# Governance News

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## Diversity

**Top Story | Gender diversity in US companies has stalled: McKinsey's fourth annual study tracking progress on gender diversity has found that despite public commitment to the issue, the proportion of women in US corporations remains barely changed.**

McKinsey's fourth annual study tracking progress on gender diversity has found that progress has stalled.

**Key Points**

1. **Progress has stalled:** The study found that women remain underrepresented at every level in US corporations, despite awareness and acceptance in the majority of organisations, of the benefits of diversity/commitment to diversity.
2. **Key Reason?** The study, which is the largest of its kind (including 20 million participants since 2015), identifies the key cause the problem as the lack of action by companies to act to address discrimination in hiring and promotion practices that disadvantage female applicants rather than other causes eg attrition.
3. **How to fix it?** According to McKinsey, if companies continue to hire and promote women to manager at current rates, the number of women in management will increase by just 1% point over the next ten years. However, were companies to hire women and women at the same rates, (near) gender parity in management (48% women, 52% men) would be reached over the same period.

**Introduction**

LeanIn.org and McKinsey have released their fourth *Women in the Workplace survey* which tracks progress on gender diversity in US companies. The latest report is based on data from, 279 companies and interviews with more than 64,000 employees. Since 2015, 462 companies employing almost 20 million people have participated in the study making it, according to McKinsey the largest ever study of its kind.

Overall, the report found that, despite expressions of commitment to gender diversity by many firms, progress towards gender equality has effectively stalled with women (especially women of colour) continuing to be 'vastly underrepresented at every level'. According to the report, the key cause of this is that current hiring and promotion practices disadvantage female applicants and female employees.

Given this, the report argues that progress on gender equality will only occur if companies treat gender diversity as a business priority and act to change their hiring and promotion practices. 'To achieve equality, companies must turn good intentions into concrete action' the report states.

**Some Key Findings**

- Since the first year of the study (2015), there has been 'almost no progress in improving women's representation' and women remain underrepresented at every level. Women of colour are the most underrepresented group. At senior leadership level, women make up 1 in 5 C-suite leaders. For women of colour, the proportion is less, accounting for only 1 in 25 C-suite leaders.
- The report found that the lack of female representation is **not** attributable to:
  - **Attrition** as women and men leave companies at similar rates (15% of women and 15% of men left their jobs in the last year).
  - **Lack of ambition:** Overall, the survey also found that women ask for promotions and raises as often as men do and the desire for promotion is similar for women and men (71% and 75% respectively). The survey also found that some groups of women more ambitious than their male counterparts. For example: Asian women (83%), Black women (80%) and Latinas (76%) were found to be more ambitious than their male counterparts (75%) and slightly more ambitious than white women (68%).
  - **Failure to apply for promotions or to seek pay rises:** According to the survey, women are asking for promotions and raises at about the same rates as men. However, women early in

their careers are less likely to get promoted, and on average women are paid less than men in similar roles.

- **An uneven playing field?** According to the survey, women get less day-to-day support and less access to senior leaders, are more likely to deal with harassment and everyday discrimination and often feel the added scrutiny that comes from being the only woman in the room. For women of colour and lesbian women, the biases and barriers to advancement are amplified.
- **Lack of representation is attributable to hiring and promotion practices that disadvantage women (especially early on in the pipeline):** Representation of women at every level over the period 2015 to the present was found to be virtually unchanged with improvement at 2% or less at every level. According to the report, if companies continue to hire and promote women to manager at current rates, the number of women in management will increase by just 1% point over the next ten years. However, were companies to hire women and women at the same rates, (near) gender parity in management (48% women, 52% men) would be reached over the same period.

**Concrete actions to drive progress**

- **Treating equality as a business priority:** The report calls for companies to treat gender diversity 'like the business priority it is' by:
  - making a strong business case for gender diversity (including calculating the positive impact on business); setting targets, communicating them to employees and holding leaders accountable for results;
  - ensuring that hiring and promotions do not discriminate (especially early on in the leadership 'pipeline');
  - making senior leaders and managers champions of diversity (and ensuring female employees have access to/are given the support they need from managers to progress);
  - fostering an inclusive and respectful culture including (for example: ensuring sexual harassment policies are implemented in practice and addressing 'everyday' discrimination in the workplace);
  - offering employees flexibility and making the experience of being the 'only' woman in the room rare.

*[Sources: McKinsey report: Women in the Workplace 2018; McKinsey blog post: Women in the workplace 2018]*

## United States | Cynical about the focus on gender diversity but more open to consideration of social issues? PwC has released the results of its latest annual survey of US director views on various corporate governance issues including diversity, culture and board renewal.

PwC has released the results of its *Annual Corporate Directors Survey 2018* which gauges the views of US public company directors on a range of corporate governance matters.

**Some Key Findings**

- **Cynical about diversity efforts?** Though 94% of directors agree that diversity brings unique perspectives to the boardroom and 84% agree that it enhances performance, PwC found that directors appear 'cynical' about the issue with over half (52%) of the view that diversity efforts are driven by political correctness and 48% of the view shareholders are overly preoccupied with the issue.
- **Oversight of cybersecurity — boards appear to be unsure where responsibility should sit:** 12% of boards moved oversight of cybersecurity from a committee to the full board, 21% moved it from one committee to another and 11 moved it from the full board to a committee.
- **Pre-crisis preparations a priority (but PwC found gaps in preparedness)**: In relation to crisis preparation, 84% of respondents said that they've discussed management's plans to respond to a crisis but only 47% said that they had a written escalation policy. In terms of level of preparedness

for a cyber incident, 66% of respondents said that they've provided directors with more cyber education but only 34% had staged crisis management drills. PwC questions whether the level of preparedness is sufficient.

- **More open to consideration of social issues?** Overall, PwC found that directors appear increasingly willing/open to consider social issues in the context of company strategy. For example: 31% of directors said that resource scarcity should impact on company strategy (a 10 point increase on 2017) and 28% of directors said that human rights should impact strategy (an 8 point increase). However, there are still 29% of directors who are of the view that shareholders are overly focused on the issue, and a number who are neutral or do not think the issues relevant to consideration of company strategy.
- **Board performance, accountability and board renewal?** For a second year in a row, almost half (45%) of directors think one or more of their fellow directors should be replaced. PwC attributes this to the rapidly changing business environment which requires all directors to consistently deliver at the highest level.
- **The 'root causes' of poor company culture** were perceived to be: the tone set by the executive team (87%); followed by the tone set by middle management (79%) followed by excessive focus on short term results (74%).
- **Revision of remuneration plans to address poor culture?** PwC also found that companies are taking steps to address cultural issues eg by enhancing employee training, improving whistleblower programs. However, PwC found that only 17% say they have revised compensation plans, though 67% are of the view that remuneration plans can drive bad behavior when poorly designed.

**About the survey:** The survey was undertaken by 714 directors over the US summer of 2018. The respondents were drawn from a cross section of industries, 76% of which have annual revenues in excess of $1bn. 81% of respondents were men, 19% were women. Board tenure varied, but 64% of respondents have served on their board for five or more years.

*[Sources: PwC report: The evolving boardroom: signs of change PwC's 20189 Annual Corporate Directors Survey; Fortune 19/10/2018]*

### United States | No progress on racial discrimination in the US job market since 1989?

A new study from researchers at Harvard, Northwestern University, and the Institute for Social Research in Norway tracking changes in hiring practices over time in the US, has found no change in the level of hiring discrimination against Africans Americans over the past 25 years (though there was minimal improvement in the level of discrimination against Latino applicants).

The researchers conclude that 'contrary to claims of declining discrimination in American society, our estimates suggest that levels of discrimination remain largely unchanged, at least at the point of hire'.

*[Sources: Vox 18/09/2018; Proceedings of the National Academy of Sciences of the United States of America (PNAS): Lincoln Quillian, Devah Pager, Ole Hexel, and Arnfinn H. Midtbøen, Meta-analysis of field experiments shows no change in racial discrimination in hiring over time 12/09/2018]*

## Shareholder Activism

### Lazard has released its latest quarterly review of global trends in shareholder activism for Q2 2018: though there was a decline in campaign activity in Q3, 2018 has seen a record number of companies targeted.

Lazard has released its latest quarterly review of trends in shareholder activism: *Lazard's Review of Shareholder Activism — Q3 2018.*

**Some Key Points**

- **2018 has seen a record number of companies targeted:** Activists targeted 174 companies in the first three quarters of 2018 (5 more than were targeted over the course of 2017 and 12 more than were targeted in 2016).

