Governance News

12 November 2018

Mark Standen
Partner

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

Siobhan Doherty
Partner

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

Kate Hilder
Consultant

T +61 3 8608 2907 | **M** +61 416 353 877

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

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Boards and Directors

Telstra CFO Robyn Denholm has replaced Elon Musk as chair of the Tesla board

Tesla has announced that Telstra CFO and Tesla board member, Robyn Denholm, has replaced Elon Musk as Chair of the Tesla Board. Mr Musk remains CEO of Tesla but was required under the terms of a settlement with the US Securities and Exchange Commission (SEC) to step down as Chair (see: Governance News 13/08/2018; 27/08/2018; 23/10/2018).

Details

- Ms Denholm will take up her role as Tesla Chair immediately and will leave her role as CFO and Head of Strategy at Telstra once her 6-month notice period is complete.
- Tesla states that Ms Denholm 'will continue to provide the necessary focus and time to Telstra during the remainder of her time there' and that Mr Musk 'will be a resource to Robyn and provide any support that she requests in her role as Chair' during the transition period.
- In a statement, Telstra thanked Ms Denholm for her service and noted that 'to ensure that any new commitments as Tesla Board Chair will not detract from her ability to focus on her responsibilities as the Telstra CFO during this six-month notice period, Tesla will be asking another Board Director [Mr Musk] to support Robyn by taking on the majority of her Chairman responsibilities. Robyn will also be stepping down from her other Tesla Board Committee responsibilities [Chair of Tesla's Audit Committee] during this time'.

Implications for the activist campaign at Tesla? Ms Denholm's appointment follows recent calls from activist investors for Tesla to implement a number of measures (including plan for board 'refreshment') to address alleged accountability and governance issues (see: Governance News 05/11/2018). The Washington Post reports that some investors have questioned Ms Denholm's appointment as Chair on the basis that she both lacks experience (direct experience in running operations at a manufacturing company) and on the basis that she lacks independence from Mr Musk (as she has been on the Tesla board since 2014 and was on the board during the period when Mr Musk's 'erratic communications on Twitter' occurred). The Washington Post comments however, that Institutional Shareholder Services (ISS) has previously published a report in which it classified Ms Denholm as 'independent'.

[Sources: Tesla media release 07/11/2018; Telstra media release/ASX Announcement 08/11/2018; CNBC 09/11/2018; The Washington Post 08/11/2019]

In Brief | 'Unprecedented' optimism? Despite 74% of local executives being concerned about political stability, EY's 18th Global Capital Confident Barometer has found that there is unprecedented optimism in the state of the global economy among business leaders with 100% of Australian and New Zealand respondents of the view that the local and global economy is either stable or improving.

[Sources: EY Australasia global capital confidence barometer; [registration required] The Australian 07/11/2018]

Diversity

A missed opportunity? McKinsey research shows that incoming CEOs are likely to reshuffle their management teams at the beginning of their tenure but that only very few take the opportunity to boost diversity in senior ranks by doing so.

McMKinsey writes more than two thirds of CEOs replace at least 50% of the members in their senior teams within two years of taking office, but their analysis indictates that only a small number take the opportunity to boost diversity in those teams by doing so.

Some Key Findings

- According to McKinsey, within three years, gender diversity in senior teams that were reshuffled increased only 2% and did not improve when the time period was expanded to cover the entire period of the CEO's tenure.
- McKinsery found that CEOs who took charge in recent years were no more likely to promote women to senior roles than those who became corporate leaders 20 or 30 years ago. Even if the lack of women in the management pipeline limited progress during the CEO's transition period, the findings suggest that the CEOs didn't change the pipeline and promotion practices at their organisations during their tenure.
- McKinsey also found that companies with the highest percentage of women in senior roles (15% or more of the management team) at the point of CEO transition were the least likely to improve gender diversity and that on average that the percentage of women in senior roles fell in these companies in reshuffles.
- By contrast, McKinsey found that in the least (gender) diverse companies and industries were more likely to increase female representation in management roles. In addition, CEOs promoted from within companies (who may have more information about where talent is within the organisation) tended to improve female representation in management teams 6% more than external CEOs (who tended to keep gender ratios stable).

[Note: The findings follow the release of McKinsey's fourth annual study tracking progress on gender diversity: *Women in the Workplace survey 2018* which (among other things) identified discriminatory hiring and promotion practices as the key cause of the lack of progress on gender diversity in US companies. See: Governance News 29/10/2018]

[Source: Closing the gender gap: A missed opportunity for new CEOs, McKinsey Quarterly October 2018]

Heidrick & Struggles has announced that it has become the first executive search firm to commit to diversity in its board of director searches

In an announcement, Heidrick & Struggles has publicly committed to promoting diversity in board of director searches globally. More particularly, it has said that at least 50% of its slate of initiatial board candidates presented to clients globally will be 'diverse'. Developed in collaboration with Stanford's Rock Center for Corporate Governance, Heidrick & Struggles' pledge is designed to increase the number of women and members of underrepresented groups considered by boards.

To accelerate this effort, Heidrick & Struggles states that it will proactively identify and interview diverse director candidates, with an emphasis on prospective directors who have not previously served on a corporate board and monitor the results. The results will be used to inform the firm's improvement efforts.

[Source: Heidrick & Struggles media release 07/11/2018]

In Brief | Practical recognition and acceptance of a 'broader' conception of diversity: The SMH reports Westpac's new employment agreement includes paid transgender leave, domestic violence leave, extends parental leave benefits to long-term foster carers, includes paid leave for support carers and includes 'sorry business' leave for Indigenous employees.

[Source: [registration required] The SMH 08/11/2018]

Remuneration

In Brief | Pay cuts at the major banks: ABC reports that the major banks have acted to reduce executive pay in the wake of the Financial Services Royal Commission: Westpac executives received an average 25% cut to short term bonuses; CBA announced that $100m had been cut for 400 executives over the last two years; and NAB announced cuts to its executive pay of up to 15%.

[Source: ABC News 07/11/2018]

Shareholder Activism

In Brief | Premier has threatened Myer directors with legal action? Activist Premier Investments' legal team has reportedly issued a letter to Myer's directors demanding the release of the latest quarterly trading figures, an explanation as to why Myer made the decision to stop providing quarterly updates, and information regarding whether any third parties (such as financiers or advisers) have been provided with trading updates. Reportedly, the letter threatens legal action against the Myer board if these demands are not met.

[Sources: The SMH 07/11/2018; [registration required] The Advertiser 08/11/2018]

Institutional Shareholders and Stewardship

Should US exchanges act to counter the trend for companies to go public with unequal voting rights? The Council of Institutional Investors (CII) recently filed petitions with the New York Stock Exchange (NYSE) and the NASDAQ, asking that both exchanges act to limit listings of companies with dual-class share structures.

The Council of Institutional Investors (CII) has called on the New York Stock Exchange and the Nasdaq to amend their listing standards to require that, going forward, companies seeking to list that have multiple share classes with unequal voting rights include in their governing documents, 'sunset' provisions that convert the share structure within seven years of the initial public offering (IPO) to 'one, share-one, vote.'

'While some companies that are controlled by virtue of special voting rights function as benevolent dictatorships, we have seen others stumble because of self-dealing, lack of strategic planning and ineffective boards…When problems emerge, external shareowners have little recourse. Now, a consensus is emerging—among investors, companies and the law firms and other IPO gatekeepers—that time-based sunsets are a sensible solution to the growing problem of unequal voting rights, which poses danger to long-term resilience of an increasing number of companies' CII Chair Ash Williams, executive director and CIO of the Florida State Board of Administration said.

According to CII both BlackRock and California State Teachers' Retirement System are supportive of the petition.

Pensions and Investments reports that Nasdaq president Nelson Griggs commented in response to the petition: 'Nasdaq is a firm believer in the flexibility of share structure, in order to provide all investors access to growth companies. That said, we consider the input of all stakeholders when establishing and modifying listing standards and have an independent body that includes investor representation, which makes recommendations to our board about changes to those standards. We will continue to review our listing standards to make sure they protect investors, while also allowing those investors access to innovative companies.' Reportedly NYSE is yet to respond.

[Sources: CII media release 24/10/2018; Harvard Law School Forum on Corporate Governance and Financial Regulation 02/11/2018; Pensions and Investments 24/10/2018]

Meetings and Proxy Advisers

United States | The Securities and Exchange Commission has announced the agenda and panellists for the 15 November roundtable on possible proxy reforms.

The Securities and Exchange Commission (SEC) has announced the agenda and panellists for roundtable on the proxy process to be held on 15 November 2018.

The agenda includes three 'panel' sessions on the following issues.

- **Proxy voting 'mechanics' and the role of technology in the process:** The focus of discussion will be on the current proxy voting and solicitation process for shareholder meetings and recent concerns raised about this process. More particularly, discussion will centre on the question on how the accuracy, transparency, and efficiency of the proxy voting and solicitation system can be improved and possible regulatory steps to facilitate these improvements. The role of technology in enhancing the voting process and ability of shareholders to exercise their voting rights will also be considered.

