prudent banker' in the particular circumstances and more particularly whether the approach taken to assessing loan serviceability was sufficiently stringent to meet this requirement. Ms Gibson said that ANZ disagreed with the FOS determination on the basis that it would have required ANZ to adopt an uncommercial approach to assessing the ability of customers to service a loan (that it would potentially have a detrimental effect on the ability of small businesses to get credit more generally), and on the basis that it acted reasonably in the circumstances.

ANZ was also questioned about whether a focus 'on new to bank lending may have contributed to poor practices' with regard to bringing in new loans. ANZ denied that this was the case and added that there was 'no culture of sales pressure'. Asked whether ANZ viewed the risk in taking on a loan ultimately sits with the borrower (rather than the bank) Ms Gibson said: 'I think in – in a case where the bank is lending money to them, it's a risk for the bank, as well. But I agree with you that the decision to invest in a small business is the decision of the small business owner'.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 22 May 2018 – Draft Transcript for Day 21; 23 May 2018 – Draft Transcript for Day 22]

- **Pie Face franchise case study:** The case study concerned Westpac's assessment of the suitability of a loan to Ms Marion Messih (and her sister in law and business partner), provided for the purposes of purchasing a Pie Face franchise. The Commission heard evidence from Ms Messih about the loan approval process which Ms Messih said relied largely on the fact that Pie Face was, at the time the loan was approved, 'accredited' with Westpac as a franchisor and on the security provided by Ms Messih and her business partner (rather than on projected revenue). The commission also heard about the transfer by Ms Messih of all her banking (including her mortgages) to Westpac, the eventual failure of the business and her decision (when unable to service loan repayments) to sell her investment property. Ms Messih told the commission that she intended that the proceeds of the sale of investment property go towards settlement of various debts, including a proportion against 'her' 50% share of the business loan for the Pie Face franchise. Ms Messih said that instead, Westpac required that 100% of the proceeds be used to repay the business loan in full (ie including her sister-in-law's 50% share). The Commission heard that Ms Messih lodged a complaint with the FOS claiming that the loan should never have been made on the basis that the bank should have known that she and her sister in law would be unable to make the repayments. The FOS found Westpac should have applied a larger 'buffer' (50% higher than had been applied in this case) to test Ms Messih's ability to repay the loan and directed that Westpac repay interest and fees on the loan back to Ms Messih. However, Ms Messih was still required to repay the principal.

  Asked whether the loan should have been made in this case, general manager for commercial banking at the Westpac group Mr Alastair Welsh maintained that it should have been made. Mr Welsh, said that the bank disagreed with (though complied with) the FOS finding in the case on the basis that it would be uncommercial to adopt the FOS approach to assessing serviceability. Had the bank adopted the approach FOS advocated he said it 'would prohibit a lot of business lending….[and] that would be very concerning for me' he said. Westpac was also questioned over possible conflict of interest arising in relation to sales incentives. Westpac outlined changes that had been made to the incentive programs since the Sedgwick revue which mean that incentives are now not solely reliant on the achievement of financial targets.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 22 May 2018 – Draft Transcript for Day 21; 23 May 2018 – Draft Transcript for Day 22]

- **Wendys case study:** The case study concerned the credit assessment undertaken by the Bank of Queensland (BOQ) in relation to a business loan to Suzanne Riches for the purpose of purchasing two Wendys outlets in a shopping centre in Adelaide. The Commission heard that Ms Riches applied for the loan with the intention of running the business with her husband (who had some experience in the industry). She provided the family home and another block of land (investment property) both of which were in her name as security. Following a meeting with the manager of BOQ, Ms Riches said she had made an offer for two Wendys franchises on the understanding that BOQ would provide her with the necessary financing, but before securing formal approval for the loan from BOQ. Ms Riches said that due to delays in the loan approval, and after missing the settlement date, she ultimately accepted a revised loan from BOQ on different terms from what had previously been discussed with her. Notably the repayments were significantly higher than what she had originally been offered. The Commission heard that Ms Riches defaulted on the loan and after one of the Wendys outlets closed, took her case to the FOS seeking reimbursement for her losses. Ms Riches then described her experience following bringing the complaint.