- **There was a decline in campaign activity in Q3** with 45 campaigns initiated (down from 'record setting' Q1 (70 new campaigns) and Q2 (73 new campaigns) levels).
- **Technology companies** were the most likely to be targeted (27%) followed by industrials (18%) and Consumer companies (10%). .
- **Elliott remains the most active** with 19 new campaigns launched in Q3 2018 followed by ValueAct (6 campaigns) and Third Point and Icahn (which each initiated 4 campaigns).
- **Board change and M&A are the most common objectives of activist campaigns:**
  - **Board change:**
    - **Activists have targeted board seats in 34% of campaigns launched in 2018 YTD.** Based on current activity, the number of board seats won this year appears on track to surpass the 2016 record of 145.
    - **The majority of board seats have been won through settlements** with only 15% won through proxy contests.
    - **Only 25% of board seats won YTD were filled by activist fund employees**, which is the lowest level on record.
  - **M&A activity:** 34% of campaigns launched in 2018 3Q YTD have been M&A driven, with a high proportion aimed at catalysing a whole of company sale or industry consolidation.
- **Targets are becoming increasingly global:** 42% of campaigns YTD targeted non-US companies, including 21% launched at European companies, 10% at Asian companies, 6% at Canadian companies, and 3% at Latin American companies
- **Growing influence of passive managers:** Cumulatively, Vanguard, BlackRock and State Street now hold 40.9% of S&P500.
- **Increasing Engagement from Traditional Active Managers?** Lazard comments that a 'growing list' of institutional managers have become increasingly vocal in advocating for strategic change themselves or encouraging management to engage with activists that are agitating for change.

*[Sources: Lazard: Review of Shareholder Activism — 2018 3Q YTD; Harvard Law School Forum on Corporate Governance and Financial Regulation 22/10/2018]*

## Board analyses not determinative, but 'helpful'? SEC has provided additional information about its views on the exclusion of shareholder proposals in a follow up to Staff Bulletin 14I which provides further information on the operation of Rule 14a-8 under the *Securities Exchange Act of 1934*.

The US Securities and Exchange Commission (SEC) has issued a staff bulletin (SB 14J) which outlines its views on the exclusion of shareholder proposals under rule 14a-8(i)(7) of the *Securities Exchange Act 1934*. More particularly, the bulletin provides additional information on the following issues.

- **Board analyses provided in no-action requests** that seek to rely on Rules 14a-8(i)(5) or 14a-8(i)(7) as a basis to exclude shareholder proposals. SEC comments that the absence (or presence) of board analysis of the shareholder proposal/reasons why it should be excluded is not determinative but that 'without having the benefit of the board's views on the matters raised, the staff may find it difficult in some instances to agree that a proposal may be excluded'. SEC also said that it has found no-action requests that include a discussion of the board's analysis 'helpful in evaluating the requests, even where we did not ultimately agree with the company's position'. More particularly SEC writes that it found that requests which 'included the specific substantive factors the board considered in arriving at its conclusion' the most helpful and gave a number of examples of these factors including: the extent to which the proposal relates to the company's core business activities, quantitative data including financial statement impact related to the matter that illustrates whether it is of significance to the company, whether the company has already addressed the issue, the extent of shareholder engagement on the issue and whether the company's shareholders have previously voted on the matter (and the voting results).

- **The scope and application of micromanagement as a basis to exclude a proposal** under the 'ordinary business exception' permits a company to exclude a proposal that deals with a matter relating to the company's ordinary business operations. The exception has two arms, the first is the subject matter of the proposal and the second is micromanagement. The micromanagement arm refers to the degree to which the proposal 'micromanages' the company 'by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment.' The bulletin states that the two arms are independent of each other ie 'a proposal that may not be excludable under the first consideration may be excludable under the second if it micromanages the company'.
- **The scope and application of Rule 14a-8(i)(7) for proposals that touch upon senior executive and/or director compensation matters**. Under Rule 14a-8(i)(7), proposals that raise matters that are 'so fundamental to management's ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight' may be excluded, unless such a proposal focuses on 'policy issues that are sufficiently significant because they transcend ordinary business and would be appropriate for a shareholder vote'. Generally SEC writes, proposals that focus on significant aspects of senior executive and/or director compensation are not excludable under the rule. However, SEC notes that its decision will turn on whether the focus of a proposal is senior executive/director compensation or whether 'its underlying concern relates primarily to ordinary business matters that are not sufficiently related to senior executive and/or director compensation.' That is, in evaluating proposals that raise both ordinary business and senior executive and/or director compensation matters, the staff examines whether the focus of the proposal is an ordinary business matter or aspects of senior executive and/or director compensation. Where the focus appears to be on the ordinary business matter, the proposal may be excludable under Rule 14a-8(i)(7). In addition, SEC writes that where the focus is on aspects of compensation that are available or apply to senior executive officers, directors as well as to the general workforce, companies 'may generally rely' on the rule to exclude the proposal.

SB 14J follows the release of an earlier bulletin SLB No 14l released last year which addressed the scope and application of the 'economic relevance' exception and the 'ordinary business' exceptions.

*[Source: SEC Shareholder Proposals: Staff Legal Bulletin No. 14J (CF) 23/10/2018]*

## Pushing for a second 'strike': Activist Premier Investments has written to Myer shareholders calling on them to vote against the remuneration report at the forthcoming AGM to deliver a second 'strike' and trigger a board spill (opening the door to appointing Premier nominees to the board).

The AFR reports that Myer has been engaging with institutional investors on remuneration, and has made a number of changes to remuneration structures ahead of the upcoming AGM in an attempt, The AFR writes, to avoid a second strike against its remuneration report. Reportedly, Myer has indicated that it will cut board fees (reduce the Chair's fee by $50K in 2019, and reduce directors' fees by $30K), require non-executive directors to buy Myer shares, and cap executive salaries.

More particularly, there will be no increase in Myer CEO John King's salary which remain $1.2m (which is the same as that of his predecessor and reportedly has not increased since 2015). In addition, he will reportedly not participate in the short term incentive plan until 2020, and no payments will be made under the short term incentive plan unless Myer achieves net profit growth. Mr King must also hold Myer shares equivalent to 75%of his total fixed remuneration for the duration of his employment.

Premier Investments has written to Myer shareholders attacking the present board and Chair and calling on them to vote against the remuneration report (to trigger a board spill): 'As you know, thousands of you voted at the 2017 Myer AGM to give the Myer Board a "first strike" due to the dismal performance of the company and Board. If shareholders join forces again and do the same at the 2018 AGM on 30 November, the entire Board will face a motion to be spilled. This will potentially provide the opportunity to vote in a new highly-credentialed set of experienced directors' Premier writes.

*[Sources: [registration required] The AFR 25/10/2018; [registration required] The Australian 26/10/2018; Premier Investments Letter to Myer Shareholders 26/10/2018]*

## Other Shareholder News

**United States | A counterweight to short-termism? A group of prominent companies and institutional investors have released a revised and expanded version of the 'Common sense' Corporate Governance Principles.**

In 2016 a group of America's largest and most prominent corporations and institutional investors published, and committed their businesses to a set of voluntary governance principles entitled: *The Common sense Principles* for public companies. The Principles were designed to encourage dialogue about the responsibilities of companies, their boards and investors and to encourage a move away from short-termism which the group views as detrimental to the interests of both public companies and financial markets.

**New version of the principles released**

In response to 'a precipitous decline in the number of public companies' driven at least in part by the short-term focus of market participants, the group has released a revised set of Principles and also endorsed similar initiatives by other groups (the ISG Framework, the BRT Principles and The New Paradigm) 'as counterweights to unhealthy short-termism'.

The group notes that ultimately its hope is that the many sets of principles will be 'harmonised and consolidated' to reflect 'the combined views of companies and investors' commenting that 'we do worry that dueling or competing principles could impede, rather than promote, healthy corporate governance practices'.

**Scope of the principles**:

The original version of the Principles covered: board composition and internal governance; board responsibilities; shareholder rights; public reporting; board leadership; management succession planning; compensation of management; and asset managers' role in corporate governance.

The revised Principles cover the same areas but there is increased emphasis on certain issues including: board independence; shareholder engagement and disclosure. More specifically changes include the following.

