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Boards and Directors

Does regular board refreshment deliver increased value? A global study by ISS has found companies with a balanced board composition relative to director tenure, tend to show better financial results and have lower risk profiles than their peers.

Writing in Harvard Law School Forum on Corporate Governance and Financial Regulation, Institutional Shareholder Services (ISS) outlines the findings their own research into a possible link between board refreshment practices, financial performance and firms' ability to manage risk.

- **Balanced boards appear to 'pay off in terms of financial performance and the risk profile of the company':** Overall, ISS found that companies with a balanced board composition (balance of experience and new capacity on the board) relative to director tenure, tended to show better financial results and have a lower risk profile as compared to their peers. Conversely, companies whose directors' tenure was heavily concentrated (either mostly short-tenured or mostly long-tenured) tended to deliver poorer financial returns and have a higher risk profile. As such, ISS concludes that by practising 'basic board refreshment' (by maintaining a balance of experience and new capacity on the board), companies may gain significant benefits.

- **Within the group of boards with poorly balanced tenure, companies whose board members were mostly new were ranked the worst** both in terms of performance and risk, while boards with a higher concentration of long-tenured directors ranked at par with the market median. ISS attributes this trend in part to the fact that often boards with high concentrations of new directors, are appointed in a period when the firm is in a period of recovery eg after a scandal which necessitates a 'board overhaul'.

- **'Renewing for the sake of renewal can be more detrimental than beneficial'** ISS writes, 'the ultimate objective for both boards and investors is not simply the frequent turnover of the directors but rather a healthy balance that combines experience and continuity with new capacity'. This can be achieved, ISS argues not necessarily 'arbitrary rules such as mandatory retirement ages and tenure limits' but through boards practising 'basic board refreshment'. In ISS' view companies should: conduct annual individual director evaluations; review and assess director skills in the context of long term strategy and the market environment and establish board renewal and succession programs with medium and long term goals.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 01/09/2018]

United States | How much oversight of business decisions is needed for a director to discharge their duties? A MoviePass Director has reportedly stepped down from the board citing governance concerns, including insufficient insight into business decisions.

The FT reports that Carl Schramm, director of Helios and Matheson Analytics (which owns MoviePass), has resigned from the board, reportedly citing a lack of communication between the board and management such that his ability to discharge his duties as a director had been 'compromised beyond repair'. In a letter to the CEO and Chair of the company, Mr Schramm reportedly said that: information about the company's financial status, operations and strategy was not provided on a number of occasions upon request; and that the board had not been given sufficient time to consider the decisions presented to it. 'These concerns have increased substantially over the past eight weeks as management apparently has made a number of important corporate decisions and executed significant transactions either without board knowledge or approval, or in board meetings initiated with only a few hours of advance notice by email' he is quoted as stating.

The FT notes that Mr Schramm's resignation comes following the recent launch of a new business model by the company, designed to significantly reduce its cash deficit.

[Source: [registration required] The FT 31/08/2018]

Diversity

Progress towards gender balance? According to the second annual ASX200 Senior Executive Census the number of ASX 200 companies with zero female representation has decreased significantly (from 21% in 2017 to 12% in 2018) since last year.

Chief Executive Women has released the results of its second annual survey of female representation in ASX senior executive roles: *ASX 200 Senior Executive Census 2018*. Overall, the survey found that there has been some progress towards gender balance in leadership roles across with ASX 200 with 21 ASX200 companies achieving gender balance (40% men, 40% women, 20% either) in their executive leadership teams, having 40% to 60% women in their teams an increase from 16 companies in 2017.

Key Points

- **The number of ASX 200 companies with zero female representation has decreased** from 21% in 2017 to 12% in 2018.
- **Women in leadership roles:**
  - 7% of CEOs are women (an increase of 2% on 2017).
  - 12% of line roles are held by women (an increase of 0.3% on 2017); 34% of functional roles are held by women (an increase of 4% on 2017); and 12% of CFO roles are held by women (an increase of 3% on 2017).
  - Overall, more than 50% of the ASX 200 have 0% female representation in line roles in their executive leadership team.
- **General balance in line roles by industry:**
  - Overall, women hold 15% (or fewer) line roles across industries (except in telecommunications).
  - Telecommunications services (33%), Real estate (15%), and Financials (14%) had the highest proportion of women in leadership roles. Though proportion of women in leadership roles in the Real Estate actually decreased 1% since 2017.
  - The industry with the lowest proportion of women in line roles was Utilities with 0% (down from 5% in 2017).
  - The roles with the highest concentrations of women are Human resources roles (79% of roles are held by women) and Corporate Affairs/Investor Relations (60% of roles are held by women).
- **Women are in the minority of ASX 200 executive teams:** According to the survey, 23% (430) roles are held by women as compared to 26% of executive level positions held by women in the S&P 500. This is an increase of 2% on the numbers of women in ASX200 executive teams as compared with 2017.
- **Pathways to CEO?** 83% (19 of 23) CEO appointments in 2018 were men with the majority of appointees coming from line roles (78%).

About the survey: The results were based on data collected on 1 August 2018 from publicly available information on company websites or where this was unavailable based on information in BoardEx. Job titles were then standardised and compared.