Asked about the process for approving the loan, banker, general manager of product performance and governance Mr Douglas Snell said that BOQ acknowledged there was 'maladministration' in the loan approval process and acknowledged various other issues at the particular branch that approved the loan (including that the manager in question acted outside his authority).

Mr Snell was also questioned about the approach the bank took to the FOS complaint. The Commission heard that internal documents showed that BOQ considered making an offer to Ms Riches to settle the complaint which for reasons that are unclear, was not put to Ms Riches. Referencing various internal BOQ documents, it was alleged that despite agreeing with the FOS's summary of the dispute, BOQ internal processes delayed the FOS process with the object of limiting the eventual payment amount to Ms Riches. Mr Snell said that the approach to resolving the complaint in the particular case 'wasn't fair and reasonable'.

Mr Snell was also questioned about the remuneration structures for BOQ franchisees and separately, about whether it is clear to SME borrowers that the bank is acting in its own (not necessarily the borrower's) commercial interests. The Commissioner asked: 'When trying to understand what is, what could be, what should be the relationship between bank and small to medium enterprise customer, is there at least a possible misunderstanding by the customer of the role of the bank arising out of comments of the kind [the Commissioner had previously given several examples including: 'putting our customer first', 'focus on the customer' and 'activing the best interests of the customer']'. Mr Snell responded that 'I think the goal and the intention is there, but if I'm – if I'm answering your question, yes, there's definitely a deviation in terms of what the client expects and gets at times'.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 23 May 2018 – Draft Transcript for Day 22; 24 May 2018 – Draft Transcript for Day 23]

Cross-collateralisation case study: Brad Wallis

This case study concerned a business loan provided by Bank of Melbourne (a Westpac subsidiary) to Brad Wallis for the purchase of a property to be used to run a bed and breakfast and restaurant business near Port Macquarie. Mr Wallis said that he and his wife also intended to live on the property and described the loan approval process in some detail. The loan eventually taken out by the couple with Bank of Melbourne was a residential loan rather than a commercial loan.

The Commission heard that the couple were required by the lender to refinance a separate investment property with the Bank of Melbourne in order to secure the loan.

When the business failed to prosper, Mr Wallis sought to sell the investment property.

As a condition of releasing the mortgage over the investment property, the couple were required by the Bank of Melbourne to set up a term deposit into which $100,000 of the surplus proceeds of sale would be held. Mr Wallis told the Commission that the couple understood that they were unable to access these funds. It was also a condition imposed by the bank that the couple agreed to restructure the residential loan (over the bed and breakfast) as a business loan.

Mr Wallis said that he regarded this action by the lender as 'unjust', and sent emails to Bank of Melbourne asking that they explain the basis on which they were making the changes. He subsequently lodged an FOS complaint.

Mr Wallis went on to say that before the FOS had made any recommendation or determination he entered into a contract to sell the bed and breakfast business and the property after which, the Bank of Melbourne released the term deposit. Following this, the FOS made a recommendation which found that the loan should have been a commercial loan, and that though entitled under the terms of the loan documents to retain part of the sale proceeds of the investment property, it was not fair for the bank do to so which the Bank accepted.

General manager for commercial banking at the Westpac group Mr Alastair Welsh was questioned about the loan approval process in this case. Counsel Assisting Rowena Orr QC questioned the reasoning behind offering the loan as a residential rather than a commercial loan suggesting that the decision to do so may have been motivated both by the fact that it enabled the bank to lend a larger amount, and that the banker may have been motivated by incentives linked to his financial performance.

Mr Welsh said that he agreed with the FOS that the loan should have been structured as a commercial rather than as a residential loan. Asked to comment on the decision by the bank to require the couple to create the $100,000 term deposit, Mr Welsh said that he agreed that it was an 'unfair' requirement: 'It was our mistake. We made the mistake originally, our banker got it wrong, and we shouldn't have imposed that mistake on the client.' Commissioner Hayne asked whether the decision was motivated by a desire on the part of the lender to improve its security position. Mr Welsh agreed that this could have been the case.