- The revised Principles explicitly state that 'all of the members of the audit, compensation and nominating and governance committees of the board should be should be independent' rather than just a 'significant majority of the board'.
- The new Principles appear supportive of the concept of annual director elections. They state: 'Requiring all directors to stand for election on an annual basis may help promote board accountability to shareholders. If a company chooses to hold elections on a staggered basis or otherwise elect directors less frequently than annually, the board should explain clearly (ordinarily in the company's proxy statement) its rationale for doing so'.
- On the topic of director communication, the Principles now explicitly state that there are some instances when direct communication between directors and shareholders 'may' be warranted: 'communication of a board's thinking to the company's shareholders is important. On some issues, such as board governance and CEO compensation, direct communication from the board may be warranted'.
- The Principles now include guidance on the treatment of shareholder and management proposals.
    - Shareholder proposals – shareholder engagement/disclosure: The Principles now state that 'in the event that a company receives a shareholder proposal, it should consider engagement with the proposing shareholder (as well as other shareholders, to the extent appropriate) early in the process, preferably before the proposal appears in the proxy' and that if the proposal receives majority support, the company should consider further engagement and either implement the proposal or explain why doing so would be contrary to the best long-term interests of the company. The Principles also state that where proposals receive 'significant but less than majority support' the board should 'formulate an appropriate response' which may include adoption of the proposal, though the principles also note that

'the board should be mindful of the fact that a majority of the company's shareholders did not support the proposal'.

  - Management proposals – shareholder engagement. As in the case of shareholder proposals the Principles provide that the company should consider engagement with shareholders early in the process. Where a proposal is defeated/there is 'significant' shareholder opposition, further shareholder engagement with shareholders should be considered and a response should 'mindful of how a majority of the company's shareholders voted'.

- On the topic of dual-class voting, the Principles already stated that it is not 'best practice'. The revised version has strengthened the wording around the need for sunset provisions to state that companies now 'should have specific sunset provisions, based upon time or a triggering event, which would eliminate dual class voting. In addition, all shareholders should be treated equally in any corporate transaction' (as opposed to 'consider' doing so).

- The 2016 Principles were silent on the topic of 'poison pills'. The revised Principles state that 'Poison pills and other anti-takeover measures can diminish board and management accountability to shareholders. Insofar as a company adopts a poison pill or other antitakeover measure, the board ordinarily should put the item to a vote of the shareholders and clearly explain why its adoption is in the best interests of the company's shareholders. On a periodic basis, the board should review such measures to determine whether they remain appropriate'.

- On the topic of board leadership, the Principles now state:

  - In circumstances where the roles of Chair and CEO are combined that the board should 'periodically review its leadership structure and explain clearly (ordinarily in the company's proxy statement) to shareholders why it has separated or combined the roles, consistent with the board's oversight responsibilities'.

  - They also now include the statement that: 'The role of the lead independent director should be clearly defined and sufficiently robust to ensure effective and constructive leadership. The responsibilities of the lead independent director and the executive chair should be clearly delineated, agreed upon by the board, and disclosed to shareholders'.

- On the topic of proxy access, the Principles now explicitly state that 'public companies should allow for some form of proxy access, subject to reasonable requirements that do not make proxy access unduly burdensome for significant, long-term shareholders'.

- On the topic of asset managers, the Principles now explicitly state that: engagement with asset managers should occur early 'to facilitate alignment on resolution of issues where possible and avoid unnecessary disruption'; that asset managements should disclose the extent to which they use recommendations from proxy advisers in their decision making, and should be 'satisfied that the information upon which they are relying is accurate and relevant'; and that asset managers should 'disclose their policies for dealing with potential conflicts in their proxy voting and engagement activities'.

[Note: The additional guidance on proxy access/disclosure included in the revised Principles, has been released ahead of the Securities and Exchange Commissions' planned roundtable on the proxy system (proxy process, shareholder engagement and possible changes to proxy rules) announced earlier in the year (see: Governance News 06/08/2018; 17/09/2018).]

- The revised Principles also acknowledge the role of institutional investors in influence corporate governance practices and include new guidance on the way in which they can 'use their position to advance sound and long-term oriented corporate governance'. The Principles suggest that 'When investing through asset managers, owners may wish to encourage such practices through, for example: the use of benchmarks and performance reports consistent with the asset owner's strategy and investment time horizon' and through 'interactions and dialogue with asset managers concerning corporate governance issues' and through self-evaluation.

The group also announced that the Columbia Law School's Millstein Center for Global Markets and Corporate Ownership will publish the Principles and maintain, on its website, a list of companies and investors that have committed to them.

New signatories to the revised Principles include: BNY Mellon, IBM, P&G, Coca-Cola, Johnson and Johnson, Dowdupont, Washington State Investment Board and Bank of America.

*[Sources: Columbia Law School Millstein Center for Global Markets and Corporate Ownership media release: Commonsense Principles of Corporate Governance 2.0; Commonsense Principles 2.0; Harvard Law School Forum on Corporate Governance and Financial Regulation 23/10/2018; Open Letter: Commonsense Principles 2.0]*

## Meetings and Proxy Advisers

### Recent AGM results: 40.1% support for a climate disclosure resolution at Whitehaven Coal, asylum seeker resolution defeated at Qantas; and a near 'first strike' at JB Hi Fi.

**40.14% proxy support for climate disclosure resolution at Whitehaven Coal Ltd**: Whitehaven Coal faced shareholder resolutions (coordinated by Market Forces) to: a) amend the constitution to allow for the submission of non-binding advisory shareholder resolutions; and two advisory resolutions: b) request increased disclosure on climate risk in line with the Taskforce on Climate Related Financial Disclosures (TCFD) recommendations for 2019 (TCFD resolution); and c) request that the company align its strategy/capital expenditure decisions with the climate goals in the Paris agreement (Paris resolution) (Governance News 23/10/2018). None of the resolutions were supported by the board.

At the 25 October AGM, the TCFD resolution received 40.14% support. In his opening address to the AGM, Whitehaven's Chair reaffirmed that the company 'want to ensure our climate change disclosure practices broadly evolve in line with industry trends and shareholder expectations. This is why we announced that for 2019 we look to align our reporting with the voluntary disclosure framework proposed by the task force on climate related financial disclosures'.

The Paris resolution received 2.8% proxy support and the resolution to amend the constitution was also unsuccessful.

In a statement, MarketForces welcomed the strong support demonstrated for the TCFD resolution but expressed disappointment that it did not receive '100% backing'. Commenting on CGI Glass Lewis' failure to support the Paris resolution, Market Forces said that the 'nonsensical approach has seen investors call upon Whitehaven to disclose risk, but not do anything to actually mitigate it'.

The SMH quotes Whitehaven CEO Paul Flynn as saying that Market Forces is incorrect in their assumption that the company is not already considering climate change: 'What we've got here is the notion as a coal company we don't think about these things. I think that's a flawed premise on which to approach us because as a coal company you must be focused on regulatory change, environment, customers, and more' he said.

[Note: The result at Whitehaven follows a similarly high level of support (46%) for an ESG shareholder resolution at Origin Energy. See: Governance News 22/10/2018]

*[Sources: Whitehaven Coal Ltd ASX announcement: AGM results 25/10/2018; Chair's address 25/10/2018; Market Forces media release 25/10/2018; The Guardian 25/10/2018; The SMH 25/10/2018]*

**ACCR/RAC resolution requiring Qantas to review asylum seeker deportations defeated:** As previously reported in Governance News 23/10/2018, two resolutions (constitutional amendment and an advisory resolution requiring Qantas to review asylum seeker deportations) neither of which was supported by the board, were defeated at the Qantas AGM on 26 October. The advisory resolution received 6.43% proxy support, the constitutional amendment received 4.26% support.

**Climate acknowledged as a concern:** In his opening address, the Chair identified climate and cybersecurity among the 'megatrends' that will inform Qantas' strategy going forward.

**Over commitment?** The remuneration report received strong support (96.69%) as did the reelection of most directors. However, audit committee member Maxine Brenner attracted a protest vote of 10.37% (against) her reelection. The SMH attributes this to concerns reportedly raised by at least one proxy adviser that she was over committed.

*[Sources: Qantas ASX Announcements: Results of 2018 AGM 26/10/2018; Chair's address to shareholders 26/10/2018; The ABC 26/10/2018; The SMH 26/10/2018]*

**21.65% vote against the remuneration report at JB Hi Fi Ltd**: JB Hi Fi received a near 'first strike' against its remuneration report at its 25 October AGM. The AFR attributes the high 'against' vote to the opposition of institutional investors to changes made to long term incentives.

*[Sources: JB hi-Fi Ltd ASX Announcement: 2018 AGM results 25/10/2018; 2018 Chairman's Address 25/10/2018; [registration required] The AFR 25/10/2018; [registration required] The Australian 25/10/2018; 25/10/2018]*

## Disclosure and Reporting

### Life Insurers will have a legal obligation to report data on claims and disputes under a new reporting standard released by ASIC and APRA.

The Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) have released a new life claim reporting standard *Life Insurance Reporting Standard LRS 750.0 Claims and Disputes* which will make it mandatory for life insurers to report data on claims and disputes. APRA states that the aim of the new requirements is to 'address the need for better quality, more consistent and more transparent data about insurance claims' which was a key finding from an ASIC review of claims handling across the life insurance industry (*ASIC report 498 Life insurance claims: An industry review. For a summary/overview see: ASIC Industry Review of Life Insurance Claims).*

The regulators anticipate publication of life insurance claims and disputes on a six-monthly basis, with the first being scheduled for release in early 2019. The publication will provide data on both an industry-level and named individual insurer-level basis.

**The new standard is intended to deliver improved transparency to consumers and to regulators**

- **APRA Chair Geoff Summerhayes** said: 'This new standard, based on more than 18 months of engagement with industry and consumer groups, codifies life insurers' reporting obligations and provides greater clarity around definitions and claims processes…The introduction of a legally binding reporting standard will improve the consistency and reliability of the data we receive, and guarantee it continues to be made available to regulators and consumers.'
- **ASIC Deputy Chair Peter Kell** said the enhanced claims data would help the regulators identify emerging problems, assess product value and take action to improve consumer outcomes. 'ASIC identified the issue of inconsistent and inadequate life insurance data in its 2016 review of life insurance claims and is pleased to be working together with APRA on this important initiative. Access to reliable and comparable data will help consumers make informed decisions about their life insurance'.

**Timeline:** The first public release of data collected under LRS 750.0, featuring insurer-level data, is due in early 2019, with ongoing publications to be issued every six months.

*[Sources: APRA media release 24/10/2018; LRS 750.0 Claims and Disputes; APRA Letter to life insurers and friendly societies setting out claims and disputes reporting requirements for life insurers 24/10/2018]*

## Regulators

### Australian Securities and Investments Commission (ASIC)

#### ASIC Chair James Shipton has reiterated the need to ensure ASIC is 'right sized' to meet enforcement expectations and has committed to ensuring against 'regulatory capture'.

Following his appearance before the Senate Economics Legislation Committee on 19 October (see: Governance News 23/10/2018), Australian Securities and Investment Commission (ASIC) Chair James Shipton appeared again before the Committee on 24 October. In his opening statement, Mr Shipton reiterated his acknowledgement of the seriousness of the observations made in the Royal Commission's Interim Report, including those made of ASIC and the impact of the issues identified on the community. He also reiterated the need, in light of the 'heightened' role that ASIC is expected to play in the context of the Australian financial services system where other market deterrents are absent, to consider whether ASIC is 'right sized' to perform this function: 'what we now need is a constructive conversation about the powers, positioning and right-sizing of ASIC' he said.

Commenting on the issue of 'regulatory capture or favouritism toward regulated entities' Mr Shipton which he said had been the subject of media controversy, Mr Shipton gave a personal commitment to 'do everything in my power' to prevent it, adding that ASIC staff value their independence and integrity and 'are eager and dedicated to working towards a fair, strong and efficient financial system for all Australians. What they need is effective strategic guidance as to where their energy is best deployed, and my fellow Commissioners and I are firmly committed to giving them that strategic direction'.

*[Sources: Speech by ASIC Chair, James Shipton to the Senate Economics Legislation Committee: Opening statement 24/10/2018]*

### Consultation on stronger powers for ASIC: Draft regulations to implement the *Corporations Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* reforms have been released for consultation. Consultation will close on 13 November.

The government has released exposure draft regulations: *Corporations Amendment (Design and Distribution Obligations and Product Intervention Powers) Regulations 2018,* to support the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* for public consultation. Consultation closes 13 November 2018.

*Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* proposes to implement certain recommendations made by the Financial System Inquiry (FSI) by introducing:

1. **design and distribution obligations for financial products** to ensure that products are targeted at the right people (FSI recommendation 21); and
2. **a product intervention power for the Australian Securities and Investments Commission** (ASIC) when there is a risk of significant consumer detriment (FSI recommendation 22).

Mr Robert comments that in relation to the Design and Distribution Obligations, the regulations are intended to give effect to the legislation 'by applying the regime to a range of financial products not covered by the Bill and by ensuring that the regime operates as intended when applying to distributors of financial products'. More particularly, the draft Regulations propose to:

- **extend the design and distribution (DDO) regime** so that it applies in relation to certain products: simple corporate bonds depository interests in simple corporate bonds, where the simple corporate bonds are, or are to be, issued under a 2 part simple corporate bonds prospectus; debentures of a body that is an Australian ADI or registered under section 21 of the *Life Insurance Act 1995*; basic banking products; custodial arrangements that are not already subject to the new regime, including an interest in an investor directed portfolio service (IDPS); and products sold in situations where the DDO could be avoided.
- **exempt certain products from the design and distribution regime**: interests in eligible rollover funds (ERFs); defined benefit interests; medical indemnity insurance products; and depository interests in foreign fully paid ordinary shares, being shares in relation to which, if they were offered directly to retail clients) from the design and distribution regime.

In relation to the Product Intervention Power, the regulations the draft regulations propose to extend the product intervention regime contained in Part 7.9A of the *Corporations Act 2001 (Cth)* so that product intervention orders can be made in relation to:

- funeral expenses policies;
- certain extended warranties that are 'functionally equivalent to add-on insurance'; and
- short-term credit that is not regulated under the National Consumer Credit Protection Act 2009 (Credit Act).

Commenting on the release of the draft legislation, the Canberra Times comments that if passed a number of financial products that have 'become the hallmark of the banking royal commission could be pulled from sale'. The article adds that both ASIC has reportedly welcomed the legislation and that the Australian Banking Association (ABA) is broadly supportive of the proposed changes.

**Progress of the primary legislation:** The government released exposure draft legislation for consultation on 21 December 2017 and on 20 July 2018. *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* was introduced into the House of Representatives on the 20 September and referred to the Senate Economics Legislation Committee for report by 9 November 2018 (see: Governance News 24/09/2018).

*[Sources: Assistant Treasurer Stuart Robert media release 23/10/2018;Treasury media release 23/10/2018; Exposure Draft regulations; Draft explanatory statement; [registration required] The Canberra Times 24/10/2018]*

## An ASIC commissioned UNSW pilot study has found that despite concerns to the contrary, ASIC's use of enforceable undertakings do have a deterrent effect on financial institutions.

The Australian Securities and Investments Commission (ASIC) has released the results of a pilot study into the deterrent effects of Enforceable Undertakings (EUs): *The general deterrence effects of enforceable undertakings on financial services and credit providers.* The study found that despite controversy over the effectiveness of EUs, they do have a deterrent effect on financial institutions. 'The clear finding of the study which we did not anticipate, is that a majority of interviewees reported their organisation being deterred by EUs with their competitors' Professor Dimity Kingsford-Smith said.

The study was commissioned by ASIC in June 2017 in response to a recommendation of the Australian National Audit Office (ANAO) that the regulator should periodically assess the effectiveness of EUs and was conducted by the Law Faculty of the University of NSW. The study was led by Minter Ellison Chair of Risk and Regulation and Director of the UNSW Centre for Law Markets and Regulation Professor Dimity Kingsford-Smith.

**Further detail**

**Study aims:** The study had two aims, a) to appraise the general deterrent effects of EUs in changing the behaviour of peer providers; and b) to report to ASIC generally on the 'efficiency' or 'effectiveness' of EUs in acting as a deterrent through observations drawn from qualitative empirical data.

**Findings:** The study found that the majority of the peer providers interviewed do perceive deterrence effects of EUs entered by competitors. Deterrence was found to be motivated by a number of factors including: avoiding reputational damage or loss; avoiding the perceived penal effects of harsher sanctions and intrusion of outsiders; and avoiding financial and time costs and distraction from the business.

In addition, the study identified a number of opportunities for future research. ASIC said it will proceed with a scoping study on potential options for further research into the impact of EUs and other regulatory actions and will discuss with other regulators the potential to work collaboratively on future research.

*[Sources: ASIC media release 25/10/2018; UNSW media release 25/10/2018; The general deterrence effects of enforceable undertakings on financial services and credit providers 25/10/2018]*

## ASIC has released an update on the EU agreed with CBA advice subsidiary CFPL

The Australian Securities and Investments Commission (ASIC) has provided an update on an enforceable undertaking (EU) on Commonwealth Bank advice subsidiary Commonwealth Financial Planning Limited (CFPL) in relation to fees for no service (FFNS) conduct. As required by the EU, Ernst and Young (EY) was appointed to assess whether customers had received remediation over two specific time periods and the effectiveness of control processes in place to ensure customers receive contracted services going forward.