[Sources: CEW Senior Executive Census 2018 September 2018; The SMH 04/09/2018]

In Brief | 'Our results have proved the doubters wrong' voluntary targets are effective writes AICD Chair Elizabeth Proust: The Australian Institute of Company Directors June-August 2018 Quarterly Report has found women account for 28.5% of ASX 200 board positions, indicating that the 30% representation target for the end of the year is in sight.

[Sources: ACID media release 07/09/2018; June-August Quarterly Report Volume 13: 30% by 2018: Gender Diversity Progress Report]

Institutional Shareholders and Stewardship

In Brief | Japanese Stewardship Code update: The Financial Services Agency has announced that 233 institutional investors have now become signatories to the Principles for Responsible Institutional Investors as of August 31, 2018.

[Source: FSA media release 04/09/2018]

Other Shareholder News

In Brief | No evidence that shareholder power is excessive? Harvard Law School Professor Jesse M Fried writes that there is no evidence that shareholder power in the US is excessive or a 'critical problem' and that consequently efforts to address it — both President Trump's proposal to shift away from quarterly reporting and Senator Warren's Accountable Capitalism Act — are 'both wrong'. He suggests that the 'consensus' on both sides on the need to act is concerning because it 'creates a real risk that one or both of their policy proposals could be adopted, either in this administration or the next one'.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 06/09/2018]

Meetings and Proxy Advisers

Improved technology means that virtual and hybrid AGMs can actually deliver shareholder benefits, so time to focus on best practice and embrace the change?

Writing in Governance Directions, Lumi Technologies writes that the global trend towards adoption and acceptance of virtual AGMs (digital only) and hybrid AGMs (in person meeting, in addition to digital access) appears to be gaining momentum. This is particularly the case in the US, the authors note, where virtual meetings are 'widely accepted' and rapidly gaining in popularity — it's estimated that 300 companies will follow a format allow remote participation in 2018, a significant increase on the 236 held in 2017 — despite concerns from some investors (eg Glass Lewis).

By contrast, the authors concede, the expected 'floodgates' to virtual meetings have not opened in the UK. In Australia, though 'a small but growing number' of ASX listed companies have added an online component to their physical meetings, there is also less uptake they note.

Nevertheless, the authors argue that the move towards adoption of new technology is both 'almost unstoppable' and potentially beneficial to shareholders given improvements in technology as it enables real-time engagement/participation in the meeting process (to the same extent as physical attendees) without the need to physically attend. Going forward, and over time, in their view the change may even be helpful in 'reversing' the trend towards declining attendance/participation. Based on this, Lumi suggests that the debate about whether to adopt the technology should shift, and that companies should now focus on best practice, and how to increase the relevance and purpose of the AGM.

[Source: Governance Directions August 2018]

In Brief | Potential to address structural issues inhibiting shareholder engagement? Tillburg University academics Christoph Van der Elst and Anne Lafarre argue that use of private blockchain technology could increase shareholder engagement and address many of the limitations of the current AGM structure.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 06/09/2018]

Disclosure and Reporting

Climate risk disclosure

More aware of the need to disclose climate risk but slow to provide detail on strategies to meet Paris climate goals: Many Australian companies operating in sectors identified by the TCFD as most exposed to climate risk are making 'painfully slow' progress towards disclosure according to Market Forces analysis.

Market Forces has released the findings of its analysis of the public disclosures of 74 ASX100 companies (as of July 2018) that operate in sectors highlighted by the Task Force on Climate-related Financial Disclosures (TCFD) as facing the highest levels of climate risk. Market Forces found that companies are generally becoming more aware of the need to disclose climate risk, but that 'the majority are failing to demonstrate strategies to bring their business models into line with the Paris climate goals'.

Key Points

- **55% of companies now identify climate change as a material business risk** (though all the companies in the sample were assessed by the TCFD to be highly exposed to climate risk). According to Market Forces, this figure has actually decreased since March 2018.
- **39% detail climate risks and opportunities in mainstream reporting**: 39% of companies provide a detailed discussion of climate risks and opportunities in mainstream annual reporting, which is an increase of 14% since March.
- **20% disclose climate change scenario analysis** (and, according to Market Forces, analysis of 'barely half of those can be considered detailed'). 80% of companies have not produced any analysis of how their business is expected to fare under different climate change scenarios.
- **58% of companies have not set any clear emissions reduction target and 78% of companies have not released any plan to reduce carbon emissions.** Only 19% of companies have released a plan. 22% of companies that have set absolute emissions reduction targets, a further 20% have set emissions intensity targets.
- **31% of companies remunerate executives to reduce greenhouse gas (GHG) emissions** (as compared with 16% in March).
- **Only three companies** (South32, AGL and Stockland) currently disclose in line with all recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) though the Commonwealth Bank, BHP, Westpac and ANZ have all committed to satisfying the recommendations and 'come close' to doing so Market Forces writes and adds that Macquarie and Mirvac have also committed to addressing all recommendations in their 2019 reporting.

Market Forces also includes a 'scorecard' naming each of the companies in the sample, and indicating any strengths/gaps in disclosure.

Call for regulators to mandate the TCFD recommendations: Noting that the Australian Securities and Investments Commission (ASIC), Australian Prudential Regulation Authority (APRA) and ASX Corporate Governance Council have all 'stepped up their public rhetoric on the issue' and are 'taking steps to ramp up guidance and scrutiny around climate risk disclosure' Market Forces nevertheless has called for more explicit guidance from regulators and a 'mandate for TCFD compliant climate risk reporting for all companies operating in 'high risk' sectors as well as financial institutions.