Commissioner Hayne went on to note that 'cross-collateralisation' is common in business lending and asked Mr Welsh to comment on how bankers think about fairness in this context: 'by what criteria is a banker to determine whether insisting on the letter of the law and insisting on the letter of an all moneys instrument, is fair to the small business enterprise? What sorts of consideration can come to bear upon that?' Mr Welsh responded that some measure of flexibility was necessary to enable businesses to 'back themselves' and that requiring additional information could add additional complexity to the process. He said: 'I don’t want our bankers making too many of the judgment calls on – on what they [SMEs] should or shouldn’t do. You know, we need a set framework to be very clear and I want our clients to be informed, I want them to understand what they’re getting into, because that’s absolutely critical, but I also want them to be able to operate their businesses and – and go for the things they want to go for'.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 24 May 2018 – Draft Transcript for Day 23; 25 May 2018 – Draft Transcript for Day 24]

Process of identifying a 'systemic' issue, notifying and remediating customers: case study

In his opening statement to the Commission, Mr Hodge QC summarised the submissions received from the various lenders including issues identified by the Commonwealth Bank of Australia (CBA). He said that one of the issues identified in the CBA submission concerned the charging of incorrect interest rates on some accounts. More specifically, the Commission heard that some customers were charged interest at a rate of 33.94% rather than 16%. Mr Hodge said that the defect was first identified in CBA in 2013 with 'manual remediation being carried out until 2015 when it was thought a systemic fix had been put in place'. After additional cases relating to the same issue were identified as a result of an FOS dispute in 2016, an enhanced system fix was introduced by CBA in 2017. The issue has since been reported to ASIC.

CBA's handling of this issue — the process undertaken to identify and correct it, to notify and remediate customers and to report it to the regulator — was the primary (though not the exclusive) focus of questions put to CBA Executive General Manager Retail Products Clive Van Horen. The Commission heard that there was initially no investigation to ascertain whether the issue was 'systemic' following the FOS complaint. The Commissioner asked Mr Van Horen whether it was 'practical, sensible, useful to impose a system that said, in effect, "Unless and until you demonstrate that this error is unique, it will be treated as systemic"'. Mr Van Horen said that this would not be a practical solution, given the number of errors (most of which were not systemic).

The Commission also heard that the average time for remediating customers was 960 days and that there had been some delay in notifying customers of the issue, to avoid it being brought up at House of

Representative hearings. This was acknowledged by Mr Van Horen not to have been the correct decision. Asked why disclosure of the issue was not made to ASIC until 15 May 2018, Mr Van Horen said that no disclosure had been made initially on the basis that it was not considered at the time to be a reportable breach (though it was now acknowledged to be so) and confirmed that a report has been made to the regulator.

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 24 May 2018 – Draft Transcript for Day 23]

The Code of Banking Practice: The revised code is a 'step in the right direction' according to Philip Khoury.

One of the topics to be considered in the third round of public hearings at the Financial Services Royal Commission is the Code of Banking Practice.

The commission heard evidence from Philip Khoury who conducted an independent review of the Banking Code of Conduct in 2016 and 2017 regarding the efficacy of the code, his recommendations and the recent revisions to the latest version of the code (currently with the Australian Securities and Investments Commission (ASIC) for approval). The Commission heard that Mr Khoury had reviewed the revised code and that overall the proposed changes were 'a step in the right direction' if not, exactly in line with his specific recommendations in every case. In particular, attention was drawn to the definition of small business adopted in the code. Mr Khoury was of the view 'the cap on whether a business qualified as a small business' under the code should be $5 million, but the industry was of the view that it should be a lower figure of $3 million. The lower figure was included in the draft code submitted to ASIC.

Mr Michael Hodge QC noted that this is the first time ASIC has been asked to approve the code which means it must meet the criteria for codes in the financial services set out in section 1101A *Corporations Act 2001* (Cth), and ASICs regulatory guide 183, including in relation to compliance monitoring and enforcement. He went on to note that the revised code is yet to receive ASIC approval and that before these hearings, the drafts had not been made public. Mr Hodge noted that 'the state of the code and its contemplated approval by ASIC will be considered in a case study next week'.