- **Shareholder proposals and shareholder engagement:** The focus of discussion will be on shareholder engagement through the shareholder proposal process including: the application of the shareholder proposal rule [rule allowing companies to apply to exclude certain shareholder proposals] and related guidance and the experiences of the panellists with shareholder proposals and the related benefits and costs involved for the company and shareholders.

- **The role of proxy advisory firms:** The focus of discussion will be on the role of proxy advisory firms and their involvement in the proxy process drawing on a range of perspectives from proxy advisory firms, institutional investors, the academic community, and corporate issuers. More particularly discussion is expected to focus on the evolution of the role of proxy advisers over time and the ways in which the role of proxy firms and their relationships with institutional investors and companies can be improved.

[Source: SEC media release 08/11/2018]

Markets and Exchanges

In Brief | The New York Times reports that the Shanghai Stock Exchange will test a US style system registration based system for new listings in a bid attract high stakes technology public offerings.

[Source: The New York Times 06/11/2018]

Regulators

Australian Prudential Regulation Authority (APRA)

APRA is consulting on proposed increases to ADI's total capital requirements 'to support orderly resolution in the unlikely event of failure'. Consultation closes 8 February 2019.

The Australian Prudential Regulation Authority (APRA) has released a discussion paper for consultation outlining proposed changes to the application of the capital adequacy framework for authorised deposit-taking institutions (ADIs). Consultation closes on 8 February.

Purpose of the changes: The proposed changes are designed to support 'orderly resolution in the unlikely event of failure' by ensuring ADIs have adequate financial resources available. APRA proposed that this would be accomplished through increasing, where appropriate, an ADI's Total Capital requirement.

The key features of the proposals include:

- for the four major banks – increasing Total Capital requirements by four to five percentage points of risk-weighted assets (see the illustrative example attached); and

- for other ADIs – APRA writes that there is 'likely no adjustment'. APRA adds that 'a small number may be required to maintain additional Total Capital depending on the outcome of resolution planning'.

APRA notes that the proposed changes are distinct from APRA's work on ensuring ADI capital levels are 'unquestionably strong'. APRA added that 'the proposed changes are expected to marginally increase each major bank's cost of funding – incrementally over four years – by up to five basis points based on current pricing' but that this is 'not expected to have an immediate or material effect on lending rates.'

Proposed implementation timeframe: Depending on the outcome of consultation, APRA proposes that the increased requirements will take full effect from 2023, following relevant ADIs being notified of adjustments to Total Capital requirements from 2019. In addition to the proposals outlined in this discussion paper, APRA will consult on a framework for recovery and resolution in 2019, which will include further details on resolution planning.

APRA Chairman Wayne Byres commented 'the events of the global financial crisis demonstrated the impact that failures can have on the broader financial system and the subsequent social and economic consequences. The aim of these proposals and resolution planning more broadly is to ensure that the failure of a financial institutions can be resolved in an orderly fashion, which protects the interests of beneficiaries and minimises disruption to the financial system'.

Cautiously positive? The AFR reports that S&P Global Ratings has said that the proposal, when/if implemented, may prompt it to revise its outlook for the major banks to 'stable' (they are currently 'negative'). 'In our view, today's announcement is a pragmatic recognition that the Australian government considers that it remains imperative for the government to be highly supportive of the systemically important banks, and that the government would very likely provide additional financial support, if needed' S&P Global Rating is quoted as stating. Moody's Investors Service associate managing director Patrick Winsbury has reportedly said it views the changes 'as credit positive for the banking industry'.

[Sources: APRA media release 08/11/2018; Discussion paper: Increasing the loss-absorbing capacity of ADIs to support orderly resolution; [registration required] The AFR 08/11/2018;

APRA has released the Private Health Insurance Operations Report 2017/18 detailing the operations and financial activities of registered private health insurers for the previous financial year.

The Australian Prudential Regulation Authority (APRA) has released its latest report detailing the operations of private health insurers including details about premiums and other amounts payable to the fund, fund benefits and other amounts payable out of the fund, management expenses, the balance of the fund as at the end that year and how the assets of the fund have been invested. The report is based on statistics collected by APRA in the course of the regulation of the industry.

[Source: APRA PHI operations 2018 06/11/2018]

Overseas Developments

Evidence of a 'philosophical shift in governing that favours big business and prioritises the interests of individual investors' under President Trump? The New York Times has published the results of its investigation into the enforcement approach of the SEC and DOJ under President Obama vs President Trump.

The New York Times (NYT) has published the findings of its comparison of enforcement activity and the Securities and Exchange Commission (SEC) and the US Department of Justice (DOJ) during the first 20 months of the Trump Presidency against those filed during the first 20 months of the Obama Presidency.

Some Key Findings

- There has been a 62% decline in penalties imposed and illicit profits ordered returned by the SEC from $5bn under the Obama administration to $1.9bn under the Trump administration.
- There has been a 72% decline in corporate penalties from $14.15 billion under the Obama administration to $3.93 billion under the Trump administration (and a similar drop in civil penalties against financial institutions).
- There is evidence that the regulators have shifted their enforcement focus/are taking a 'lighter touch' to regulation with regulators bringing fewer cases against banks in particular. For example, the DOJ brought 71 cases under the Obama administration as compared with only 17 under the Trump administration.
- In addition the NYT found that SEC has charged fewer high profile defendants under the Trump administration as compared with the Obama administration eg the SEC has charged 40% fewer public companies) under the Trump administration than was the case under the Obama administration.

The NYT concludes from this (among other things) that the decline in penalties is a partial reflection of a 'broad shift in philosophy' in governing that 'favors big business and prioritises the interests of individual investors' and that 'white collar prosecutions may be taking a back seat to other priorities'.

The NYT reports that both the SEC and the DOJ have challenged the findings. The SEC has reportedly said that the methodology used is flawed, arguing that it should be judged by the overall impact of its cases, rather than by financial penalties alone. The DOJ has reportedly said that the number of defendants prosecuted for white-collar crime trended downward during the second half of the Obama administration (which is not captured in the findings) and that in addition, the DOJ has also increased its focus on other priorities eg violent crime.

[Sources: The New York Times 05/11/2018; 03/11/2018]

Financial Services

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

Round 7 Hearings: The Financial Services Royal Commission has released the names of entities to appear in the seventh and final round of hearings (though list is subject to change)

The Financial Services Royal Commission will hold its seventh and final round of public hearings from Monday 19 November to Friday 30 November.

The Commissioner writes that the purpose of the hearings is to 'an opportunity to explore with senior executives from certain financial services entities, and the regulators of those entities, some of the policy issues identified in the Interim Report, and following Rounds 5 [superannuation] and 6 [insurance] of the public hearings'.

Focus of the hearings: The seventh and final round of public hearings will focus on:

- **causes of misconduct and conduct falling below community standards and expectations by financial services entities** (including culture, governance, remuneration and risk management practices);
- **possible responses, including regulatory reform**;
- **the role of the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA)** in supervising the actions of financial services entities, deterring misconduct by those entities, and taking action when misconduct may have occurred.

Entities to appear

- Australian Prudential Regulation Authority (APRA)
- Australian Securities and Investments Commission (ASIC)
- AMP Limited
- Australia and New Zealand Banking Group Limited
- Bendigo and Adelaide Bank Limited
- Macquarie Group Limited
- National Australia Bank Limited
- Westpac Banking Corporation
- Commonwealth Bank of Australia

The Commission notes that additional entities may be included before the hearings commence.

In accordance with Practice Guideline 5, there will be no process for applications for leave to appear for this round of hearings.

[Sources: Financial Services Royal Commission Round 7; Practice Guideline 5]

The Financial Services Royal Commission has released submissions received ahead of the final hearings

- **Submissions in response to the initial request for information:** The Financial Services Royal Commission has released 200+ submissions received in response to the Commission's initial request for information concerning instances of misconduct or conduct falling below community standards and expectations that the entity had identified in the past 10 years (including Macquarie Group's submissions). In some cases, entities were asked to provide additional information. The submissions include submissions from Macquarie Group (who has been named among the entities to appear in Round 7 hearings). Macquarie has not previously appeared before the Commission.
- **(Some) submissions received in response to the Interim Report** have been released. The Commission notes that additional submissions may be added in the coming days.
- **Submissions in response to round 5 (superannuation) and round 6 (insurance)** have also been released.
- **Research paper: *Conflicts of Interest and Disclosure* released**.

[Sources: Financial Services Royal Commission: Submissions in response to initial request; Financial Services Royal Commission: Submissions in response to Round 5 (superannuation); Financial Services Royal Commission: Submissions in response to Round 6 (Insurance); Research Paper: Conflicts of Interest and Disclosure 07/11/2018]

Submissions in response to the Interim Report

Top Story | Additional powers (and funding) for ASIC rather than a narrower remit and/or a separate regulator? ASIC's submission in response to the Financial Services Royal Commission's Interim Report argues against change to the 'twin peaks' model.

The Australian Securities and Investments Commission's (ASIC's) submission in response to the Financial Services Royal Commission's Interim Report addresses three issues: ASIC's role and approach to regulation; how conduct risk should be addressed and a range of more specific questions/law reform issues. An overview of some of the issues raised in ASIC's submission is below.