Investor group action: Market Forces notes that investors are increasingly active in driving progress on this issue (eg the work of the Climate Action 100+ initiative and efforts by BlackRock) but notes that demands from these groups generally fall short of calling for companies to operate in line with a Paris-aligned climate scenario. Market forces argues that for this reason, individual investor engagement remains necessary and has called on members to demand their super funds apply pressure to companies to meet Paris goals.

[Note: Despite acknowledged regulatory uncertainty, disclosure of climate risk was highlighted in the Australian Securities and Investment Commission's (ASIC's) latest report on corporate finance regulation (ASIC Report 589: ASIC regulation of corporate finance: January to June 2018) as an area of focus for the regulator over the next six months. ASIC flagged (among other things) that a review of relevant regulatory guidance will be published by the end of the year and reiterated that the review of a climate risk disclosure across the ASX 300 is underway with the findings to be released later in 2018. See: Governance News 03/09/2018.]

[Source: Market Forces: Investing in the Dark August 2018 update]

Sound commercial reasons to consider adopting the TCFD recommendations? Writing in Harvard Law School Forum CCLI argues that failing to adopt the TCFD recommendations is actually more risky for companies than the alternative.

Writing on Harvard Law School Forum for Corporate Governance and Financial Regulation, Cynthia Williams (York University) and Ellie Mulholland (Commonwealth Climate and Law Initiative or CCLI) make the case for companies to voluntarily adopt the Task Force on Climate-related Financial Disclosure (TCFD) recommendations arguing that there are commercial benefits for companies in doing so. 'Disclosure in line with the TCFD recommendations is not just a compliance strategy for companies and directors. In light of increasing market demand for robust climate risk disclosure, there are also significant commercial benefits associated with making such disclosures' they write.

Key Points

- **Climate change is increasingly recognised as a mainstream business and investment consideration by investors and regulators.**
- **There is increasing demand for climate disclosure from investors**.
- **Many major investors are demanding robust climate risk disclosure and view the TCFD recommendations as the strongest framework for this.**
  - **The framework has international credibility and wide support:** The recommendations are the result of substantial consultation with stakeholders in the business and investor community and were developed by a global panel of experts drawn from large banks, insurers, asset managers, pension funds, large non-financial companies, accounting firms and credit rating agencies. They're also widely supported and when released, the authors note, nearly 400 global investors representing more than US$22 trillion in assets called on the G20 heads of state to implement them.
  - **Enable/facilitate reporting on climate change as a material financial risk:** The TCFD recommendations provide guidance on the forms of financial analysis and disclosure that are likely to be necessary for companies 'to make a fair presentation of material financial risks relating to climate change'.
  - **Capable of application across sectors/organisations/jurisdictions:** The framework is sector-agnostic and capable of adoption 'by all organisations across all jurisdictions for disclosure of climate-related risks and opportunities within mainstream financial filings'.
- **Institutional Investors are closely monitoring implementation.** For example, Blackrock has encouraged companies to use the TCFD recommendations and has cautioned that if boards are not dealing with material climate risks appropriately, it will vote against the re-election of directors most responsible for board process and risk oversight.

- **More risk in failing to adopt than in adopting the recommendations?** The authors challenge some of the 'commonly cited' reasons for failing to adopt the recommendations put by investee companies, such as that adoption could lead to increased liability exposure, arguing that there is more risk in failing to adopt them than to do so. 'Companies and their directors are likely to face greater liability exposure in many jurisdictions if they fail to assess and, where material, meaningfully disclose the financial risks associated with climate change and their impact on company performance and prospects' they write.

The authors conclude that 'Disclosure in accordance with the TCFD recommendations is just that: disclosure of the right kind. It is the kind of disclosure that will minimise the chances of litigation against the company and its directors and it is the kind of disclosure that investors are increasingly demanding. The direction of travel on this issue is clear: companies and directors who begin their climate risk reporting journey now will be rewarded and the laggards will be left facing the spectre of liability'.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 02/09/2018]

Markets and Exchanges

In Brief | The ASX has announced that it will delay the go-live date for its planned distributed ledger technology (DLT) based CHESS replacement system until early 2021, in response to industry feedback over the original implementation timeframe.

[Source: CHESS Replacement: New Scope and Implementation Plan Response to consultation feedback September 2018]

Regulators

Australian Prudential Regulation Authority (APRA)

Top Story | Embrace BEAR and fix executive remuneration: APRA Chair Wayne Byres has said BEAR implementation will be a focus for the regulator, and has called on banks to make improvements in the design and implementation of executive remuneration to rebuild trust.

The theme of Australian Prudential Regulation Authority (APRA) Chair Wayne Byres' address to the Annual Risk Management Association CRO Conference this year was 'regaining the trust'. Though the task of rebuilding trust can only be accomplished by firms themselves, Mr Byres said, there are 'range of regulatory and supervisory activities that APRA is pursuing' to assist in the task such as ensuring that the Banking Executive Accountability Regime (BEAR) is implemented in practice, and that improvements are made to the design and implementation of remuneration.