[Note: The ABA released a copy of the draft code (currently with ASIC for approval) on their website on 21/05/2018. The draft code can be accessed here.]

[Source: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 21 May 2018 – Draft Transcript for Day 20; *[registration required] The Australian 22/05/2018]*

Banking

Open Banking update | Treasurer Scott Morrison has announced Andrew Stevens will serve as the interim Chair of the Data Standards Body for the Consumer Data Right.

Treasurer Scott Morrison has announced that Mr Andrew Stevens (former managing director of IGM Australia, and member of the UNSW Business School, Business Advisory Council) has been selected as the interim Chair of the Data Standards Body for the Consumer Data Right.

Mr Morrison said that the Data Standards Body, established within the CSIRO's Data61, 'will facilitate the development of data sharing standards to provide consumers with safe, convenient, and timely methods of accessing and transferring their data to trusted and accredited data recipients'. The Treasurer said that Mr Stevens as Independent Chair, would 'ensure the standards maximise the benefits for consumers and are developed in consultation with technology firms, and consumer and privacy groups'.

[Sources: Treasurer Scott Morrison media release 23/05/2018]

In Brief | Westpac BBSW case: Justice Beach of the Federal Court found that Westpac engaged in unconscionable conduct under s12CC of the *Australian Securities and Investments Commission* Act 2001 (Cth) by its involvement in setting the bank bill swap reference rate (BBSW) on four occasions. A

further hearing on penalty and relief will be held on a date to be determined. Separately, ASIC and the RBA have welcomed the new BBSW calculation methodology which commenced 21 May.

[Sources:18-151MR Federal Court finds Westpac traded to affect the BBSW and engaged in unconscionable conduct Australian Securities and Investments Commission v Westpac Banking Corporation (No 2) [2018] FCA 751; 18-151MR Federal Court finds Westpac traded to affect the BBSW and engaged in unconscionable conduct; Joint media release ASIC and RBA welcome the new BBSW calculation methodology 21/05/2018]

Superannuation

Superannuation Guarantee Amnesty Bill: A new Bill proposes to give employers a 12 month amnesty to pay any unpaid superannuation to workers or risk new penalties, among other measures.

Treasury Laws Amendment (2018 Superannuation Measures No1) Bill 2018 (the Bill) was introduced into the House of Representatives on the 24 May.

Minister for Revenue and Financial Services Kelly O'Dwyer said that the legislation would complement the Superannuation Guarantee (SG) Integrity package already before parliament by introducing a 12 month amnesty to allow employers to self-correct historical underpayments of Super Guarantee (SG) amounts without incurring the usual penalties for late payment.

Ms O'Dwyer said employers would not be totally 'off the hook' and must still pay all SG shortfall amounts owing to their employees, including the nominal interest.

Minister O'Dwyer said that employers that do not take advantage of the one-off amnesty would face higher penalties — 'in general a minimum 50 per cent on top of the SG charge they owe' — if they are subsequently identified.

Timing: The amnesty will start from the date the Bill was introduced (24 May 2018) and run until 24 May 2019. To qualify for the amnesty, a disclosure must be made to the ATO in the approved form (and must not have been previously disclosed).

[Sources: Treasury Laws Amendment (2018 Superannuation Measures No. 1) Bill 2018; Explanatory Memorandum; Minister for Revenue and Financial Services Kelly O'Dwyer media release 24/05/2018; Financial Standard 24/05/2018; [registration required] The Australian 24/05/2018]

Insurance

In Brief | APRA and ASIC have jointly released new data on life insurance claims and claims related disputes for the period 1 January 2017 to 30 June 2017. According to the data, 90% of claims that go to decision are paid in the first instance. APRA states that overall the results are consistent both with previous data released in November 2017 and with the results of ASIC's report 498 Life Insurance claims: An industry review 2016.