Key Takeaways

1. **No need to revise the 'twin peaks' model:** Consistent with APRA (and others) ASIC argues against revising the existing 'twin peaks' model and explicitly rejects the idea of creating a separate agency on the basis that doing so 'may also create additional risks concerning clarity of roles and overall accountability for financial regulation. For a standalone regulator, for example, of superannuation – the issue may be exacerbated as it could not rely on economies of scale or existing infrastructure and systems' ASIC writes.
2. **Expansion of ASIC's powers:** The submission suggests that ASIC could more effectively execute its mandate if it were granted additional powers including through: the extension of the BEAR regime; granting ASIC rule making powers (similar to APRA's); and extending (proposed new) design and distribution obligations and product intervention powers. The submission also makes the point that changes in ASIC enforcement priorities (greater emphasis on litigation) will have resourcing implications.
3. **Conflicted Remuneration:** The submission argues that conflicted remuneration 'should be prohibited or removed as a general policy, though ASIC adds that in some cases, transitional arrangements will need to be considered in the implementation of such a change.

Regulatory architecture should not be changed

- **'ASIC supports the "twin peaks" model':** Like APRA (see: Governance News 05/11/2018), ASIC argues against the need to rethink the current 'twin peaks' model.

- **ASIC's remit is not too wide:** ASIC argues against the need to create a third regulatory agency or allocating part of its responsibilities to another agency (eg the ACCC) stating that 'the transfer of parts of ASIC's regulatory remit to another agency or regulatory body would be a major legislative and practical change. It would also be unwarranted. There are significant benefits in having integrated consumer protection and market integrity functions and one regulator administering both positive conduct rules and licensing, as well as general consumer protection, within those areas' ASIC writes'. Commenting specifically on the idea of transferring consumer protection matters in connection with financial services/products to the ACCC, ASIC argues that to do so would be inefficient 'if positive conduct rules and licensing regimes were detached from ASIC and given say to the ACCC (which does not administer a licensing regime or other positive conduct rules like ASIC's), it would need to develop (or acquire from ASIC) new expertise' ASIC writes.

ASIC's role and approach to regulation

- **Conduct Risk:** ASIC writes that it agrees that there is room for improvement in its response. More specifically, it states that it is in agreement with the Commission that there has been 'a focus on management of financial risk at the cost of conduct risk and prioritising fair outcomes for customers'. ASIC adds that changes to its enforcement approach to emphasise 'court action' will 'sharpen financial institutions' focus on conduct risk because it will increase the costs, including the reputational costs of engaging in misconduct'.

- **Conduct falling below community standards/expectations:** ASIC states that it considers it has been 'broadly effective' in identifying the areas of systemic and widespread problems of this kind (through use of various enforcement 'tools' other than court action) 'even having regard to failures or deficiencies in breach reporting noted in the Interim Report'.

- **Currently reviewing its approach:** ASIC writes that it agrees with the Commission that a proper starting point is to ask 'why not litigate?' in response to misconduct. ASIC adds that it is conducting a review and analysis of its enforcement priorities, processes and decision making procedures including the use of court action which is expected to be completed by the end of 2018 and that various interim measures whereby the Chair of ASIC's Enforcement Committee reviews all decisions to proceed other than by way of litigation, have been introduced pending the outcome of that review. ASIC adds that proposed changes to legislation (*Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018*) will also assist ASIC in holding financial institutions to account.

- **Use of a range of enforcement tools remains appropriate:** Though conceding the limitations of its current approach and the need to alter it (by prioritising litigation), the submission makes clear that the use of a range of enforcement tools remains appropriate in ASIC's view. The submission explains the theoretical basis underpinning ASIC's enforcement approach noting that 'The enforcement pyramid model of sanctions of escalating severity has been found to be a sound foundation for enabling a regulator to address corporate misconduct – particularly by larger financial institutions'. Quoting Professor Braithwaite, ASIC adds that it is not workable, possible or desirable for any agency to apply the most severe sanctions/punishments in every instance, as it would be 'unaffordable, unworkable and counterproductive' to do so. ASIC comments that this is the more so in ASIC's case given the 'exceptionally large number of corporations and corporate actors it oversees'.

[Note: The UNSW submission in response to the Interim Report is also supportive of ASIC's use of a range of enforcement tools. The submission is covered in a separate post in this issue (12/11/2018) of Governance News.]

- **Resourcing:** The submission makes the point that 'A step change in regulatory priority and practice towards criminal and civil court action on a wide range of fronts will likely necessitate a permanent increase in resources provided to ASIC. A central question is: what level of funding and resources best enables a re-balancing of priorities, alteration of practices and implementation of decisions weighted more heavily towards litigation-based enforcement or a 'deterrence strategy', taking into account the real resource impacts and real resourcing risks of that those approaches?'

[Note: Funding is also identified in the UNSW submission in response to the Interim Report as a key issue. 'If funding is a proxy for political will, then guaranteeing funding in the forward estimates sufficient for ASIC to be credible in its enforcement work over the coming decade, will be the best signal that the politics of regulation have changed and that systematic non-compliance in the financial sector is no longer acceptable' the submission states. The submission is covered in a separate post in this issue (12/11/2018) of Governance News.]

Expansion of ASIC's powers?

In addition to product intervention and design and distribution obligations, as well as increased penalties ASIC states that it considers further powers or extensions of existing proposals would assist it in executing its mandate. These include the following:

- extending the application of the Banking Executive Accountability Regime reforms 'across financial services and credit businesses'
- granting ASIC a rule making power (similar to APRA's) to enable it to make standards in relation to prudential matters under s11AF of the Banking Act 1959 (Cth).
- extending design and distribution obligations to: credit products regulated under the National Consumer Credit Protection Act 2009 (Cth) (NCCP Act) (such as payday loans, and credit cards) and to promoters of self-managed superannuation funds;
- extending design and distribution obligations and product intervention powers to products regulated only under the ASIC Act (eg funeral expenses policies, some extended warranties, short-term credit exempted from the national credit laws and buy now pay later arrangements); and
- expressly permitting ASIC, when applying the product intervention power, to require training of staff focused on poor practices in relation to the particular product involved; and
- removing the exemption from general licensee obligations to have adequate resources to provide financial services and carry out supervision and have adequate risk management systems for bodies regulated by APRA.

Banking Executive Accountability Regime (BEAR)

- **BEAR is too limited in scope:** ASIC writes that it 'strongly supports' greater executive accountability for poor conduct throughout retail financial services and credit businesses (as does the community) and that this is 'not met by BEAR's present scope'. ASIC adds that the as presently drafted, BEAR would not address some instances of misconduct identified by the Commission (as the conduct in question would not meet the 'systemic and prudential' test necessary to trigger BEAR).
- **Follow the UK example?** ASIC writes that it supports expanding the BEAR in line with the UK Senior Manager and Certification Regime and in line with the Economics Legislation Committee report on BEAR (2017) so that it is administered by ASIC in relation to conduct as well as APRA in relation to prudential issues. More particularly, ASIC suggests the BEAR could be extended to cover conduct by: imposing an obligation on managers within financial services or credit licensees to take reasonable steps within the scope of their management roles to ensure compliance with financial services and credit laws; requiring larger financial services and credit licensees to map key responsibilities; and giving ASIC enforcement powers (power to disqualify managers for serious breaches of their reasonable steps obligation and to seek civil penalties if a financial services or credit licensee breaches BEAR obligations).

Conflicted Remuneration

- **ASIC states that 'conflicted remuneration in financial services should be prohibited or removed as a general policy',** though in some cases, transitional arrangements will need to be considered in the implementation of such a change. ASIC adds that 'if there are evidence-based arguments that the removal of conflicted remuneration would generate costs associated with competition or consumer access that clearly outweigh the benefits of reduced consumer harms, then these particular cases could warrant limited exceptions to this rule. This should require ongoing public monitoring and gathering of data on the impacts of conflicts to test whether any exemption should be retained'.

- **Mortgage brokers:** Commenting specifically on the issue of payments to brokers ASIC writes that the risks of poor outcomes from the payment of mortgage broker commissions could be mitigated by a combination of broker-specific responsible lending obligations (which would be in addition to existing responsible lending obligations for lenders), restrictions on, or a complete prohibition of conflicted remuneration, and a best interests duty. ASIC adds that lenders have started to voluntarily remove some types of conflicted remuneration (eg volume based commissions) in this context but that ASIC considers that it is 'too early to determine whether these changes to remuneration go far enough, and whether a complete prohibition on conflicted remuneration is necessary'.
- **Disclosure is not effective in addressing the risk:** ASIC writes that it does not consider that disclosure is an effective means of addressing the harms arising from conflicts of interest in remuneration.