Key Takeouts

1. **Insufficient focus and value given to non-financial risk:** Commenting generally on the approach taken to managing risk, Mr Byres reiterated that 'risk – and hence risk culture – has too narrowly been looked at through a financial lens ('what will it cost our bottom line?'), without regard to reputational impacts ('what will it cost our good name and standing?'). The latter has been materially underestimated. This will need to change if the industry is to regain the trust, but it will challenge the risk (and regulatory) profession because it will require skills, expertise and insights that may not be in the domain of a traditional risk manager'.
2. **APRA to focus on BEAR implementation:** Mr Byres said that APRA will be looking to 'see how well the allocated responsibilities [under BEAR] work in practice' adding that the regulator is 'quite open to revisiting these as we learn from experience'. Mr Byres added that APRA will be 'looking to see how accountable persons understand and oversee their areas of accountability in practice – to repeat a point I have made already, having the paperwork in good shape is not enough'.
3. **Industry's approach to the design and implementation of remuneration must change to address the issues previously identified in APRA's remuneration review.** In particular, poor risk outcomes need to be reflected in executive pay (as well as at lower levels); board remuneration

committees need to exercise stronger oversight; and excessive focus on financial measures in performance assessment needs to be addressed.

General remarks

- **Insufficient focus on non-financial risk:** The issues that have led to the loss of public confidence (eg issues brought to prominence that the Financial Services Royal Commission) were attributed by Mr Byres, in part to 'miscalculation of the risk-return trade-off in the way business has been conducted. Reputation and trust have been undervalued in that calculation, and therefore squandered' he said. In concluding his speech he expanded on this theme stating: 'With hindsight…it's open to question whether the 'quantification' of the risk management profession has created something of a blind spot for those types of risk that are difficult to quantify. The finance industry, and the risk profession that serves it, has a natural affinity for measuring things in dollars and cents, percentages and basis points. But that means the conventional risk management frameworks and processes find it difficult to grapple with difficult-to-quantify risks, such as those relating to behaviour and reputation. If what gets measured gets managed, then I suspect that has played some role in bringing the industry to where it is today'. He added that this would be a key challenge going forward.

[Note: Insufficient focus on non-financial risk was a key finding in the recent APRA report into CBA culture. See: Governance News 04/05/2018.]

- **APRA's role:** Mr Byres said that 'it is not the regulators' job to regain that trust for you' but rather a task for industry to 'earn and sustain the community's trust through its own actions'. Commenting on APRA's role in overseeing risk culture, Mr Byres drew a distinction between the Australian Securities and Investments Commission (ASIC) approach and that of APRA. He said that APRA's work on 'culture should be focused on those areas that are naturally of interest to a prudential regulator' adding that this means that 'we view it very much through a risk lens' whereas ASIC will have a different perspective. Mr Byres also said that APRA views 'culture as a critical but underappreciated component of the post-crisis regulatory response' and that 'understanding attitudes to risk – the risk culture – are fundamental to gaining confidence that an institution has robust risk management and is likely to remain in a sound financial position' as without culture to reinforce them, well documented policies and procedures were unlikely to be effective.
- **Risk culture is a job for the board:** Mr Byres said that 'in the same way that we [APRA] don't prescribe the business models and strategies that financial institutions must adopt, we don't seek to prescribe the risk culture either. We expect executives and their Boards to establish and maintain the risk culture that they consider (and note, we do expect a conscious consideration) to be appropriate to their organisations, given their strategy and risk appetite. As set out in CPS220, we also make clear that it is the Board's job – but inevitably supported by management – to form a view as to whether their risk culture is appropriate, and insist on changes when they consider it not to be the case'.

Areas of specific focus for banks (and for APRA): BEAR implementation and Remuneration

Banking Executive Accountability Regime (BEAR) – how well has it been implemented in practice? Mr Byres said that feedback to APRA has been that the set up process created some organisational challenges including debate about where accountability properly lies within institutions. Commenting on this he said that in his view, clarification of accountabilities was itself a useful exercise.

He went on to say that now the system is operational APRA will shift its attention to how well it has been implemented and more particularly that APRA will be looking to 'see how well the allocated responsibilities work in practice' adding that the regulator is 'quite open to revisiting these as we learn from experience'. Mr Byres added that APRA will be 'looking to see how accountable persons understand and oversee their areas of accountability in practice – to repeat a point I have made already, having the paperwork in good shape is not enough'.

Mr Byres also encouraged ADIs not already subject to BEAR 'start your preparations now if you haven't already done so. The obligations of BEAR are significant, so it's important that you take the time to get them right'.

Mr Byres said that he hoped that over time, BEAR would have a positive impact in terms of forcing industry to hold itself to account 'much more firmly and quickly than has been the case to date' as it appears to have done in other jurisdictions with similar regimes.

Remuneration

On the topic of remuneration Mr Byres noted that earlier this year APRA released the findings from its review of remuneration policies and practices across a sample of large APRA-regulated entities (see: Governance News 06/04/2018) observing that the review 'found that remuneration frameworks and practices across the sample did not consistently and effectively meet our [APRA's] objective of sufficiently encouraging behaviour that supports risk management frameworks and long-term financial soundness. Though all institutions had remuneration structures that satisfied minimum requirements, implementation was often some way from better practice'.