[Source: APRA media releases: APRA and ASIC release new life claims data 24/05/2018]

In Brief | APRA has released life insurance statistics for March 2018; Quarterly General Insurance Performance Statistics for March 2018; and statistics for general insurance institution-level performance for March 2018.

[Sources: APRA releases life insurance statistics for March 2018 24/05/2018; APRA releases statistics on general insurance performance for March 2018 24/05/2018; APRA releases statistics for general insurance institutional level performance for March 2018 24/05/2018]

Other Developments

United States | Partial roll-back of Dodd-Frank legislation (at least for smaller lenders): A Bill to roll back some aspects of the financial reforms enacted in the aftermath of the financial crisis has passed both houses and pending Presidential approval, will become law.

Having passed the senate in March, the US House of Representatives passed *S 2155 - Economic Growth, Regulatory Relief and Consumer Protection Act* on 22 May and, pending Presidential approval, it will become law. S 2155 rolls back some aspects of financial reforms enacted in the aftermath of the financial crisis (*Dodd–Frank Wall Street Reform and Consumer Protection Act* 2010 reforms).

Among the reforms included in S 2155 are the following:

- Regulatory relief for smaller and community banks:
  - Raise the threshold for a systemically important financial institution (SIFI) to $250 billion in assets from $50 billion. This is significant, according to MarketWatch on the basis that it 'essentially eliminates' the possibility of designation as a systemically important financial institution for all but the largest banks.
  - Permit banks with between $50-$250 billion in assets to run with less regulatory oversight from the Financial Stability Oversight Council (FSOC).
  - Requires the Federal Reserve to take size of banks into account when crafting regulations, rather than taking a 'one size fits all' to regulations.
  - Eases trading, lending and capital rules for banks with less than $US10 billion in assets including exempting banks with less than $10bn in assets from complying with the 'Volcker Rule'.
- The Bill also gives regulators more discretion in deciding when to require stress tests of capital adequacy for banks with between $100 billion and $250 billion in assets in the event of another crisis.

The AFR describes the Bill as the 'the first significant rewrite of US financial rules introduced following the [global financial] crisis, which saw Wall Street lenders bailed out to the tune of $US700 billion ($924 billion)'.

[Sources: GovTrack US House vote on passage 22/05/2018; S.2155 - Economic Growth, Regulatory Relief, and Consumer Protection Act; MarketWatch 22/05/2018; The New York Times 22/05/2018; [registration required] The WSJ 21/05/2018; 22/05/2018; [registration required] The AFR 23/05/2018]

United Kingdom | The Crown Court has dismissed SFO fraud allegations against Barclays concerning 2008 capital raisings but Barclays has cautioned the market that the SFO is likely to reinstate the charges.

Barclays has issued an announcement confirming that the Crown Court has dismissed all charges brought by the Serious Fraud Office (SFO) against Barclays PLC and Barclays Bank PLC regarding matters which arose in the context of Barclays' capital raisings in 2008. The statement added that The SFO is likely to seek to re-instate the charges by applying to a High Court Judge to re-commence proceedings via a new indictment of the same charges.

In addition, the statement reiterated that:

- the United States Department of Justice and the US Securities and Exchange Commission investigations are ongoing;
- that a civil claim has been served on Barclays Bank PLC by PCP Capital Partners LLP and PCP International Finance Limited in relation to the November 2008 capital raising, which Barclays Bank PLC is defending; and
- that the FCA's investigation had been stayed due to the SFO proceedings.

The FT reports that the SFO has indicated that it is considering its position in light of the ruling.

'Victory' for Barclays? The FT notes that the action against Barclays was the first set of charges in the UK to be brought against a bank for actions taken during the financial crisis and describes the court's decision as a 'major victory' over the SFO for Barclays and a serious 'setback' for the SFO after 5 years of investigation into the 2008 fundraising. The report also comments the decision is the latest in a number of 'regulatory issues cleared up this year' including the FCA/PRA investigation into Barclays CEO Jes Staley (see: Governance News 18/05/2018).