Regulatory Complexity

- **Complexity is not excuse for misconduct:** 'Complexity is not and never will be an excuse for misconduct, and this is particularly so for large, sophisticated and well-resourced financial institutions' ASIC writes. However, ASIC goes on to say that it does 'weaken the basic infrastructure for the regulation of financial institutions and complicates their compliance and ASIC's supervision and enforcement. It also adds costs to business and may deter new entrants to the market'.
- **Prohibition of certain conduct/products may be warranted:** 'ASIC agrees the present regulatory regime is complex and in parts overly detailed' ASIC writes. The submission goes on to detail a number of sources and examples of complexity in the current regime that have resulted in poor outcomes. Among the issues identified is the success of industry in 'securing exceptions, carve outs or other qualifications or compromises' to reform efforts eg exceptions to the Future of Financial Advice reforms and or 'the exemptions enjoyed by the insurance industry from various parts of the consumer protection regime in financial services'. ASIC goes on to suggest that the simplest way to remove complexity may be to 'prohibit certain types of conflict or conduct'.
- **Sale of funeral related financial products:** ASIC writes that the current regulatory framework in respect of funeral expenses products is not adequate and that amendments are required. These are that: a funeral expenses policy should be a financial product covered by the financial services licensing and conduct regime of the Corporations Act. That is, the exclusion effected by regulation 7.1.07D of the *Corporation Regulations 2001* (Cth) should be removed; and subject to this, a funeral expenses policy should also be covered by the proposed new design and distribution obligations and product intervention power.

Oversight and review of ASIC's performance

ASIC writes that it would 'encourage formalised review of its performance against its mandate. Given the challenges in measuring or assessing the effectiveness of regulatory outcomes and the time needed for strategic regulatory decisions to bear fruit, reviews on say a three-year cycle may allow deeper analysis'.

[Source: The Australian Securities and Investments Commission submission in response to the Financial Services Royal Commission's Interim Report]

Top Story | UNSW recommendations to address 'conflicted remuneration': UNSW Centre for Law Markets and Regulation submission in response to the Financial Services Royal Commission Interim Report recommends (among other things) that conflicted remuneration provisions be extended to managers and bank executives.

Among the submissions released by the Financial Services Royal Commission in response to the Financial Services Royal Commission's Interim report, was the UNSW Centre for Law Markets and Regulation Submission. A very high level overview of some of the views put forward in the submission is below.

Some Key Points

The existing regulatory structure and ASIC's approach to enforcement

- **No need to fundamentally rethink the 'twin peaks' regulatory structure:** The submission argues that Australia should continue with the ‘twin-peaks’ regulatory structure constituted by the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA). However, the submission suggests that consideration should be given to 'improving' the 'twin peaks' model by legislating to enable both regulators to make rules governing the same subject matters in their overlapping remits (as has successfully been adopted in South Africa).
- **ASIC’s remit is not too wide**: The submission argues that as a ‘twin-peaks’ regulator, ASIC’s remit is not too wide, and that there is no need for detachment of part of its mandate in order to increase its effectiveness. 'Detachments from ASIC’s remit would damage the regulatory design of the twin peaks model: it would add co-ordination costs and would not provide savings. Detachment would also surrender any possibility of realising the single regulator, single licence and single rules regime for conduct regulation envisaged as central to the twin peaks approach' the submission states.
- **Funding is crucial to enabling ASIC to execute on its mandate**: 'If funding is a proxy for political will, then guaranteeing funding in the forward estimates sufficient for ASIC to be credible in its enforcement work over the coming decade, will be the best signal that the politics of regulation have changed and that systematic non-compliance in the financial sector is no longer acceptable' the submission states. In addition to funding, the submission also argues that there is a need for ASIC to have both 'fierce independence (from industry and politics), and appropriate personnel' in order to withstand political pressure. Accordingly, the submission suggests that ASIC’s funding and recruitment should be reviewed and forward estimates its work made for the next 10 years to ensure it has resources to discharge its mandate. The submission also notes that if this were implemented, funding for the Commonwealth Department of Public Prosecutions (CDPP) would also need to increase to cope with the additional prosecutions referred by ASIC.
- **ASIC's approach to enforcement**: The submission argues that 'ASIC is and should remain an enforcement regulator: an enforcer that is enabled politically, financially and legislatively to use a wide range of techniques strategically and credibly' (including a greater focus on pursuing civil and criminal penalties, and acting to suspend or revoke financial services licences as appropriate/proportionate). Given the need for ASIC to work closely with the Commonwealth Department of Public Prosecutions (CDPP) the submission suggests that there is 'merit in considering the return of ASIC to the Department of the Attorney-General'.

Simplification of existing laws?

The submission argues that financial regulation in Australia 'suffers from rules complexity'. The submission suggests that to address this, a standing expert regulatory law reform advisory body should be formed in the Attorney General's Department, to advise on changes to regulation. The submission adds that 'Rule complexity, which is not in the public interest, would be better addressed by the development of rules (including simple principles if so agreed) understood to work well, from prior regulatory or other legal experience'.

Conflicted remuneration

The submission argues that extending the application of conflicted remuneration across the financial service industry and removing carve outs and exceptions would be 'the most effective means of reducing misconduct risk and regulatory complexity related to remuneration' and would also assist in restoring public confidence. The submission also argues that the extension of conflicted remuneration should be 'combined with regulatory action and meaningful efforts by industry to evaluate and reform culture. We submit that these steps will result in a financial service sector that is robust, effective, and responsive to customer needs'.

The submission includes a number of specific 'recommendations' on this issue. These include the following:

- Customer facing employees should have access to variable remuneration, but the statutory ban on conflicted remuneration should be extended to all customer-facing employees without limitation. Other carve outs and limitations to this regime should be substantially reduced.

- The same conflicted remuneration provisions should apply to managers and executives in banks. Intermediaries should also be subject to a ban on conflicted remuneration.
- Banks should consider extension of malus and clawbacks for staff who continue to receive variable remuneration, as a mechanism to incentivise long-term outcomes and customer wellbeing.
- Banks should continue to build on their application of the Sedgewick Report and be encouraged to adopt regular reviews of their systems and structures, to assess and enhance the practical impact on institutional culture at all levels.

[Source: UNSW Centre for Law Markets and Regulation submission in response to the Financial Services Royal Commission Interim Report]

Could the professionalisation of the financial advice industry go some way to mitigating the risks of vertical integration? While not opposing the simplification of the law or more rigorous enforcement, the Ethics Centre argues that 'the ethical dimension of reform' should be accorded more weight when considering possible reforms in its submission in response to the Financial Services Royal Commission Interim Report.

In its submission in response to the Financial Services Royal Commission's Interim Report, the Ethics Centre has argued in favour of granting 'the ethical dimension' of reform, greater weight in determining what reforms may be appropriate on the basis that measures to drive commitment to a strong, shared, ethical foundation on the part of industry could add to the efficacy of regulatory changes/other reforms by providing a basis for better decision making. 'A practical commitment to ethics, rather than obedience to the law, leads and enables employees to ask about the "right thing", to understand that, "can does not imply ought"' the submission states.

This 'practical commitment' requires, the submission argues, the implementation of various measures including: the development and articulation of an ethical framework of values, principles and purpose; a related program of education and training to build the capacity of individuals to make responsible decisions in line with the ethical framework; the review of systems, policies and structures to ensure that they are not driving behaviour that is inconsistent with the ethical framework; routine monitoring and assessment of the experience of key stakeholder; the establishment and effective implementation of processes by which examples and causes of misaligned behaviour can be reported and addressed; and the 'provision of support to those who attempt to do what is right - rather than a sole focus on discipline those who do what is wrong'.

[Note: The measures outlined above appear consistent with those suggested in a guide 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: *Managing Culture – A Good Practice Guide*. The guide argues that an ethical framework should sit at the heart of the governance framework of an organisation to drive good culture. See: MinterEllison 15/12/2018]

Vertical integration: the impact of the professionalisation of financial advisers should be taken into account?

Commenting specifically on the issue of vertical integration, the Ethics Centre suggests that 'the risks of vertical integration are directly proportionate to the quality of the "ethical skin" enveloping those working in such a structure'. For those working in 'professions' (eg lawyers, medical practitioners, engineers and accountants employed by corporations) the submission argues, 'no amount of commercial pressure would ever justify their acting in a manner that is inconsistent with their professional obligations' because the ideology of the professions 'requires' members of the professions to subordinate self-interest and instead 'to act in a spirit of public service'.

As such, the submission argues that as the financial advice sector is professionalised, the 'worlds of banking superannuation and financial services will change in proportion to the number true professionals that are employed in their ranks'.

Having said this, the submission states that the Ethics Centre is not opposed to either the simplification of the law, as suggested in the Interim Report, or to more rigorous enforcement 'Rather, we think that the public interest will best be served by a more nuanced approach in which the ethical dimension of reform is given greater weight'.

[Note: The Research Paper: *Conflicts of Interest and Disclosure*, released by the Commission appears to cast doubt on the impact of 'professionalism' in addressing conflicts of interest. 'While a sense of professionalism may help in protecting against intentional corruption, it cannot reduce unintentional bias that the individual is unaware of committing….Financial Advisers' conflicts of interest are not merely problems for the intentionally corrupt (ie "bad apples"), but also for well-meaning professionals who succumb to unintentional bias' it states. The research paper is available on the Commission's website here]

[Source: Ethics Centre: Submission in response to the Financial Services Royal Commission's Interim Report]

An answer to the issue of 'conflicted remuneration'? The Australia Institute's Centre for Future Work has proposed to the Commission that a system of sector wide collective bargaining in the financial services industry could establish clear and ethical benchmarks for compensation and uniform compensation (avoiding the problem of 'conflicted remuneration').