He then highlighted three areas in which 'improvement is needed' (and which were previously flagged in APRA's remuneration review), noting that though APRA has previously said that it intends to strengthen prudential requirements in this area, 'boards and senior executives shouldn't wait to take action to improve the design and implementation of remuneration frameworks'.

1. **Executive accountability for poor risk outcomes:** Mr Byres said that though employees at lower levels received downward adjustments to remuneration 'overall, senior executives seemed somewhat insulated from the consequences of poor risk outcomes. This must change'.

2. **Performance metrics need to evolve in line with best practice:** Though financial metrics should be part of performance assessment Mr Byres said, excessive weightings risk driving the wrong behaviours. 'One reason that there seemed to be a misalignment between outcomes and remuneration was that measures by which performance was judged are too focused on shareholder metrics such as return on equity (RoE) and total shareholder return (TSR). The current structure of long-term incentives in Australia is particularly problematic in this regard, and is out of step with how best practices in remuneration are evolving internationally. This will also have to change'.

3. **Board Remuneration Committee oversight is weak: '**From insufficient challenge to insufficient documentation, it was clear that stronger governance of executive remuneration is needed' Mr Byres said. He added that for ADIs the BEAR will require that this occur, but it will also require a more 'structured and systemic contribution from the risk functions within banks'.

[Sources: APRA Chair Wayne Byres speech, Annual Risk Management Association CRO Conference, 04/09/2018; [registration required] The AFR 04/09/2018]

Related News

Practical insights: MinterEllison Partner Gordon Williams has recently written on some of these issues and has highlighted a number of questions for consideration in the design/implementation of remuneration packages. His article is available here: *InsideHR* 03/09/2018.

Australian Securities and Investments Commission (ASIC)

Top Story | ASIC Commissioner has outlined three new supervisory initiatives: embedding ASIC staff, enhanced supervision and enforcement focus on the superannuation sector and the corporate governance taskforce.

In a speech to the Risk Management Association Annual Chief Risk Officer Conference, Australian Securities and Investments Commission (ASIC) Commissioner John Price has outlined the regulator's priorities over the next year and outlined three new supervisory initiatives.

Key Takeouts:

1. **'Close and continuous monitoring'** which refers to embedding ASIC staff in major financial institutions. The initial focus, Mr Price said will be to drive 'significant improvements' to breach reporting. ASIC staff will also assess responses to the Australian Prudential Regulation Authority's (APRA's) CBA prudential inquiry; assess 'appetite for change' within institutions and identify key decision-makers and influencers within each institution to engage with directly.

2. **Strengthened supervision and enforcement focus of the superannuation sector** through various measures including: more frequent on-site visits; better leverage of data; and 'significant public actions' including enforcement outcomes.

3. **Corporate Governance Taskforce:** The taskforce will enable ASIC 'to shine a light on "good" and "bad" practices observed across these entities' and will look at a range of issues. These will include director and officer risk oversight (particularly in relation to non-financial risk); executive remuneration (particularly decisions by the remuneration committee to award and grant variable remuneration); and the adequacy of corporate governance disclosures.

'Close and continuous monitoring': embedding ASIC staff in large financial institutions.

Mr Price said that a 'key goal' of this initiative 'is to modify the behaviour of the large institutions to further encourage them to place consumers first in their decision-making and quickly identify and respond to conduct that produces unfair outcomes'.

The initial focus of the teams will be to:

- **Drive significant improvements to breach reporting**. This work will build on work already completed and described in ASIC's 'imminent' public report on breach reporting which he said would provide 'robust baseline data' against which future progress — 'how the institutions are improving their breach detection, reporting, rectification and customer remediation processes' — could be measured. Mr Price added that it currently takes the entities who participated in the review around four years to identify a breach.

- **Assessment of response to CBA prudential inquiry:** Focus on assessing the specific internal governance issues raised by the CBA prudential inquiry across the other institutions and collaborate with APRA in assessing the banks' responses.

[Note: APRA released the Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia (CBA), which examined the frameworks and practices in relation to the governance, culture and accountability within the organisation, on 1 May. The report includes 35 recommendations which APRA said 'provide a roadmap for the CBA Board and executive team to deliver organisational and cultural change across the CBA group' as well as 'important insight for all institutions particularly about the need to maintain a broad focus on all aspects of risk and stakeholder interest'. For an overview of the report see: Governance News 04/05/2018]

- **Assessment of 'appetite for change'**: Understand differences between institutions in appetite for change to culture and practices, governance, structure and organisation, reporting practices and gaps, products sold or distribution arrangements that affect the outcomes we are seeking and the ability to get effective changes (to inform longer term planning).

- **Identify key decision-makers and influencers** within each institution to engage with directly.

- **Future areas of focus?** Mr Price said that 'future areas of focus will be selected based on the potential for consumer harm, as well as other factors such as the suitability for intervention through on-site supervision, the prioritisation of issues by the relevant stakeholder team(s) and issues identified/resolved in other jurisdictions'.

Strengthening ASIC's 'supervision and enforcement focus of the superannuation sector'

Mr Price said that ASIC will be delivering an 'enhanced supervisory approach for superannuation' adding that the regulator has already 'strengthened our team focused on this area'.