[Sources: Barclays announcement: Dismissal of SFO charges re 2008 capital raisings 21/05/2018; [registration required] The FT 21/05/2018]

In Brief | Fortune reports that Japan's biggest bank Mitsubishi UFJ Financial Group will reportedly switch on blockchain payments in 2020. The service is expected to be capable of handling 10 million transactions per second. By contrast, Bitcoin can process seven transactions per second at latencies exceeding 10 minutes.

[Source: Fortune 21/05/2018]

Accounting and Audit

United Kingdom: The Labour Party has commissioned a review of the auditing and accounting regulatory framework. Proposals for reform are due to be delivered at the Labour Party conference in September.

Following the release of the joint parliamentary inquiry report into the Carillion plc collapse (see: Governance News 21/05/2018), the Labour Party has announced that it has commissioned a review of the regulatory framework for auditing and accounting.

The review will be led by Professor Prem Sikka who is the Professor of Accounting and Finance at the University of Sheffield. Professor Sikka has been asked to examine the 'regulatory system and bring forward proposals for reform to reinvigorate it'. For example, the review is expected to consider whether regulatory bodies should be merged, abolished or restructured as well as the question of what penalties or fines should be imposed in future.

Timeframe: The reform proposals will be brought to the Labour Party Conference in September 2018.

[Sources: Labour media release 19/05/2018]

In Brief | No case to break up audit firms as is being considered in the UK? Australian audit firms have reportedly said competition remains strong and despite downward pressure on the price of audits there has been no impact on audit quality or independence. Consequently, they are reportedly of the view that there is no case to break up the firms as is being considered in the UK.

[Note: The UK Work and Pensions and BEIS Committees recently released their report into the collapse of Carillion plc. Among other things the report recommended that KPMG, EY, PwC and Deloitte should be referred to the Competition Authority for possible break up. See: Governance News 21/05/2018]

[Source: [registration required] The AFR 22/05/2018]

Risk Management

Top Story | New decision fuels risk of pre-action discovery against companies facing misconduct allegations.

A recent Federal Court decision means that companies should be aware more than ever before of any public statements which might trigger an action for preliminary discovery. The decision creates a new level of concern for companies that their confidential internal documents may be produced to prospective applicants before commencement of formal legal proceedings.

On 18 May 2018, Gleeson J handed down judgment in *McFarlane as Trustee for the S McFarlane Superannuation Fund v IOOF Holdings Limited [2018] FCA 692*. The decision enabled McFarlane, a prospective applicant for a shareholder class action, to obtain numerous documents (including board minutes and board papers) from IOOF Holdings Limited (IOOF) in relation to allegations of misconduct following publication of articles in the Sydney Morning Herald (SMH) that alleged corporate misconduct by employees of IOOF to consider whether to commence legal proceedings.

The decision is likely to be of concern to financial institutions in the midst of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services, in which evidence of misconduct being made publicly available (or commented upon in the media) may place companies at risk of extensive preliminary discovery for potential class action claims.

Background

Between 20 - 27 June 2015, a series of articles published in the SMH reported various allegations of corporate misconduct, insider trading and front-running by employees of IOOF dating back to 2009. The articles cited internal reports and emails, as well as a report prepared by PwC which investigated the alleged offences. IOOF was later called before the Senate Economics References Committee, Scrutiny of Financial Advice Inquiry (Senate inquiry) to respond to questions about the alleged corporate misconduct.

McFarlane, who held 2,000 shares in IOOF, proposes to commence an action alleging that, during the period from the publication of the first SMH article until the date of the appearance of the Senate inquiry, IOOF's share price experienced a significant fall as a result of IOOF's misconduct.

McFarlane subsequently filed a preliminary discovery application, in order to decide whether to commence a representative action on behalf of persons who acquired shares in IOOF between 1 March 2014 and 5 July 2015, seeking compensation for losses suffered as a result of IOOF's alleged breaches of continuous disclosure obligations and/or misleading or deceptive conduct.

Outcome and reasons

McFarlane requested preliminary discovery of a wide range of documents. His Honour accepted that McFarlane had a reasonable basis for believing that he may have a right to obtain relief (on the basis of the SMH articles and evidence given at the Senate inquiry), and that the information currently available to McFarlane was insufficient to enable to him to determine whether to commence proceedings.