[Sources: The Australia Institute media release 05/11/2018; Submission in response to the Financial Services Royal Commission's Interim Report]

Submissions in response to Round 5 (Superannuation)

No need for a separate regulator, ASIC could take on an expanded role for ASIC in supervising conduct in superannuation? ASIC's submission to the Financial Services Royal Commission Round 5 (Superannuation) hearings argues against rethinking the twin peaks model.

Ahead of the next and final round of public hearings (which will commence on 19 November) the Financial Services Royal Commission has released submissions received in response to round 5 (superannuation) and round 6 (insurance) hearings.

A high level overview of some of the points raised in the Australian Securities and Investments Commission's (ASIC's) submissions is below.

Remuneration

ASIC writes that the hearings demonstrated that 'conflicts of interest and incentives are driving conduct that does not deliver good outcomes for consumers' and consequently that changes are required.

- **Grandfathered commissions:** ASIC writes that in light of the evidence considered by the Commission, its view is that the 'grandfathering of commissions should cease as soon as reasonably practicable and to the maximum extent possible, although consideration may need to be given to a short transition period to allow financial advisers to adjust their businesses.' ASIC goes on to say that it supports Counsel Assisting's suggestion to prohibit all commissions payable from superannuation products and end grandfathering by law reform if possible as an industry solution is 'unlikely' to be 'sufficient comprehensive'. In addition, ASIC states that it supports the Productivity Commission's recommendation for increased transparency regarding commissions for as long as they remain in place.

- **Ongoing service fees:** Commenting on the issue on whether there is justification for prohibiting ongoing service fees (including advice fees and plan service fees) from being deducted by trustees from superannuation accounts, ASIC states that the fee for no service issue provides a 'powerful illustration of why the proposal to prevent the deduction of fees for financial advice by trustees from superannuation accounts is sound'. ASIC goes on to say that it considers that further consideration should be given to what arrangements, if any, are appropriate if advisers are to receive payments from superannuation accounts. 'Further research and cost benefit analysis would need to be undertaken to understand the effects of any reforms'.

Conflicts of interest

- **Selling superannuation through bank branches:** ASIC writes that, rather than an outright prohibition, it supports instead, 'initiatives designed to better regulate how superannuation products are distributed and sold in order to protect customers' including the 'banning of unsolicited superannuation sales'.

- **Dual regulated entities (DREs):** ASIC writes that 'consideration should be given to prohibiting DRE structures' but at this stage, that despite 'the significant problems arising from conflicts in relation to superannuation outcomes it cannot be concluded that blunt legislative intervention to prohibit or require changes to structures' more broadly is desirable.

Role of the regulators and the regulatory structure

- **ASIC submits that 'any suggestion that ASIC has not been prompt in responding to this misconduct is not correct'.**
- **ASIC supports the 'twin peaks' framework but suggests that it could assume an 'expanded role in the regulation of conduct in the superannuation sector'** (working together with the Australian Prudential Regulation Authority (APRA)) which could 'involve some allocation to ASIC of the primary regulatory responsibility for particular provisions directly impacting consumers'. ASIC specifies that it 'does not support any change in roles that would prevent APRA from properly carrying out its prudential functions' and that it explicitly does not support the creation of a new superannuation regulator.
- **Expanded powers required to ensure accountability:** Were ASIC granted an expanded role, it adds that it would need a 'corresponding set of broad powers' under the primary legislation ie under the *Superannuation Industry ((Supervision) Act 1993 (Cth)* (SIS Act).

Law Reform: stronger accountability mechanisms

ASIC writes that there are currently challenges in ensuring the appropriate level of accountability given existing regulatory settings. In particular, ASIC writes that SIS Act provisions 'require amendment, particularly to increase the powers of the regulators and consequences of misconduct'. For example ASIC suggests that:

- Sanctions for contravention of the best interests covenants under s 52(2)(c) and s 52A(2)(c) of the SIS Act should be strengthened by making them civil penalty provisions (which would also mean that they could attract criminal sanction if the contravention met the requirements of s 202 of the SIS Act).
- ASIC also submits that the 'no employer kick back rule' (s68A of the SIS Act) should be 'strengthened' to make it more effective and the provision should be transformed into a civil penalty provision that ASIC can enforce and therefore also a criminal provision if a contravention were to meet the requirements of s 202 of the SIS Act (to increase the deterrent effect).
- ASIC also submits that it should be given the power to issue infringement notices with penalties for a breach of s 68A.

[Source: ASIC's submission in response to the Financial Services Royal Commission Round 5 hearings]

The Association of Financial Advisers has questioned the need for any change to either grandfathered commissions and/or ongoing fees in its submission to the Financial Services Royal Commission Round 5 (Superannuation) hearings.

In response to the Financial Services Royal Commission Round 5 (Superannuation) hearings the Association of Financial Advisers (AFA) submission has challenged, in a number of instances the premise upon which the Commission has based its 'general' or policy questions and consequently the need for changes to existing settings in those instances.

On the topic of grandfathered commissions the AFA questions whether the 'existence of grandfathered commissions is universally contrary to the best interests of clients' has been established given that 'insufficient investigation' has been carried out into the remaining level of grandfathered commissions in the sector, the products clients are invested in or the extent to which 'the continuation of grandfathered commissions is inappropriately impacting upon the quality of financial advice or consumer outcomes' by Treasury and APRA. On this basis, the AFA writes that 'we do not believe that sufficient work has been done on this issue to establish an informed debate. We believe that this level of knowledge needs to be developed before decisions are made'.

On the topic of ongoing advice fees the AFA writes that though it is not 'advocating for the continuation of adviser payments where no service is being provided and particularly in the case where a client has no assigned adviser' in its view, the 'majority of clients are getting good value from their financial advice arrangements and that this value is very deep and broad'. Consequently, the AFA questions whether change is necessary. 'There is simply no basis for considering a ban on financial advice fees being charged on an ongoing basis and being deducted from a client's superannuation account, provided they are appropriate and comply with the sole purpose test. We strongly oppose any suggestion or consideration of banning this' the AFA writes.

[Source: Association of Financial Advisers (AFA) Submission in response to the Financial Services Royal Commission Round 5 (superannuation) hearings]

In Brief | The Australian Institute of Company Directors' submission advocates (among other things) a stronger focus on board composition and more particularly a stronger focus on directors' knowledge, skills and experience' as well as clearer delineation of the regulators' roles. In addition, the submission supports the application of civil liability to breaches by the trustee and trustee directors of the duties to act in the best interests of members and 'targeted measures' to improve the management of conflicts of interest in the industry. The AICD expresses reservations however, about the extension of the 'best interests' obligation to parties other than the trustee and trustee directors.

[Source: Australian Institute of Company Directors' submission in response to Round 5 (superannuation) hearings]

Other Developments

The Federal Court has ordered penalties and other relief against Westpac for BBSW conduct

The Australian Securities and Investments Commission (ASIC) has announced that the Federal Court has ordered that Westpac Banking Corporation (Westpac):

- pay a pecuniary penalty of $3.3 million for contravening s12CC of the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act) through its involvement in setting BBSW in 2010;
- be subject to an independent review (to be conducted by an independent expert agreed between ASIC and Westpac) of Westpac's current systems, policies and procedures to assess whether they are appropriate, and to report back to ASIC within 9 months;
- pay ASIC's costs.

ASIC Commissioner Cathie Armour welcomed the decision saying: 'ASIC brought this litigation to hold the major banks to account for their unacceptable conduct, and to test the scope of the law in combating benchmark manipulation. ASIC actions have led to these successful court outcomes, and also contributed to new benchmark manipulation offences being enacted by Parliament, and the calculation method and administration of the BBSW being radically overhauled.'

Context: The orders follow Justice Beach's judgment (previously reported in Governance News 28/05/2018) 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.

[Source: ASIC media release 09/11/2018]

AFS licensees are reminded to provide ASIC with AFCA membership details by 30 November (after which late fees will apply)

The Australian Securities and Investments Commission (ASIC) issued a statement reminding Australian Financial Service Licensees (AFSL holders) that they are required to notify ASIC about their Australian Financial Complaints Authority (AFCA) membership details by 30 November 2018.

Firms can notify ASIC by logging in to ASIC's online services and updating their details. ASIC said late fees will not apply if AFCA details are updated by 30 November.

[Source: ASIC media release 06/11/2018]

No need to increase the superannuation guarantee? A report by the Grattan Institute has questioned the necessity and the efficacy of raising the superannuation guarantee to 12%

The Grattan Institute has released a report: *Money in retirement: More than enough* which challenges the 'conventional wisdom' that Australians don't save enough for retirement. According to the report, 'the vast majority of retirees today and in future are likely to be financially comfortable' with most retirees 'more comfortable financially than younger Australians who are still working'. The report also found that increasing compulsory super contributions to 12% would be less effective in increasing retirement incomes and budget revenues than reducing superannuation fees.

The report makes a number of recommendations including the following.