EY concluded that there was no evidence to suggest that CFPL had not taken reasonable steps to remediate customers for one period, but that there had been less customer testing for a second period, and consequently further work would be required. EY also found that CFPL is in the process of taking reasonable steps to identify and remediate those customers and added that it would reassess and report on period 2 in January 2019.

In relation to CBA's control processes, EY found that they are adequate.  EY did identify that some improvements could be made to address the high reliance on manual systems, limitations on the bank's ability to analyse and report information, and the low level of control awareness within the business.

ASIC stated that CFPL has requested an extension of time for EY to produce its final report and for CFPL to provide its senior executive attestation as required under the EU, to 31 January 2019 which has been granted.   ASIC also notes that CFPL is required by to submit a detailed plan setting out the specific actions that it will undertake to ensure that it addresses EY's findings and recommendations.

*[Sources: ASIC media release 22/10/2018;  Investor Daily 22/10/2018; Independent Financial Adviser 22/10/2018]*

## Australian Prudential Regulation Authority (APRA)

### APRA reviewing its enforcement approach: APRA Chair Wayne Byres has said that the review will consider the potential for greater use of by the regulator of its enforcement powers.

The Australian Prudential Regulation Authority (APRA) has released APRA Chair Wayne Byres' opening statement to the senate economics legislation committee.

**Some Key Points**

- **Australia's financial system remains sound (though this does not excuse/lessen the failings identified by the Commission):** 'I want to emphasise the overarching point that Australia's financial system remains fundamentally sound…[however the ] financial strength of the system does not make the evidence at the Royal Commission, or its Interim Report, any less confronting or uncomfortable. Clearly, there have been too many instances of behaviour that do not meet community expectations, and in some cases, the law. The Commission has identified failings that ultimately will need to be addressed by institutions, regulators and the Parliament'.
- **Review of APRA's enforcement approach — greater use of court-based sanctions?** Mr Byres said that Deputy Commissioner John Lonsdale will lead a review of APRA's enforcement approach, and take 'responsibility for APRA's work on governance, culture and remuneration (including implementation of the Banking Executive Accountability Regime).  More particularly, he said that the enforcement review would 're-examine' the regulator's 'enforcement philosophy, our governance structures for enforcement decisions' and resourcing with a view to identifying how they can be improved.  Mr Byres added that the review would 'take account of not only the lessons from the Royal Commission, but also the need for new processes and structures to be developed for the BEAR. I do not wish to preempt the outcome of the review, but in our submissions to the Commission we have already flagged the potential for greater use of enforcement powers to achieve general deterrence across the industry' Mr Byres said.
- **APRA to work with ASIC to review remuneration and incentives**: Mr Byres said that the Financial Services Royal Commission had 'rightly highlighted' the potential for poorly designed remuneration and incentive structures to 'incentivise poor consumer outcomes' and noted that APRA's focus to date had been on the potential of poor incentives to undermine the long-term financial stability of institutions.  In response to the Commission's suggestion that a 'broader examination of the issue is needed' he said, APRA and ASIC 'will need to work together to consider how this can best be done without exacerbating existing concerns that the responsibilities between the two agencies are becoming blurred'.
- **IMF independent assessment of APRA's capabilities and performance:** Referencing the Financial Sector Assessment Program (FSAP) review of Australia's financial stability/regulatory oversight, being conducted by the International Monetary Fund (the results of which are expected to be released early in 2019), Mr Byres said APRA had been subject to a comprehensive assessment of its supervisory approach and capabilities in banking and insurance supervision, as well as an assessment of the adequacy of its systemic risk oversight.  Mr Byres said that he welcomed 'this independent assessment as providing a valuable scorecard against which to measure our capabilities and performance'.

*[Sources: APRA Chair Wayne Byres' opening statement to the Senate Economics Legislation Committee 25/10/2018; [registration required] The AFR 25/10/2018]*

**In Brief | In his address to COBA, APRA Executive General Manager Policy and Advice Division Pat Brennan has reiterated the need for smaller ADIs to prepare for implementation of the Banking Executive Accountability Regime (BEAR) and highlighted some of the areas on which they should focus. He also said that APRA would shortly write to smaller ADIs (that will be subject to BEAR from 1 July 2019) requesting submission, in the coming months, of an initial draft list of accountable persons and draft accountability statements for feedback to help them prepare for formal submission as 1 July 2019 approaches.**

*[Sources: APRA Executive General Manager Policy and Advice Division Pat Brennan: speech, COBA 2018: The challenge of change 23/10/2018; [registration required] The AFR 23/10/2018]*

### Australian Competition and Consumer Commission (ACCC)

**In Brief | The government has extended Mr Rod Sims' term as Chair of the Australian Competition and Consumer Commission (ACCC) until 1 August 2022. 'Mr Sims' reappointment will ensure continued stability and strong leadership of the Commission, particularly with important inquiries currently underway including the impact of digital platforms such as Facebook and Google on Australian media and advertising markets, the supply and demand for wholesale gas in Australia and residential mortgage products' Treasurer Josh Frydenberg said.**

*[Source: Treasurer Josh Frydenberg media release 25/10/2018]*

## Corporate Social Responsibility and Sustainability

**BlackRock has reportedly signalled plans to become a global leader in sustainable investing.**

BlackRock CEO Larry Fink has flagged BlackRock's intention of becoming a global leader in 'sustainable investing' the FT reports, with the asset manager launching a range of exchange traded funds in the US and Europe that incorporate ESG criteria. BlackRock currently has close to 25% of the market segment with $7bn of assets

Mr Fink is quoted as commenting that:

- Assets in ETFs that incorporate ESG factors are likely to grow from $25bn to more than $400bn in a decade.
- Sustainable investing does not mean investors had to sacrifice returns. He also flagged that BlackRock is working with MSCI to produce data to support this view which he expects will show that sustainable investing is going to be at least equivalent to core investments over the long term adding, 'I believe personally it will be higher'.

BlackRock defines sustainable investments as those that drive positive social or environmental impact alongside financial results. Some of those investments will screen out companies which operate in controversial sectors, such as fossil fuels, tobacco or weapons, while others will target businesses that advance low carbon use or renewable energy.

The FT notes that though BlackRock is of the view that sustainable investing promises competitive risk-adjusted returns, the asset manager will not be rolling out ESG criteria across its entire range of active investment products.

*[Source: [registration required] The FT 23/10/2018; TriplePundit 19/10/2018]*

**In Brief | Defunding big tobacco? 45 Australian superannuation funds have reportedly signed on to the UN sponsored Tobacco Free Finance Pledge. The ABC comments that superannuation funds that declare they are tobacco-free may still be exposed on the retail level through shares in supermarkets Woolworths and Coles-owner Wesfarmers.**

*[Source: ABC 23/10/2018]*

## Royal Commission into Misconduct in the banking, superannuation and financial services industry (Financial Services Royal Commission)

### The West Australian reports that APRA has no intention of pushing for additional powers in its submission in response to the Financial Services Royal Commission's Interim Report.

The West Australian reports that Australian Prudential Regulation Authority (APRA) Chair Wayne Byres has written to WA Liberal senator Dean Smith advising that 'APRA's submissions to the commission [Financial Services Royal Commission] will not be advocating any changes to the current legal framework' despite the criticisms made of the approach taken by the regulator in the Commission's Interim report and despite calls from consumer and other interest groups for both APRA and the Australian Securities and Investments Commission (ASIC) to take more punitive actions against bankers and insurers.

Submissions in response to the Commission's Interim report closed on 26 October and the next and final round of hearings considering policy issues arising from the first six rounds of hearings will commence on 19 November.

*[Source: The West Australian 24/10/2018]*

### In Brief | The Australian reports that the Commonwealth Director of Public Prosecutions (CDPP) has said it lacks resourcing to prosecute the expected influx of cases referred by ASIC in the wake of the Financial Services Royal Commission.

*[Source: [registration required] The Australian 23/10/2018]*

## Other Developments

### Review of UCT protections for SMEs: Treasury will review of the operation of the existing regulatory regime in place to protect small businesses from unfair contract terms. The review will commence in November 2018 and report to the Government by 1 February 2018.

Assistant Treasurer Stuart Robert has announced that the Treasury will conduct a review of the effectiveness of protections for small businesses against unfair contract terms (UCTs) to ensure that the existing framework is operating effectively.

**Current regulatory settings**

- Mr Robert said that the UCT protections currently apply to all small business contracts that meet certain criteria, namely: that the contract is a standard form contract; that at the time the contract is entered, at least one party to the contract is a business that employs fewer than 20 persons; and where the upfront price payable under the contract does not exceed $300,000 or $1 million if the contract runs for more than 12 months.
- Mr Robert noted that passage of the *Treasury Laws Amendment (Australian Consumer Law Review) Act 2018* which passed the Parliament on 18 October 2018, would give the Australian Competition and Consumer Commission (ACCC) and the Australian Securities and Investments Commission (ASIC) stronger powers to protect small businesses from UCTs in the form of investigative powers to assess whether a term in a standard form contract may be unfair.