However, because the documents sought by a prospective applicant must be 'directly relevant' to the question of a right to obtain relief, his Honour limited the documents discoverable by reference to the specific instances of alleged misconduct identified in articles published in the SMH and the evidence before the Senate inquiry, and did not allow for a wider discovery regarding any similar potential misconduct in the relevant period.

Nonetheless, the orders granted preliminary discovery of any documents or communications which concerned the relevant allegations including:

1. any documents raising the allegations reported in the SMH articles;
2. reports, communications and any other documents setting out the findings from any investigations by IOOF, PwC, or any other entity as to whether any of the alleged misconduct occurred;
3. minutes and board papers evidencing any action taken as a result of any of the alleged misconduct; and
4. notifications to industry regulators, reviews of compliance measures and controls and independent investigations conducted in relation to the issues raised in the SMH articles.

[Source: McFarlane as Trustee for the S McFarlane Superannuation Fund v IOOF Holdings Limited [2018] FCA 692]

United States | The beginning of the end for employee class actions? In a 5:4 ruling, the US Supreme Court has found that employers can include 'forced arbitration clauses' in their employment contracts.

In a 5:4 ruling, the US Supreme court has found that employers can include 'forced arbitration clauses' in their employment contracts ie a clause in their employment contracts requiring employees to arbitrate their disputes individually, and to waive the right to resolve those disputes through joint legal proceedings.

In a dissenting judgment Justice Ruth Bader Ginsburg called the majority opinion 'egregiously wrong' on the basis that 'The inevitable result of today's decision will be the underenforcement of federal and state statutes designed to advance the well-being of vulnerable workers'.

Particular significance for women? Some commentators have suggested that the decision has particular ramifications for women and more particularly, that the decision will make it easier for companies to 'get away with sexual harassment'. The Huffington Post writes: 'Going it alone, the most a woman can generally hope for is a monetary judgment. But banding together, women who file class actions can do far more to ensure that a company stops discriminatory behavior.'

The beginning of the end for employee class actions? The New York Times quotes Vanderbuilt University law professor Brian T Fitzpatrick as suggesting the decision signals that 'it is only a matter of time until the most powerful device [ie class actions] to hold corporations accountable for this misdeeds is lost all together'.

[Sources: Epic Systems Corp v Lewis No 16–285. Argued October 2, 2017—Decided May 21, 2018; SCOTUS blog 21/05/2018; The Hill 21/05/2018; Quartz 22/05/2018; Insurance Journal 21/05/2018; The Huffington Post 22/05/2018; The New York Times 21/05/2018]

In Brief | National Scams Awareness Week (21-25 May): ASIC has warned investors to be on high alert to investment scams. The ACCC's *Targeting Scams Report* show that investment scams have replaced romance and dating scams as the most lucrative method of fraud.

[Sources 18-145MR Scammers turn up the heat on Australian investors; ACCC media release 21/05/2018; Targeting scams: Report of the ACCC on scam activity 2017]

In Brief | The US Securities and Exchange Commission launched a fake, fully interactive website promoting a fictitious initial coin offering (Howeycoins) as an 'educational tool to alert investors to possible fraud' involving digital assets like crypto-currencies and coin offerings. Fortune writes that securities regulators across the US and Canada have recently commenced dozens of investigations into potentially fraudulent cryptocurrency investment products.

[Sources: SEC ICO — Howeycoins; HoweyCoins.com; Investing.com 21/05/2018; Fortune 21/05/2018]

In Brief | The EU General Data Protection Regulation came into effect on May 25, 2018. OAIC has released a resource to assist Australian businesses to understand the new requirements and how they can comply with Australian and EU privacy laws.

[Sources: Office of the Australian Information Commissioner Privacy business resource 21: Australian Businesses and the EU General Data Protection Regulation March 2018]

Corporate Misconduct and Liabilities

United States | Time to rethink successor criminal liability? The case for strengthening incentives for companies to self-report and reform, rather than conceal misconduct.