- The superannuation guarantee should remain at 9.5% (rather than being increased to 12%)
- Further reforms to superannuation tax breaks should be implemented eg age-based tax breaks should be reformed, annual super contributions from pre-tax income should be limited to $11,000 a year, lifetime contributions from post-tax income should be limited to $250,000, or an annual cap on post-tax contributions of $50,000 a year, earnings in retirement — currently untaxed for balances below $1.6m — should be taxed at 15%, the same as superannuation earnings before retirement
- The Productivity Commission should investigate raising the age of access to the Age Pension and superannuation to 70 years.

Labour has no plans to amend its policy? Investment Magazine reports that Shadow Treasurer Chris Bowen has said that despite the report findings, the Labor party has no plans to amend its plans to increase the superannuation guarantee to 12% by 2025 (if elected). 'I am not swayed…I support getting to 12% and the Labor government will…There is no magic to the 9.5 figure. It's not a great figure; 12 was always the intention, 12 was the number that most analysis shows is necessary for adequacy and 12 is what we should get to' he reportedly said.

[Sources: The Grattan Institute: Money in Retirement: More than Enough; The Guardian 07/11/2018; Investment Magazine 07/11/2018]

In Brief | The Senate Standing Committee on Economics has recommended that legislation that would impose design and distribution obligations and grant ASIC product intervention powers be passed.

[Note: *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* was introduced into the House of Representatives on 20 September. See; Governance News 05/11/2018. The Bill is currently at second reading stage in the House of Representatives and is yet to pass the senate. Both Houses are due to resume sitting on 26 November.]

[Source: Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 Report]

In Brief | Open Banking update: Data61 has released a working draft of the standards that will underpin the Consumer Data Right (CDR). It's proposed that open banking will require the four major banks to make data about their customer's card, deposit and transaction accounts available to different services by 1 July 2019.

[Note: Consultation on the draft legislation to implement the Consumer Data Right: *Treasury Laws Amendment (Consumer Data Right) Bill 2018* closed on 7 December. For an overview of the draft legislation, see: Empowering consumer choice – ACCC to regulate the Consumer Data Right 17/08/2018. On 12 September the ACCC released a proposed rules framework to implement the Consumer Data Right (CDR) for consultation (though the ACCC will have no authority to finalise/make rules until the legislation is passed). Consultation closed on 12 October (see: Governance News 17/09/2018). Consultation on issues expected to arise when the CDR is rolled out to the energy sector is expected to be scheduled for early 2019.]

[Sources: Data61: Consumer data standards version 0.1.0; The AFR 11/11/2018; The Conversation 09/11/2018; Computerworld 05/11/2018]

In Brief | ASIC is consulting on proposed updates to organisational competence requirements for advice licensees in line with FASEA's draft guidance and in anticipation of the implementation of new

professional standards reforms for financial advisers. Consultation will close on 6 December. An updated regulatory guide will be released in March 2019.

[Sources: ASIC media release 08/11/2018; Consultation Paper 305: Organisational competence requirements for advice licensees: Update to RG 105 08/11/2018; Draft updated regulatory guide 105: Licensing Organisational Competence 08/11/2018]

Overseas Developments

Top Story | FMA/RBNZ Report on Conduct and Culture in the Banking sector

The Financial Markets Authority and Reserve Bank of New Zealand have released their Report into Conduct and Culture in the Banking sector. A summary of the report findings and implications is here.

[Source: FMA/RBNZ Report on Conduct and Culture in the Banking sector 05/11/2018]

Canada | OFSI has released the final version of its corporate governance guideline setting out its expectations for the boards of federally regulated financial institutions

The Office of the Superintendent of Financial Institutions (OSFI) has published a revised version of its Corporate Governance Guideline for federally regulated financial institutions. The guideline was first issued in 2003 and last revised in 2013. Among other things, the revised guideline:

1. Consolidates and rationalises all OSFI requirements for boards into one guideline.
2. Clarifies the delineation between board and senior management responsibilities.
3. Provides boards with greater discretion over how they meet the principles of the guideline, taking into account their institutions' size, complexity and risk profile.

Application: The Guideline applies to all federally regulated financial institutions other than the branch operations of foreign banks and foreign insurance companies.

[Sources: OFSI media release 18/09/2018; Revised Corporate Governance Guideline September 2018; Letter to federally regulated financial institutions 18/09/2018]

Accounting and Audit

In Brief | The government is seeking feedback on the tax impacts of implementing a new accounting standard for insurance contracts (AASB17) which will apply for annual reporting periods beginning on or after 1 January 2021 to inform the government's consideration of whether changes to the tax law are required. Consultation closes 31 January 2019.

[Sources: Treasury media release 05/11/2018; Consultation paper 05/11/2018]

Overseas Developments

United Kingdom | Financial Reporting Council CEO Stephen Haddrill will step down from his role in late 2019.

The Financial Reporting Council (FRC) has announced that FRC CEO Stephen Haddrill has announced his intention to step down from his role in late 2019. The FRC writes that the exact date of his departure will depend on a number of factors including the outcome of Sir John Kingman's review of the FRC, the search for his successor, and any agreed transition period associated with that appointment.

Mr Haddrill said in a statement: 'I am incredibly proud to have led the FRC for nearly nine years. However, I believe that it should be the job of a new CEO to lead the FRC when the way ahead is decided.'

[Note: On 17 April, the UK government announced the launch of an independent 'root and branch' review of the FRC to be led by Sir John Kingman (Kingman Review). 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'. See: Governance News 20/04/2018. In addition, The UK Competition and Markets Authority (CMA) recently announced the launch of a detailed market study into the audit sector to examine 'concerns that it is not working well for the economy or investors'. See: Governance News 15/10/2018]

[Sources: FRC media release 02/11/2018; [registration required] The FT 03/11/2018]

United Kingdom | The FRC has issued a series of reports/guides highlighting areas for improvement in financial reporting practices

Smaller companies need to improve reporting quality/detail and next year the FRC will focus on impairment of non-financial assets and the effects of Brexit in company disclosures: The UK Financial Reporting Council (FRC) has issued a report: *Reporting by Smaller Listed and AIM Quoted Companies* which has identified similar weaknesses in smaller company reports as were identified in those of larger companies (see: Governance News 29/10/2018). More particularly, the report found that there was a need for companies to provide more specific disclosures of significant accounting judgements and more quantitative information on key sources of estimation uncertainty. 15 of the 40 companies reviewed were asked to provide additional information in relation to a substantive question relating to their disclosures. Misclassification in cash flow statements was also identified as an issue.

'The better practice examples identified by the thematic review indicate that smaller companies are able to provide high quality information to stakeholders. We expect companies of all sizes to carefully consider the findings from the review to enhance their disclosures. There is scope for companies to provide stakeholders with more tailored information about the areas of their accounts subject to most judgement and the potential effect of material changes in estimates and assumptions' Executive Director for Corporate Governance and Reporting Paul George said.

The FRC adds that in addition to the routine monitoring program in place, thematic reviews in 2019/20 will include reviews of impairment of non-financial assets, the effect of the new IFRS on leases in companies' 2019 interim accounts and the effects of the decision to leave the EU on companies' disclosures.

[Sources: FRC media release 06/11/2018; Reporting by Smaller Listed and AIM Quoted Companies]

Implementation of IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from Contracts with Customers): Separately, the FRC released thematic review findings of *IFRS 9 Financial Instruments* and *IFRS 15 Revenue from Contracts with Customers* company disclosures which identified various areas for improvement including the need for greater clarity and provision of more detailed/comprehensive explanations. The FRC also flagged that it will continue to monitor implementation noting that the FRC 'will challenge companies who do not provide an adequate level of disclosure about the impact of the new standards through their regular accounts review process next year'.

[Sources: FRC media release 05/11/2018; IFRS 9 Financial Instruments; IFRS 15 Revenue from Contracts with Customers]

Performance metrics – how to improve reporting: The FRC also released guidance from the FRC Financial Reporting Lab for companies on the presentation of performance metrics in their reporting following calls for clarity from investors. The guide includes examples of how reports can better present information to improve clarity for investors and to better link financial information to company strategy and commentary/questions for companies to consider when preparing reports. The guide is aimed at assisting companies to better meet investor demands for clearer information, namely that 'performance metrics…be aligned to strategy, transparent, in context, reliable and consistent'.

[Sources: FRC media release 07/11/2018; Performance metrics – Principles and practice*]*

In Brief | Should directors be more accountable for audit mistakes? In response to the CMA review of the UK audit sector, EY CEO Steve Varley has reportedly suggested to EY partners that the UK should introduce a system comparable to the US Sarbanes-Oxley scheme and directors should be more directly accountable for audit mistakes.

[Note: The UK Competition and Markets Authority (CMA) recently announced the launch of a detailed market study into the audit sector to examine 'concerns that it is not working well for the economy or investors'. The review is being undertaken, the CMA writes, 'amid growing concerns about statutory audits, in particular following the collapse of construction firm Carillion and the criticism of those charged with reviewing the organisation's books, as well as recent poor results from reviews of audit quality'. As part of its review, the CMA will investigate whether the sector is competitive and resilient enough to maintain high quality standards. See: Governance News 15/10/2018.]