**Timeline:** The review will commence in November 2018 and report to the Government by 1 February 2018. Mr Robert stated that the experience and view of stakeholders about 'legislative settings' will be sought during the review process.

[Note: The adequacy (or not) of the existing regulatory framework governing lending to small to medium enterprises (SMEs) was among the issues considered during the Financial Services Royal Commission round 3 hearings (see: Governance News 08/06/2018). Among the policy questions identified in the Interim Report (to be considered at the next and final round of public hearings in November) were the questions of whether there should any change to the current legal framework governing SME lending and more particularly, whether the *National Consumer Protection Act 2009 (Cth)* protections should be extended to

SMEs. The interim report also took the view that the Code of Banking Practice is the 'chief' protection for SMEs though there is disagreement over the appropriate definition of an SME. See: Governance News 08/10/2018].

*[Sources: Assistant Treasurer Stuart Robert media release 23/10/2018]*

### Not encouraging? An EY study tracking the performance of 141 initial coin offerings listed on cryptocurrency exchanges in 2017 has found that 86% of the ICOs are below their initial listing price and 30% have lost 'substantially all' their value.

An EY study: *Initial Coin Offerings (ICOs) The Class of 2017 – one year later* has tracked the performance of 141 initial coin offerings (ICOs) that were listed on a cryptocurrency exchange in 2017 following up on their performance between January 2018 and September 2018.

**Some Key Points**

- **According to EY 86% of the ICOs are below their initial listing price** and 30% have lost 'substantially all' their value.
- **Demand continues to grow** with claims of over US$15b raised in the first half of 2018 (compared to $4.1bn over the same period in 2017).
- **About a year after raising money, only a small portion of ICO-funded start-ups have progressed towards working product offerings**: EY found that only 29% (25) of the 2017 ICO projects that EY assessed have progressed to prototypes or working products – an increase of just 13% from December 2017. The remaining 71% have no offering in the market.

**Not encouraging?** EY concludes that there is not enough data as yet to form a 'a full perspective on the risk and return mix of this new investment medium' but having said this, the early 'returns from ICOs are not encouraging' in comparison to venture capital investing. In addition, EY suggests that globally, sources of funding are likely to shift away from retail investors toward venture capital and digital asset-focused investment funds which can better understand and manage the downside risks.

EY Global Innovation Leader, Blockchain Paul Brody said: 'Despite the past year's hype around ICOs, there appears to be a significant lack of understanding around the risks and rewards of these investments. In addition, there is a disparity between those who invest in ICOs and the ICO project developers regarding the anticipated timelines of ROI. While ICOs are an entirely new way to raise capital, those participating should understand that there are factors – such as the slow progression toward working product offerings – that can introduce greater risk in ICO investing.'

*[Sources: EY media release 19/10/2018; Infographic: EY Study: Initial Coin Offerings (ICOs) The class of 2017 – one year later; Initial Coin Offerings (ICOs) The Class of 2017 – one year later 19/10/2018]*

### In Brief | Time to make breaches of banking codes of conduct a criminal offence? The Conversation argues that the way to address 'ineffective' banking codes of conduct is to 'enshrine' the principles highlighted by Commissioner Hayne in his Interim Report (obey the law, do not mislead or deceive, be fair, provide services fit for purpose, deliver services with reasonable care and skill and when acting for another, act in their best interests) and to make any breach a criminal offence.

*[Source: The Conversation 26/10/2018]*

### In Brief | Ireland to introduce a Senior Executive Accountability Regime to ensure clearer accountability? The Central Bank of Ireland has released a report into the current behaviour and culture of the largest five banks which proposes greater accountability for senior individuals in banks, insurance firms and MiFID investment firms and flags its intention to 'enhance' its supervision of conduct and culture risk, especially in firms which pose the greatest risk to consumers.

*[Sources: ICSA Ireland media release 24/10/2018; Behaviour and Culture in Irish Retail Banks]*

## Accounting and Audit

## ISS has released revised draft voting policies for consultation. The questions of auditor independence, fees and credibility are the key focus for the UK, Ireland and the Asia-Pacific regions.

Following the release of its global policy survey results (see: Governance News 15/10/2018), Institutional Shareholder Services (ISS) has released a number of draft voting policies for consultation and potential application in 2019. Submissions close on 1 November 2018.

**Proposed changes in relation to audit:** Having previously sought views on the issue, ISS is seeking feedback on proposed changes to its policies in relation to auditor ratification, independence and fees. ISS notes that recent scandals have shaken confidence in the quality of financial statements and the quality of audits, prompting the proposed changes.

- **Tracking and reporting on auditors' links to controversies (UK/Ireland and Europe):** ISS proposes that where the information is available, ISS research reports will note any lead audit partners (and/or partnership firms) who have been linked with significant auditing controversies and, where they are engaged in the audit for other public companies, this will be raised for investor attention (even if no audit concerns have been identified at the subject company). ISS states that in the most severe cases (eg where the lead audit partner has previously been linked with a corporate failure scenario/other material 'destruction of shareholder value arising from fraud or other accounting issues') a negative recommendation on auditor ratification might be issued. ISS writes that the intent of the proposed change is to align UK/Ireland and European Voting Guidelines with emerging investor views this issue and to address an area of growing investor concern.

- **Audit Committee Independence (Europe):** The proposed policy update would extend the current ISS European Voting Guidelines on majority audit committee independence to all countries in Continental Europe covered under the European Voting Guidelines. In addition, the proposed update would strengthen the policy by requiring the chairman of the audit committee to be independent. Under the proposed change, a negative ISS recommendation would be applied to the reelection of any non-independent members of the audit committee if it would lead to a non-independent majority on that committee and a negative recommendation would also be applied to the reelection of a non-independent char of the audit committee.

- **Auditor Fees/Audit Committee (India and Asia Pacific Region):** The proposed policy change would hold audit committee members accountable (by issuing a negative vote recommendation on the election of all audit committee members who appear on the ballot) if the company paid excessive non-audit fees to the auditors or if the company has not provided sufficient disclosure on the details of the auditor remuneration. ISS writes that non-audit fees will generally be considered excessive if the non-audit fees have constituted more than half of the total auditor compensation during the fiscal year. The proposed policy change would generally align the policies for Bangladesh, India, Malaysia, Philippines, Pakistan, Thailand, and Sri Lanka with other ISS Asian market policies and also has the intent to encourage issuers to improve the disclosure of auditor fees.

[Note: As has previously been reported in Governance News, loss of trust in the audit sector resulting from the collapse of Carillion (among other high profile issues) has been the topic of media/regulator focus for some time. An independent review of the UK Financial Reporting Council (Kingman Review) is currently underway. In addition, the Competition and Markets Authority is reviewing the UK audit sector. The FRC has also announced a number of reform actions to address loss of community trust in the sector.]

**Other proposed areas of change**

ISS is requesting feedback on a number of voting policy areas, including:

- Board Gender Diversity in the US and separately in Canada.
- Board Independence and Disclosure in Taiwan.
- Director Independence and Tenure in Latin America
- Director Independence in Japan.
- Financial Performance Assessment Methodology in the US and Canada.

*[Sources: ISS media release: Draft policies by market/region]*

## Not good enough: The UK Financial Reporting Council's annual review of corporate governance and reporting has identified a number of quality issues prompting the regulator to call on directors and finance committee chairs to make improvements in a number of areas including key accounting judgements and estimates, eliminating basic errors and how companies have applied the Principles of the UK Corporate Governance Code.

The UK Financial Reporting Council (FRC) has published its annual review of corporate governance and reporting: *Annual Review of Corporate Governance and Reporting 2017/2018*.

The FRC notes that for the first time, the report also includes information on compliance with, and the quality of reporting against, the Corporate Governance Code. The FRC comments that as its current monitoring of annual reports does not include corporate governance statements, (as the FRC does not have powers to challenge and secure changes to these parts of the annual report) its assessment of governance is based 'largely on evidence gathered through research conducted by external parties'.