Writing in Harvard Law School Forum, and in a recent paper in the Yale Journal of Regulation, Associate Professor Mihailis Diamantis has questioned the current US approach to successor criminal liability. More particularly, he questions whether holding corporate successors liable for the crimes of their predecessors, regardless of the circumstances, is the most effective or efficient way of preventing corporate crime.

Limitations for the current approach: In his view the current approach is limited in a number of ways, including that it assumes authorities can adequately detect corporate misconduct when it occurs. Citing the sale by Volkswagen of 11 million cars with 'illegal feat devices' before 'getting caught' as an example, he argues that corporate misconduct can be difficult to uncover without the help of the corporations themselves. However, under the current system, he suggest, corporations tend to adopt 'better concealment programs rather than better compliance programs' as there is little incentive for them to do otherwise. 'When it comes to encouraging rehabilitation, the current law of successor liability falls flat. It gives corporations weak incentives to detect misconduct and reform their compliance programs' he argues.

Incentivising corporations to self-report and self-reform? In his view, the current approach could be improved 'by weakening the incentives corporations have to conceal their misconduct and strengthen[ing] their incentives for self-reform'. This could be accomplished, he suggests through taking a more 'sophisticated' approach to criminal liability. More particularly, he suggests that rather than being automatic, 'liability should follow whatever compliance vulnerability encouraged, permitted, or failed to catch the crime in the first place'. To illustrate, when a criminal corporation merges with an innocent corporation, he argues that the successor should only be punished for past crimes if it 'inherits the defective features of the criminal predecessor's compliance program. If, in the course of the merger, the successor adopts the innocent corporation's compliance program or otherwise reforms the defects, it should emerge from the reorganisation free of criminal liability'. This approach, would in his view 'incentivize corporations to structure reorganizations in ways that improve compliance and minimize the likelihood of future offenses. At the same time, it would do a better job of ensuring that the criminal law punishes corporate successors only when they deserve it'.

[Sources: Harvard Law School Forum on Corporate Governance and Financial Liability 11/05/2018; [registration required] Diamantis, Mihailis, Successor Identity (February 27, 2018) Yale Journal on Regulation, Forthcoming; U Iowa Legal Studies Research Paper No. 2018-07 SSRN]

Other News

A step closer to constitutional recognition of Aboriginal and Torres Islander people: The Joint Select Committee on Constitutional Recognition relating to Aboriginal and Torres Strait Islander Peoples has requested submissions.

The Joint Select Committee on Constitutional Recognition relating to Aboriginal and Torres Strait Islander Peoples was appointed by resolution of appointment in March 2018 to, among other things:

- 'examine the methods by which Aboriginal and Torres Strait Islander Peoples are currently consulted and engaged on policies and legislation which affects them, and consider if, and how, self-determination can be advanced, in a way that leads to greater local decision making, economic advancement and improved social outcomes'; and
- 'recommend options for constitutional change and any potential complementary legislative measures which meet the expectations of Aboriginal and Torres Strait Islander Peoples and which will secure cross party parliamentary support and the support of the Australian people'.

The committee recently released a statement confirming that briefings with Indigenous leaders and other stakeholders on issues relating to constitutional recognition have commenced and requesting submissions on one or more of the terms of reference. Submissions will close on 11 June 2018. The committee will submit an interim report at the by 30 July 2018 and a final report by 29 November 2018.

[Sources: Joint Select Committee on Constitutional Recognition relation to Aboriginal and Torres Strait Islander Peoples media release 22/05/2018; Joint Select Committee on Constitutional Recognition relating to Aboriginal and Torres Strait Islander Peoples Resolution of Appointment]

In Brief | Consultation on measure to address the 'black economy': Treasury has released a consultation paper inviting feedback on the measure announced in the Federal Budget 2018-2019, to introduce an economy wide cash payment limit of $10,000. Consultation closes on 24 June 2018.

[Source: Minister for Revenue and Financial Resources Kelly O'Dwyer media release 25/05/2018; Consultation paper: Introducing an economy-wide cash payment limit 25/05/2018]