[Source: SkyNews 04/11/2018]

Risk Management

Cybersecurity

Top Story | New cybersecurity prudential standard for banks, insurers and superannuation funds released: APRA has released the final version of its new information security prudential standard CPS234 Information Security for APRA regulated entities.

The Australian Prudential Regulation Authority (APRA) has released the final version of its prudential standard: *Prudential Standard CPS 234 Information Security*. The standards is intended to strengthen APRA regulated entities' resilience to cyberattack and their ability to respond in the event of an incident.

Key Takeaways

1. **Information security is a board responsibility:** The new prudential standard makes clear that information security is ultimately a board responsibility. It also requires that the information security roles and responsibilities of the board, senior management and governing bodies and individuals with responsibility for information security decision-making, oversight and operations are clearly defined and imposes new requirements for the regular testing and auditing of information security controls.
2. **New notification requirements:** Entities have 3 days (72 hours) to report serious security incidents to APRA ie if the issue 'materially affected, or had the potential to materially affect, financially or non-financially, the entity or the interests of depositors, policyholders, beneficiaries or other customers'. Entities have 10 days to notify the regulator after becoming aware of a material information security control weakness 'which the entity expects it will not be able to remediate in a timely manner'.
3. **Scope and timeframe:** The new standard applies to **all APRA regulated entities** and will (broadly) apply from **1 July 2019.**

Introduction

Following consultation earlier in the year (see: Governance News 09/03/2018), the Australian Prudential Regulation Authority (APRA) has released the final version of its prudential standard: *Prudential Standard CPS 234 Information Security* to strengthen APRA regulated entities' resilience against information security incidents and their ability to respond in the event of an incident. APRA has also released its response to issues raised during the consultation process.

Application of the new standard

The new standard will apply to all APRA regulated entities. This includes all authorised deposit-taking institutions (ADIs), general insurers, life insurers, private health insurers, licensees of registrable superannuation entities and authorised non-operating holding companies.

Timeframe

- All APRA-regulated entities are expected to meet the new requirements by **1 July 2019**.
- A transition period has been included for those aspects of the new standard that apply to information assets managed by third parties. Regulated entities will have until the earlier of the next contract renewal date or until 1 July 2020 to ensure third party arrangements comply with the new requirements.
- APRA expects to release a revised CPG 234 Management of Security Risk in Information and Technology in the first half of 2019 to provide guidance on the implementation of CPS 234.

Why is this so urgent? Commenting on the implementation timeframe APRA Executive Board Member Geoff Summerhayes said that 'fast-tracking' implementation of the new standard was justified given the high level of risk: 'A significant information security breach at an APRA-regulated entity is almost certainly a question of when – not if. In a worst-case scenario, a major breach could even force a company out of business. As a result, APRA is fast-tracking implementation of this standard' he said.

New requirements — some key points

- **The board of an APRA-regulated entity is ultimately responsible** for ensuring that the entity maintains its information security. More particularly the new standard requires that the board must 'ensure that the entity maintains information security in a manner commensurate with the size and extent of threats to its information assets and which enables the continued sound operation of the entity'.
- **Clearly defined roles/responsibilities:** The new standard also requires that APRA regulated entities 'clearly define the information security-related roles and responsibilities of the Board, senior management, governing bodies and individuals with responsibility for decision-making, approval, oversight, operations and other information security function'.
- **The new standard applies to 'all information assets managed by service providers',** this includes 'all outsourcing of information assets, whether or not those assets form part of the outsourcing of material business activities' ie the new requirements on 'information security capability, information asset identification and classification, implementation of controls, testing control effectiveness and internal audit would apply to information assets, including those assets managed by related parties and third parties'.
- **Identifying and classifying information assets:** The new standard requires regulated entities to classify all information assets by both 'criticality and sensitivity…irrespective of whether the regulated entity manages the information assets itself, or the information assets are managed by a third party or related party'. Rather than establishing a threshold whereby controls would only apply to information assets deemed 'material', APRA writes, the classification of assets in this way is intended to allow an entity to apply 'proportionate controls by assessing the impact of a loss of confidentiality, integrity and availability of each information asset'.
- **Implement controls to protect information assets and undertake regular testing and assurance of the effectiveness of controls:** eg regulated entities will be required to annually review and test their information security response plans and internal audit activities will be required to include a review of the design and operating effectiveness of information security controls including those maintained by third parties.
- **Breach notification requirements:**
  - The new standard requires that entities notify APRA of material information security incidents no later than **72 hours** 'after becoming aware' of them. Initially APRA proposed that the notification timeframe would be 24 hours. APRA comments that the 72 hour timeframe 'will provide regulated entities with appropriate time to properly assess an information security incident and determine how to deal with the issue' and also align with the breach notification regimes of other regulators.
  - The new standard also requires that entities notify APRA 'as soon as possible' (no later than **10 business days**) after becoming aware of a material information security control

weakness 'which the entity expects it will not be able to remediate in a timely manner'. This timeframe has been extended from the 5 days initially proposed.

- APRA comments that submissions received in response to consultation generally requested clarity as to the nature and form of notifications required to be provided to APRA and that in response, it plans to provide further guidance on the nature and form of notification requirements. APRA expects to do this via revisions to CPG 234 Management of Security Risk in Information and Technology. APRA adds that as a minimum it would expect an entity to advise APRA of the regulators who have been informed and the nature of the incident.

Updated guidance

APRA will shortly be undertaking consultation on an updated cross-industry prudential practice guide on information security, which will replace the current *Prudential Practice Guide CPG 234 Management of Security Risk in Information and Information Technology* to assist entities in fulfilling their requirements.

Further changes to come…

APRA states that the issue of CPS 234 is part of a broader APRA project to review and update APRA's prudential framework in respect of the management of operational risk across all APRA-regulated industries. APRA states that it intends to consult on new and revised requirements and associated guidance on operational risk, outsourcing and business continuity management in 2019.

[Sources: APRA media release 7/11/2018; Prudential Standard 234 Information Security; Response Paper: Response to submissions — Information security: Cross-industry prudential standard]

56% of boards still using personal email to communicate about board matters? A global survey targeting governance professionals across 11 countries has found 'underdeveloped' and out-dated communication practices at board level are potentially exposing organisations to increased risk of cyber-attack and inadvertent data leaks.

A global study into executive board management practices has found that board members and governance professionals don't associate or connect their own communication practices with the company's cybersecurity posture overall. More particularly, the report found that though 41% of boards are very concerned about their ability to secure their communications and data sharing, 'underdeveloped' board communication practices are exposing boards/organisations to heightened risk of cyber-attack, data breaches and inadvertent data leaks.

Some key findings

- **Challenges associated with secure data sharing/access is recognised.** 49% of boards find it challenging to secure documents/board materials and control access. There was a higher level of concern on Asia Pacific boards (60%) as compared with Europe (47%) and North America (37%).
- **56% of board members are using personal email (not business regulated email) to communicate about board matters.** Board members/directors are the largest users of personal email at 56%, followed by C-level executives at 51%.

[Note: In Australia, The Office of the Australian Information Commissioner's (OAIC's) quarterly statistics for July-September 2018 identified human error as key cause of privacy breaches accounting for 37% of breaches overall (behind cyber-attack 57%). See: Governance News 05/11/2018.]

- **Personal email usage is common across boards of all company sizes and across regions.** North America has the highest usage at 53%, followed closely by Europe at 51%, and the lowest usage is in Asia Pacific at 48%.
- **Only 35% of boards use more secure communication methods eg closed-loop messaging.** Though the rates of adoption are slightly higher in the Asia Pacific (37%) and the Europe (36%) as compared with North America (30%).

- **Each region surveyed agreed that misplaced devices is their top security challenge,** with 45% of North American board members having lost/misplaced a device, followed by 30% in Europe and 28% in Asia Pacific. Given the frequency at which devises are being lost/misplaced, the report suggests that technology solutions that offer the ability to remotely wipe a device may have increased appeal to boards whose members access board materials through mobile devices.

About the report:

- The report is based on the results of an online survey of 411 governance professionals in the United States, Canada, the United Kingdom, Spain, Germany, France, China, Singapore, Hong Kong, India, and Australia to evaluate executive board management practices.
- Survey participants included C-level executives, board members/ directors, corporate secretaries, senior IT leaders, general counsels, and investor relations staff.
- The study began in June 2018 and was completed in July 2018.
- The report was commissioned by Diligent Corporation and conducted by Forrester Consulting.

[Source: [registration required] Forrester Consulting: Directors' Digital Divide: Boardroom Practices aren't keeping pace with technology October 2018]

United States | A tougher version of the GDPR? Draft legislation proposing to strengthen privacy protections for US consumers, strengthen the regulator's capacity to oversee compliance and impose tougher penalties is being circulated by Democrat Senator Ron Wyden.

US Senator Ron Wyden (Democrat) has circulated 'discussion draft' of proposed legislation (at this stage called the *Consumer Data Privacy Act)* which is intended to strengthen consumer privacy protections for US consumers, allow consumers to control the sale and sharing of their data, and give the Federal Trade Commission (FTC) authority to 'be an effective cop on the beat'. The draft legislation has been likened to the General Data Protection Regulation (GDPR) except with respect to the proposed penalties, which go further than the GDPR in some respects.