**Some Key Findings**

- **Reported compliance rates are high:** 95% of the FTSE 350 report compliance with all but one or two provisions of the Code and declared full compliance rose from 66% to 72%. The FRC comments that high levels of compliance are not necessarily indicative of high governance standards and may instead signal 'excessive focus' on 'formulaic compliance with the Provisions'. The FRC adds that the 2018 Code (which comes into effect on 1 January 2019) may address this as it is intended to shift the focus from 'tick box compliance' towards companies explaining how they have applied the principles.
- **Reluctance to fully explain non-compliance with the provisions in the Code:** The FRC also observes that 'companies remain reluctant fully to explain non-compliance with the Provisions' of the Code, despite the fact that full explanations are essential to the effective operation of the 'comply or explain' model on which the code is based. 'Poor explanations are therefore unacceptable' The FRC Comments.
- **Disclosure of executive remuneration is 'poor':** The FRC writes that there has been no improvement in the quality of reporting adding that the standard of reporting on the relationship between directors' remuneration and employee pay, and the successful achievement of company strategy, 'is poor'. The revised Code, includes new Principles and Provisions designed to improve practice and reporting in these areas the FRC writes.
- **Risk reporting and viability statements lack detail:** The FRC comments that though the introduction of viability statements has resulted in greater focus on risk management at board and senior management level, 'viability statements are yet to deliver all the external benefits expected when they were introduced and many companies' viability statements are not sufficiently illuminating'.
- **Lack of transparency in non-financial reporting:** The FRC comments that 'companies can be more transparent, for example by explaining how they engage with their stakeholders to understand and have regard to their interests or how they allocate capital resources for different purposes such as paying dividends and tax, and funding workforce pay and capital investment'.
- **Disclosure of judgements and estimates and alternative performance measures (APMs) were the most common areas of concern**, arising in a large proportion of the 46% of companies the FRC contacted for further information. The FRC Comments that the same areas were highlighted last year as the greatest opportunities for improvement and were selected for thematic review in 2017.
- **Rise in the number of basic errors and non-compliance in some areas:** The FRC writes that it is 'disappointed' to see a rise in basic errors and non-compliance in a some areas including: misclassification of cash flows in the primary statement, where the accounting standards set out a clear requirement or direction which appeared to have been overlooked. The FRC comments that boards are expected to put in place 'effective procedures…to ensure that the basic rules and

requirements embedded in reporting standards, and which investors are entitled to assume have been complied with, are observed'.

**Call for finance directors and audit committee chairs to improve**

Separately, in an open letter to Finance Directors and Audit Committee Chairs, the Financial Reporting Council (FRC) has called for improvements in key areas of corporate reporting, including key accounting judgements and estimates, eliminating basic errors and how companies have applied the Principles of the UK Corporate Governance Code.

*[Sources: FRC media release 24/10/2018; Annual Review of Corporate Governance and Reporting 2017/2018 October 2018; Open Letter to Audit Committee Chairs and Finance Directors 24/10/2018]*

### In Brief | More pressure to reform the UK audit sector? The UK shadow secretary John McDonnell has reportedly outlined plans for reforming the UK audit market flagging that a Labor commissioned review of the accountancy sector is expected to be published within a month and will be released for public consultation.

*[Source: AccountancyAge 23/10/2018]*

### In Brief | ASIC has announced that it has deregistered, suspended or imposed conditions on 101 self-managed superannuation funds (SMSF) auditors for audit quality and independence issues or on fit and proper person criteria since the registration of SMSF auditors began in 2013.

*[Source: ASIC media release 26/10/2018]*

# Risk Management

## Climate Risk

### Top Story | AICD H2 Director Sentiment Survey 2018: Directors have identified climate action as a key long term priority for the first time.

The Australian Institute of Company Directors (AICD) has released its second bi-annual Director Sentiment Index for 2018: *Director Sentiment Index Second Half 2018*.

**Some Key Points**

1. **Directors want action on climate change and renewable energy:** For the first time directors nominated climate change as the number one issue the federal government needs to address in the long-term.
2. **In agreement on the need for stronger governance:** Directors across all industries are focused on governance practices and acknowledge the need for changes to deal with current governance issues. There is strong support (52%) for an increase in penalties for misconduct and for an increase in funding for regulators (57% support).
3. **Less optimistic overall:** Director sentiment has declined for the first time in 18 months (and was down 8.5 points on the last survey) although it remains positive at +4.2. The AICD attributes the decline largely to directors feeling more pessimistic around regulation, legal issues and directorship conditions more broadly.

**Further Detail**

[Note: For a summary of the H1 2018 survey results see: Governance News 23/04/2018]

**Climate change has emerged as a priority for directors**

- **Sustainability and long term growth prospects** continues to be the main issue that keeps directors 'awake at night'. Other concerns include: business reputation in the community, corporate culture, cybercrime as well as legal and regulatory compliance.

- **Climate change is the top long term priority:** Directors rate climate change as the top long-term priority the Federal Government to address, followed by an ageing population, energy policy, taxation reform and infrastructure. 50% of directors rate renewable energy sources as the top area of importance for infrastructure investment, followed by regional infrastructure and roads.

[Note: **The H1 2018 and H2 2017 surveys** both identified strong support for renewable energy sources as a priority for investment.]

- **Energy policy is the top short term priority:** Directors rate energy policy, taxation reform and infrastructure as the top priorities for the Federal government to address in the short term.

**Regulation**

- **'Red tape' is expected to increase:** Directors continue to feel pessimistic regarding the level of 'red-tape' in the next 12 months, with 51% expecting an increase (as compared with 42% in H1 2018). 77% of directors identify corporate reporting requirements as the aspect of their business most affected by 'red tape' (as compared with 78% in H1 2018). Consistent with the survey results for the first half of the year, this is followed by workplace health/safety and preparing/paying taxes.

**Directors across all industries are focussed on governance practices**

- **89% of directors believe their Board is trying to effect change in culture** within their organisation.
- **69% of directors perceive there to be a risk-averse decision-making culture on Australian boards.**
- **Directors acknowledge the need for changes to effectively deal with the current governance issues** with strong support (52%) for an increase in penalties for misconduct and an increase in funding for regulators (57% support).
- **The top three steps for boards to take to rebuild/regain trust** were identified as: demonstrating respect for customers/clients/communities (52%), trustworthiness of leadership (48%) and improving corporate culture (43%). Increased 'genuine' stakeholder engagement (34%) and greater accountability in cases of misconduct (33%) were also identified as important steps.

**Director liability**

- **Less willing to continue on boards/accept new board appointments:** Directors continue to feel pessimistic about the impact of legislation on director liability in H2 2018. 33% of directors feel that it has negatively affected their business decision making, 40% on their willingness to continue on a board and 51% on their willingness to accept new board appointments.

**Board diversity**

- **Consistent with the results of the H1 2018 survey, skills diversity remains a priority for boards:** The effort made to increase the diversity of skills in board membership was stable in the second half of 2018, with 74% of directors stating that their business is actively seeking to improve in this area. 53% indicated that their business is actively trying to increase gender diversity.

**Economic outlook**

- **Outlook for the Australian economy:** Directors are more optimistic about the Australian economy in the immediate term compared to the first half of 2018, with 39% perceiving the economy as strong at present. Directors are less optimistic about the Australian economy in the next 12 months compared to the first half of 2018, with 30% expecting it to be strong and 28% expecting it to be weak.
- **Outlook at state level:** NSW, VIC and ACT directors are the most optimistic about the health of their state economy in the next 12 months while QLD directors are the most pessimistic.
- **Global outlook:** The outlook for the Asian and US economies in the next 12 months is optimistic, continuing to grow in the second half of 2018. Directors view ASIC as the strongest while the US

and Australian economies are also regarded positively. By comparison the European economy is perceived as weak overall.

- **The key economic challenge facing Australian business in H2 2018 was identified as rising global protectionism** followed by global economic uncertainty and energy policy.
- **Business growth:** Directors' optimism regarding past and future business growth, although still positive (53% of directors expect their business to grow in the coming year), has had the first downward movement since the second half of 2014.

**About the survey**

- The survey was conducted with 1,252 AICD members: 12% from publicly listed entities; 42% from private/non-listed entities; 34% not for profit entities; 8% public sector government bodies and 3% overseas entities.
- The majority of survey respondents were located in NSW (28%) and Victoria (24%). 70% of respondents were male. 30% female. The report notes that results were weighted by gender to reflect the profile of the AICD member base.
- The survey was conducted over the period 13 to 27 September 2018.

*[Sources: AICD Director Sentiment Index: Second Half 2018; AICD media release 24/10/2018; The SMH 25/10/2018; The ABC 25/10/2018]*

**Related News: Companies pledge to go 100pc renewable in absence of government action?**

The AFR reports that a collective of Australian companies have signed onto a global initiative: RE100 to use 100% renewable power by 2050 both to be 'good corporate citizens' and in the interests of achieving cost savings by being more energy efficient.