Mr Price said that the 'enhanced' supervisory approach would include:

- an expanded range of supervisory techniques eg more frequent on-site visits;

- build on 'already significant public actions in the superannuation sector, including more enforcement outcomes';

- better leverage the data currently available to ASIC and APRA. In addition APRA will also make use of new data sources, including internal dispute resolution data that must be reported to ASIC, as well as data on life insurance claims coming from joint ASIC and APRA work;
- the incorporation of more consumer testing and shadow shopping; and
- a 'more intensive engagement model, where superannuation stakeholders will deal with specific ASIC staff on a more consistent and regular basis'.

ASIC will work collaboratively with other regulators

Mr Price added that ASIC will work collaboratively and closely with both APRA and the Australian Taxation Office (ATO) who also have a common interest in superannuation. He also acknowledged that there are 'boundaries to ASIC's jurisdiction in super, and some issues will be in the remit of other regulators. Nevertheless, we plan to do everything within out powers to improve member outcomes in superannuation'.

Other superannuation reforms

Mr Price noted that the new ASIC focus on superannuation is occurring in the context of other reforms, notably:

- The Productivity Commission's draft report on the competitiveness and efficiency of the super system (see: Governance News 04/06/2018);
- The implementation of the Insurance in Superannuation Voluntary Code of Practice;
- The Government's announced Protecting Your Super reform package was announced in the 2018-2019 Federal Budget

[Note: The Protecting Your Super reform package was announced in the 2018-2019 Federal Budget (see Governance News 11/05/2018). *Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018* is currently before the senate having passed the House of Representatives.]

Corporate Governance Taskforce

Referencing the recent announcement of additional funding for ASIC to undertake targeted reviews of corporate governance practices in large listed entities, Mr Price outlined three areas of focus.

1. **Director and officer risk oversight (especially of non-financial risk):** Mr Price said that the role of the board and officers in the oversight (and in the case of officers, the management) of risk would be an area of focus. More particularly, he said that 'Our review will look at how directors are actively exercising their stewardship functions, particularly in relation to non-financial risk'. Questions ASIC will consider include:
    - 'How are directors and officers ensuring that they know enough about the entity to ask the right questions? How do they know what they are not being told?
    - How are they holding their executive teams to account?
    - In large, complex entities, how do they ensure that they have meaningful oversight over all material non-financial risks of the entity?
    - How are they satisfied that the compliance and risk functions of the entity are being adequately funded?'
2. **Executive remuneration:** Mr Price said that drawing on APRA's work in this area, ASIC will be 'looking at whether executive remuneration structures, grants and vesting of variable remuneration are driving the right behaviours and accountabilities of executives in Australia's listed companies'. He added that 'an initial issue we will be considering is focusing on the decisions by the board remuneration committee to award and grant variable remuneration'.
3. **Quality of corporate governance disclosures:** Mr Price said that a third priority for the regulator is consideration of the adequacy of periodic corporate governance disclosures with a focus on determining whether investors are being provided with meaningful disclosures about the

effectiveness of a company's corporate governance practices. 'We want to understand whether those stated policies and procedures are actually reflected in practice' he said. He added that ASIC is currently 'working on the process' of selecting the entities to approach for review and noted that 'targets' would be chosen from a range of industries and would not be 'limited to financial services'. Mr Price said that ASIC is likely to publish a report at the end of the project, in which it will highlight practices that require improvement as well as those which represent good practice.

[Note: The work conducted into remuneration by APRA referred to by Mr Price appears to be the review of remuneration practices released earlier this year: *APRA Information Paper — Remuneration practices at Large Financial Institutions April 2018.* See: Governance News 06/04/2018]

ASIC's role

- **Up to industry to change:** Mr Price said that ultimately rebuilding trust and changing culture can only be achieved by industry not by regulators. 'I should say at the outset that while it is all well and good to have regulators speak about how they will improve conduct and build trust it perhaps misses a key point. That point is, of course, that it is the people we license to provide financial services or credit services and their employees that have the frontline role to comply with relevant laws and keep customers top of mind'.
- Having said this, Mr Price said that ASIC does have a role in 'driving the behaviours that will build and restore trust' and that it will do so by:
  - proactively identifying harms to consumers, investors and markets
  - prioritising and addressing the most significant harms
  - accelerating enforcement outcomes
  - implementing new supervisory approaches, and
  - promoting the adoption of regulatory technology (regtech) by industry.

[Note: The new supervisory initiatives and approach outlined in Mr Price's speech reflect priorities/approach in ASIC's latest corporate plan and areas of focus released on 7 September. See: ASIC's Corporate Plan 2018-22 Focus 2018-2019. A very brief overview of the plan is also included in Governance News 10/09/2018]

[Sources: ASIC Commissioner John Price, speech at the Risk Management Association Annual Chief Risk Officer Conference 2018 04/09/2018

ASIC Corporate Plan 2018-2022: 2018-2019 focus areas

On 7 September 2018, ASIC released its Corporate Plan 2018-2022. A brief overview of the 'focus areas' for 2018-2019 and the overall strategic priorities for the regulator to 2022 is below.

[Note: ASIC Commissioner John Price provided additional detail around the immediate areas of focus from a supervisory perspective in a recent speech outlined in a separate post above.]