Senator Wyden comments that 'It's time for some sunshine on this shadowy network of information sharing. My bill creates radical transparency for consumers, gives them new tools to control their information and backs it up with tough rules with real teeth to punish companies that abuse Americans' most private information'.

The draft legislation proposes (among other things) to give the FTC authority to:

- Establish minimum privacy and cybersecurity standards.
- Impose fines (up to 4% of annual revenue) on the first offense for companies and 10-20 year criminal penalties for senior executives.
- Create a national 'Do Not Track' system that will enable consumers stop third-party companies from tracking them on the web by sharing data, selling data, or targeting advertisements based on their personal information. The draft legislation also permits companies to charge consumers who want to use their products and services, but don't want their information monetised.
- Give consumers a way to review what personal information a company has about them, learn with whom it has been shared or sold, and to challenge inaccuracies in it.
- Require companies to assess the algorithms that process consumer data to examine their impact on accuracy, fairness, bias, discrimination, privacy, and security.
- Hire 175 more staff to police the largely unregulated market for private data.

[Sources: Senator Ron Wyden media release 01/11/2018; Summary of proposed legislation; Draft Consumer Data Protection Bill; Gizmodo 01/11/2018; Wired 03/11/2018]

Commitment to a new 'contract for the web': Over 50 companies, business leaders and governments (including Facebook and Google) have signed onto new internet standards designed by world wide web founder Tim Berners-Lee.

Over 50 companies, governments and business leaders including Facebook, Google and the French government have signed up to new internet standards designed by world wide web founder Tim Berners-Lee. The new 'contract for the web' sets out to provide a starting point/set of 'core' principles for creating a 'better web' by outlining a set of high level responsibilities for governments, citizens and governments intended to help mitigate risks (eg privacy risks, risks to democracy) associated with web usage. These include obligations for companies to make the internet universally affordable and accessible, to respect consumer privacy and personal data and to develop technologies that support 'the best in humanity and challenge the worst'.

The principles are intended to be 'built' into a full contract through a consultation process. A final set of principles will be published in May 2019 (to coincide with the point at which more than half the world's population is anticipated to have internet access/be online).

According to The FT, the final standards could include a commitment to net neutrality, which Mr Berners-Lee has fiercely advocated for after a rollback in the US.

[Sources: [registration required] The FT 06/11/2018; World Wide Web Foundation media release 05/11/2018; Contract for the web: Core principles; The case for the web report 03/11/2018]

Climate Risk

Final SASB sustainability reporting standards released: The Sustainability Accounting Standards Board (SASB) has released 77 industry-specific sustainability accounting standards aimed at providing investors with in-depth information about the impact of a company's actions on society and the environment.

The Sustainability Accounting Standards Board (SASB) has published 77 industry-specific sustainability accounting standards to assist companies to better identify, manage and communicate to investors financially material sustainability information. Though the standards may assist entities in meeting local regulatory requirements in some localities, the SASB writes, their primary purpose is to better inform investors by encouraging reporting that is comparable, consistent, and financially material, thereby enabling them to make better investment and voting decisions.

Some Key Points

- **Assist in identifying industry specific issues:** The voluntary standards are designed to identify a minimum set of sustainability issues most likely to impact the operating performance or financial condition of a typical company in a specific industry.
- **The standards are not prescriptive:** The SASB writes that its expectation is that companies should determine which standard/standards are relevant to their own business, which disclosure topics are financially material to their businesses, and which associated metrics to report, taking relevant legal requirements into account.
- **Structure/scope of the standards:** Each industry specific SASB standard describes the industry that is the subject of the standard, including any assumptions about the predominant business model and industry segments that are included. Each standard includes: disclosure topics (a minimum set of industry specific disclosure topics identified as 'reasonably likely' to constitute material information); accounting metrics to measure performance against each topic, technical protocols (guidance on definitions, scope, implementation, compilation and presentation intended to constitute suitable criteria for third-party assurance) and activity metrics (metrics that quantify the scale of a company's business are intended to be used in conjunction with accounting metrics to normalise data and facilitate comparison). The standards could be used to inform sustainability reports, integrated reports, websites, or annual reports to shareholders.

- **Not designed to add to reporting burden on companies:** The standards are designed to have global application and to facilitate improved reporting in a cost-effective and 'decision-useful manner' using existing disclosure and reporting mechanisms.
- **The standards can be used alongside other sustainability frameworks** eg the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and are complementary to the Global Reporting Initiative (GRI).
- **One benefit of using SASB standards may be achieving regulatory compliance in some markets** but the SASB cautions that there is no guarantee that SASB standards address all financially material sustainability risks or opportunities unique to an individual company's business model.

Already widely supported: The standards were finalised after six years of research and extensive market consultation, including extensive engagement with investors and businesses and already a number of entities are using them for the purpose of reporting. These include: GM, Merck, Nike, Kellogg's, JetBlue, CBRE, Diageo, Groupe PSA, Schneider Electric, Host Hotels, and NRG Energy) have already commenced using the SASB standards.

Regular review cycle: Moving forward, SASB will follow a regular, multi-year cycle of standards updates to ensure the standards remain relevant and responsive to evolving market needs.

[Sources: SASB media release 07/11/2018; SASB standards; [registration required] The FT 08/11/2018; [registration required] The WSJ 07/11/2018]

Whistleblowing

In Brief | Whistleblower Bill to be strengthened? The Australian reports that Assistant Treasurer Stuart Robert has been tasked with reviewing the stalled Federal Whistleblower Bill (which has not progressed beyond the Senate) in light of concerns it does not go far enough. Reportedly, the government intends to reintroduce a revised Bill before the end of the year.

[Note: The Bill referred to above is the *Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill 2017 (Cth)* which has not progressed past second reading in the Senate and is yet to pass the House of Representatives. For an overview of the Bill and its implications as presently drafted please refer to MinterEllison's update *24/04/2018*. The Senate is due to resume sitting on12 November. Both Houses are scheduled to resume sitting on 26 November.]

[Source: [registration required] The Australian 09/11/2018]

Supply Chain Risk

Consultation on standards to support supply chain integrity

Standards Australia has released a discussion paper: *Supply chain standards to reduce the black economy* seeking views on how standards and related material (such as technical specifications and handbooks), could help ensure responsible supply chain management in line with Recommendation 9.2 of the Black Economy Taskforce Report.

More particularly, Standards Australia is seeking feedback on the following questions (among others).

- Risks in relation to black economy activity and the impact these have from a reputational, legal and financial perspective on business.
- The impact of the black economy on competition in different sectors.
- Current approaches in use by organisations to addressing risks associated with the black economy.
- The role of current/future technology in addressing supply chain trust and assurance issues.
- The extent to which standards (or other models) could assist in addressing supply chain risks associated with the black economy.
- How prescriptive any standards should be.

- Whether there are examples of best practice locally or globally and whether organisations are already required to comply with overseas jurisdiction's black economy regimes.
- How a standards based compliance mechanism could operate in Australia and who should implement it/administer it/whether this requires legislation or other regulatory measures.

Process and Timeline: The consultation process will be based on this discussion paper, and complemented by face-to-face consultation sessions, as well as online feedback, in November 2018. The final report and recommendations will be released by March 2019.

[Source: Standards Australia Discussion Paper: Supply Chain Standards to Reduce the Black Economy 05/11/2018]

Other Developments

In Brief | The New York Times reports that Google will reportedly end forced arbitration for sexual harassment or assault after more than 20,000 Google staff globally staged a walk out in protest over how the company handles sexual harassment/misconduct claims. Facebook has reportedly announced that it will follow suit.

[Sources: [registration required] The New York Times 08/11/2018; 12/11/2018; Business Insider 09/11/2018]

In Brief | Time to remove caps on compensation payouts for sexual harassment/misconduct to better reflect current income levels? The AFR reports that corporate consultant Conrad Liveris has proposed removing caps on compensation in NSW, WA, Tasmania and The Northern Territory in line with changed community expectations, and in line with increases in income.

[Source: [registration required] The AFR 05/11/2018]

Insolvency and Restructuring

In Brief | Labor's proposed anti-phoenix measures: The ABC reports that if elected, Labor plans to bolster the proposed DIN regime and grant the Tax Commissioner powers to publicly 'name and shame' individuals and entities engaged in fraudulent phoenix activity. Master Builders Australia CEO Denita Wawn has issued a statement welcoming the announcement as a 'step in the right direction' but has called on Labor to also support government measures 'to crack down on union officials and organisations convicted of breaking the law, including disqualification orders for serial offenders'.

[Note: Consultation on legislation which would implement the proposed Director Identification Numbers regime: *Treasury Laws Amendment (Registries Modernisation and Other Measures) Bill* 2018 and modernise business registers: *Commonwealth Registers Bill 2018* has closed and the Bills have yet to be introduced. See: Governance News 05/11/2018]

[Sources: ABC news 07/11/2018; Master Builders Association media release 08/11/2018]