Reportedly, more than 154 companies worldwide have committed to the initiative to date including 75 countries with operations in Australia including Fujitsu, Mars Inc and Unilever.

Speaking at the launch of RE100 in Australia RE100 CEO Sam Kimmins said that 'Australia has a golden opportunity to play a leading role in delivering a clean economy' and that signing onto the RE100 initiative would send a strong signal to governments about what Australia's future direction on energy policy should be. 'Australia's lack of clear energy policy direction has led to inflated costs and reliance on antiquated power sources, but forward-thinking businesses are planning for the long term - they want to be competitive globally' Mr Kimmins said.

*[Sources: RE100 media release 25/10/2018; [registration required] The AFR 24/10/2018]*

### Motivated by the need to maintain a social licence to operate and the pursuit of commercial gain? HBR identifies these as the key drivers behind the trend towards CEOs advocating for regulatory intervention on climate (and other social issues).

Writing in Harvard Business Review, researchers suggest there is evidence of a growing trend towards CEOs actively lobbying for more ambitious government action and regulation on a whole range of social and environmental issues including climate change. 'There's a growing recognition that ambitious government intervention has a crucial role to play in both addressing global challenges and helping business succeed' they write.

The article goes on to identify a number of factors that contribute to the success of this kind of CEO advocacy including (among others) the need to invest to be able to advocate from a robust evidence base, the need for consistency between organisations' internal policies/actions and stated advocacy positions and the need for transparency and truthfulness (including transparency about any financial support provided by the organisation to third party lobbying organisations).

*[Source: Harvard Business Review 19/10/2018]*

### Time to put a price on carbon? BHP has reportedly renewed calls for a price on carbon to drive emissions reductions in Australia, following the release of the IPCC report, despite the government's

**rejection of the need to reconsider its current climate policies before the next election. Dr Fiona Wild, head of Sustainability & Climate Change at BHP reportedly said: 'We believe that the world must pursue the twin objectives of limiting climate change in line with current international agreements while providing access to affordable energy…And we believe there should be a price on carbon, implemented in a way that addresses competitiveness concerns and achieves lowest cost emissions reductions'.**

*[Source: [registration required] The SMH 22/10/2018; Finfeed 23/10/2018]*

**In Brief | The Australian reports that Alan Finkel has said that defeat of the Liberal candidate in the Wentworth by-election signals community dissatisfaction with Australia's current policy settings on climate. Dr Finkel also reportedly called for the government to prioritise, and invest in building a hydrogen industry despite the government's rejection of calls to alter current policy settings.**

*[Source: [registration required] The Australian 23/10/2018]*

**In Brief | A constitutional right to a stable climate? The Conversation reports that a lawsuit (Julia v United States) lodged on behalf of 21 young people in federal court in Oregon challenges US energy policies on the basis that they are destabilising the climate and violating established constitutional rights to personal security. The plaintiffs are reportedly seeking to require that the government prepare and implement an enforceable remedial plan to phase out excessive GHG emissions that cause climate change. The trial is currently scheduled to begin on 29 October (unless delayed by the Supreme Court).**

*[Source: The Conversation 24/10/2018]*

## Cybersecurity and Privacy

**Very far from compliant? A Global survey has found that 56% of companies are far from compliant or will never fully comply with the EU's General Data Protection Regulation one year after it was implemented.**

One year on from the implementation of the European Union General Data Protection Regulation (GDPR) Ernst and Young (EY) and The International Association of Privacy Professionals (IAPP) have jointly released their fourth annual report on privacy governance. The survey asked IAPP subscribers (most of whom are privacy professionals from the United States and the EU) for a variety of detailed information on privacy budgets, staffing, department structures and priorities as well as exploring how organisations are complying with the European Union's General Data Protection Regulation one year on.

**Some Key Findings**

- **76% of all respondents believe their firm falls under the scope of the European Union's General Data Protection Regulation (GDPR)** despite only 31% percent of respondent-companies being headquartered in the European Union and have invested 'heavily' in preparation (eg by hiring additional staff to undertake GDPR tasks).
- **More than half the respondents subject to GDPR (56%) say they are far from compliance or will never comply.** 19% of respondents indicated that they feel full compliance is impossible.
- **Privacy is considered by the majority (78%) of respondents to be a board level issue** and boards appear to be focused on long-term privacy compliance rather than on the risk of a cyber incident.
- **Demand for privacy professionals is increasing:** The GDPR appears to have created a significant demand for privacy professionals, especially in firms that are facing privacy regulation for the first time with a significant increase in the number of privacy professionals working full time in dedicated privacy programs. According to the survey, the global mean number of employees working full time in privacy programs has climbed over last year from 6.8 to 10 full-time privacy employees.

- **Emergence of the DPO role:** 75% of firms have appointed a data protection officer. Almost six in 10 privacy leaders, those who oversee privacy decision-making at their organisations, have taken the DPO duties on themselves, and, where they haven't, the DPO more likely than not (65% of the time) reports to the privacy lead.
- **Privacy professional appear to be gaining in influence:** The survey also found that privacy professionals are gaining in influence in their organisations as privacy is increasingly regarded as a board issue, and are more often engaged in the development and maintenance of products and services as 'privacy by design takes hold as an organisational philosophy.' According to the report, 44% of organisations elevated the position of the privacy leader in response to the GDPR.

*[Sources: IAPP-EY Annual Privacy Governance Report 2018; IAPP media release 22/10/2018; Legaltechnews 19/10/2018]*

**In Brief | Delay in reporting data leak at Cathay Pacific? A data breach reportedly discovered by the company in March exposed 9.4m passenger's data to hackers. The company reportedly knew that personal information had been compromised in May but the leak has not been disclosed by the company until now. Reportedly some customers have already expressed concern over the delay. Cathay has reportedly responded: 'we believe it is important to have accurate information to share, so that people know the facts and we can support them accordingly.'**

*[Source: [registration required] The FT 25/10/2018; [registration required] The AFR 25/10/2018; Forbes 25/10/2018]*

**In Brief | Do banks require mandatory cybersecurity tests? IT news reports that in a panel discussion at the SIBOS conference, the Reserve Bank of Australia, JP Morgan and the European Central Bank said that financial authorities and institutions need to do more to address cyber risk, and reportedly floated the idea that lenders should be subject to 'penetration tests' conducted by regulators and that lenders should also be subject to annual assessments of their cyber 'roadworthiness'.**

*[Source: ITNews 23/10/2018]*

**In Brief | Writing in the Australian, Australian Information Commissioner and Privacy Commissioner Angelene Falk has defended the Office of the Australian Information Commission's (OAIC's) approach to enforcement stating that it has been effective in delivering outcomes for those affected by breaches and adding that it 'has led to enforceable undertakings that have driven systemic change within organisations where personal information practices have been deficient'.**

*[Source: [registration required] The Australian 22/10/2018]*

## Corporate Misconduct and Liability

**Legislation to introduce tougher penalties for white collar crime has been introduced into the House of Representatives following consultation.**

Following the Treasurer's earlier announcement, the government has introduced legislation: *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018* which if passed, will significantly strengthen penalties for white collar crime. The Treasurer emphasised that 'criminal penalties are set to double, from five years to 10 years, in some cases. Civil penalties are due to increase by more than tenfold for corporations and more than fivefold for individuals'.

The Bill appears to be similar to the exposure draft (which was entitled: *Treasury Laws Amendment (ASIC Enforcement) Bill 2018*) released for consultation on 26 September. Consultation on the draft Bill concluded on 23 October (See: Governance News 08/10/2018).

*[Sources: Treasurer Josh Frydenberg media release 24/10/2018; Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018]*

### Financial adviser found guilty of breaching the FPA code of professional practice, sanctions yet to be determined.

The Financial Planning Association's (FPA's) independent disciplinary body, the Conduct Review Commission (CRC), has determined that financial adviser Sam Henderson, breached the FPA's code of professional practice. More particularly, the CRC found that Mr Henderson breached the code in a number of ways including: failing to be diligent, failing to properly consider and identify strategies which were appropriate to the client's personal circumstances and objectives, failing to adequately address the suitability of the client's existing investments, or consider any exit costs/other consequences of exiting that product. The statement of advice which Mr Henderson provided to his client was also determined not include information on the client's current financial planning strategies and also on the appropriateness or otherwise of existing strategies.

The CRC is yet to determine the sanctions to be imposed and the parties have opportunity to make submissions as to the imposition of any sanctions. The FPA writes that information in relation to sanctions will be released in due course.

*[Sources: FPA media release 11/10/2018; Determination: Financial Planning Association of Australian Conduct Review Commission Disciplinary Panel 10/09/2018]*