Strategic priorities for 2018-2019 to 2020-2022

1. **Accelerating enforcement outcomes:** Utilise additional funding to accelerate and expand ASIC's enforcement and 'ASIC's capacity to pursue actions for serious misconduct through greater use of external expertise and resources'.
2. **Implementing new supervisory approaches** for example by embedding ASIC staff in large financial institutions to monitor their governance and compliance with laws, strengthen supervision and enforcement focus on the superannuation sector, establish a corporate governance taskforce to conduct a review to identify and pursue corporate governance failings in large listed companies.
3. **'Being strategic and agile'** through enhancing ASIC's strategic planning framework to focus on 'addressing harms to consumers investors and markets'; enhancing ASIC's 'internal governance frameworks to better support strategic decision making' and allocating resources 'more strategically to adapt and respond more quickly to changes in operating environment (among other measures).

4. **Promoting regtech adoption.**

Key Focus Areas 2018-2019

1. **'Potential harms' from technology:** ASIC states that it will 'continue to focus on monitoring threats of harm from emerging products' eg ICOs and cryptocurrencies, cyber resilience, the adequate management of technological solutions by firms and markets and misconduct that Is facilitated by or through digital and/or cyber based mechanisms.
2. **Poor culture and professionalism in financial services and credit.** ASIC states that it will focus particularly on the provision of consumer credit and financial advice, the fair treatment of small business and the use of consumer data by firms (including data governance).
3. **Culture, governance and incentives that can harm markets**. We will focus on corporate governance and disclosure, the quality of financial reporting and audit, phoenix activity, and misconduct in wholesale markets.
4. **Practices that target financially vulnerable consumers** (eg low income or older Australians) by 'exploiting behavioural biases and adopting practices that affect informed decision making'. ASIC adds that it will also focus on issues around access to appropriate tools and information and on improving financial knowledge.
5. **Misalignment of retail product design and distribution with consumer needs**. ASIC states that it will 'focus on inadequate and misleading disclosure, unnecessary product complexity, and conflicts of interest resulting from sales driven incentive structures'.
6. **The impact of globalisation on financial markets and products.** 'Increased global uncertainty may lead to inconsistent international regulation and policy settings' ASIC writes. Accordingly, ASIC states that it will focus on testing cross-border businesses' compliance with domestic regulation, managing international developments that affect market infrastructure, and acting where cross-border transactions affect fair and efficient markets.

Commenting on the plan ASIC Chair James Shipton said: 'ASIC expects financial sector firms to adopt a culture of professionalism from the very top of the organisation right through to the frontline in order to win back community trust. Equally, it is important for ASIC to demonstrate professional values and to be held to account.'

[Sources: ASIC media release 07/09/2018; ASIC's Corporate Plan 2018-22]

In Brief | ASIC has announced that a former director has been convicted in the Brisbane Magistrates' Court and fined $900 for failure to comply with a Notice issued under the ASIC Act (to attend a formal examination and provide ASIC with assistance in an investigation).

[Source: ASIC media release 06/09/2018]

In Brief | Treasurer Josh Frydenberg has announced that Ms Danielle Press and Mr Sean Hughes have been appointed full-time Members of the Australian Securities and Investments Commission (ASIC) for a 5 year period. Mr Frydenberg said that the new appointments 'will boost the experience and capability of the Commission in relation to financial markets and regulation, including superannuation, and will contribute to the leadership necessary to support the Commission's new strategic direction which will enhance its ability to detect and address misconduct in financial services and protect consumers'.

[Source: Treasurer Josh Frydenberg media release 31/08/2018]

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

Responses to Round 5 hearings into Superannuation have been released by the Financial Services Royal Commission: brief overview of APRA submission.

The Banking Royal Commission has released the responses to its Round 5 hearings on superannuation. The submissions address the possible open findings, outlined by Counsel Assisting in submissions to the Commissioner.

[Note: For a high level overview of the possible open findings and policy questions arising from Round 5 hearings see: Governance News 27/08/2018]

A brief overview of some of the issues raised in APRA's submission to the Commission is below.

APRA submission to the Commission

While Counsel Assisting did not propose specific findings in respect of the Australian Prudential Regulation Authority (APRA), the regulator did make a submission in response to a 'small number of matters' raised closing submissions in relation to the APRA case study. APRA adds that it will respond in more detail to the policy/general questions raised in closing submissions in a separate policy submission.

APRA's regulatory approach

- **More use of 'strategic litigation' by the regulator will be considered in a separate policy submission:** APRA states that it 'accepts that there are legitimate questions as to whether a decision to litigate may achieve a result with wider deterrence effect as indicated in Counsel Assisting's Submissions'. APRA goes on to say that APRA will 'address further the issue of strategic litigation as a tool for achieving general deterrence in its submissions on policy issues to be submitted by 21 September 2018'.
- **Principles-based approach to setting prudential standards**: In response to Council Assisting's questions regarding APRA's Prudential Standards, APRA writes that its approach is longstanding and consistent with the government's statement of expectations, which states that the government's 'preference is for principles-based regulation that identifies the desired outcomes, rather than prescribing how to achieve them.' APRA goes on to say that:' Importantly, the Prudential Standards do not displace, and are not intended to operate as a substitute for, the obligations and covenants that are expressly imposed on trustees by the SIS Act' and adds that it will further address the role of the prudential standards in a separate policy submission.

Specific issues

- **APRA will consider 'further steps' in relation to possible contraventions of the Superannuation *Industry Supervision Act 1993* (Cth) (SIS Act)** by certain trustees. The submission went on to say that to date the regulator had 'achieved outcomes which, on the information known at the time, were considered to be in the long-term best interests of members. However, the Commission has brought additional information to light, some of which appears inconsistent with information previously provided to APRA. APRA is examining these issues further to consider whether additional action is necessary' against certain entities. The submission goes on to express concern about some of the documentary and oral evidence heard over the course of the hearings, in particular 'regarding how the individuals giving evidence saw their roles, the arrangements with related parties and the role of the RSE licensee generally' and states that APRA will further investigate, with a view as to whether further action is needed.
- **Grandfathering of commissions:** On the issue of grandfathering of commissions, APRA said that 'there has been an express legislative policy decision which permits historical commission arrangements to continue in the superannuation context, subject to the best interests test…In the absence of additional circumstances indicating a breach of the best interests test, it could be, at the very least, inappropriate, for a regulator to sanction an RSE Licensee for actions allowed by law'. The submission goes on to say

that 'APRA does not accept as a blanket proposition that grandfathered commissions looked at in the overall context of members' best interests are necessarily contrary to those interests based on the current state of the law, the current structure and operations of most RSE licensees and the superannuation industry as a whole'.

- **MySuper transition:** Commenting on this issue APRA writes that it 'does not accept as a blanket proposition that effecting changes within the statutory timeframe is inconsistent with acting in the members' best interest or that (in the absence of additional circumstances) it would be appropriate for APRA to sanction a trustee for actions allowed by law'.
- **Fees for no services and fees charged to deceased members**: The submission states that 'APRA agrees that the charging of fees for no service or the charging of fees to deceased members is unacceptable. However, what the most appropriate response is will depend on the context of the particular event'. The submission goes on to state that 'APRA does not agree that it is incumbent on it to act earlier or separately from ASIC in such matters, when ASIC action may be achieving the common regulatory objective of appropriate remediation to affected members and/or where there may be other actions in train'.

[Source: Written submissions received in response to Round 5 hearings on superannuation: APRA written submission]

Superannuation

Top Story | First ASIC FFNS enforcement action? ASIC has announced that it has commenced proceedings in the Federal Court against two NAB entities

On 6 September, ASIC announced that it had commenced proceedings in the Federal Court of Australia against two entities in NAB's wealth management division, NULIS Nominees (Australia) Limited (NULIS) and MLC Nominees Pty Ltd (MLC Nominees). The court proceedings relate to fees charged by both entities to a number of their superannuation members for services, which were (allegedly) not provided.

ASIC Allegations against MLC Nominees

- **Breach of trust:** The deduction of certain fees from members who were not linked to an adviser was a breach of trust by MLC nominees.
- **Failure to provide services efficiently, honestly and fairly:** ASIC alleges that by deducting fees for advice from member accounts when the account was not linked to an adviser, by not 'forming a reasonable belief or having in place a system to enable it to form a reasonable belief' about whether advice was being provided in exchange for the fee, by not disclosing to members that the fee could be turned off, as well as by issuing product disclosure statements which were 'defective within the meaning of s1022A of the Corporations Act' that MLC Nominees 'failed to all things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly in breach of s 912A(1)(a) of the Corporations Act 2001 (Cth)'.
- **Failure to comply with financial services law:** ASIC alleges that MLC Nominees failed to comply with the financial services law in a number of respects, in breach of s912A(1)(c) of the Corporations Act 2001 (Cth). In addition ASIC alleges that MLC Nominees failed to exercise proper care, skill and diligence and failed to act in the best interests of members in breach of 'general law duties and covenants incorporated into the Trust Deed and required under ss52(2)(b) and 522(c) of the *Superannuation Industry (Superannuation) Act 1993* (SIS Act) and s55(1) of the SIS Act.
- **Misleading, deceptive and false conduct:** ASIC alleges that MLC Nominees engaged in misleading or deceptive conduct within the meaning of s12DA(1) of the ASIC Act and s1041H(1) of the Corporations Act and made representations that were false or misleading within the meaning of s12DB(1)(g) and (i) of the ASIC Act.

ASIC Allegations against NULIS

- **Failure to provide financial services efficiently, honestly and fairly:** ASIC states that the 'case against NULIS is the same as that against MLC Nominees, except NULIS did not issue the defective PDSs and its misleading, deceptive and false conduct was more confined'. ASIC alleges that NULIS failed to do all things necessary upon becoming trustee, to 'form a reasonable belief' that service was being provided in exchange for fees being paid, and to terminate fees where no service was provided. This, ASIC alleges was a failure by NULIS to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly in breach of s912A(1)(a) of the Corporations Act.

- **Failure to comply with the financial services law:** ASIC alleges that NULIS breached s912A(1)(c) by failing to exercise proper care and skill and failed to act in the best interests of members in breach 'not only of NULIS' general law duties and covenants included pursuant to …the trust deed for the MLC Super Fund but also of s55(1) of the SIS Act'.
- **Misleading or deceptive conduct:** ASIC alleges that NULIS engaged in misleading or deceptive conduct within the meaning of s12DA(1) of the ASIC Act and s104H(1) of the Corporations Act. ASIC also alleges that NULIS made false or misleading representations within the meaning of s12DB(1)(g) and 12DB(1)(i) of the ASIC Act.

[Note: Certain of the alleged contraventions identified by ASIC appear similar to those identified by Counsel Assisting in closing submissions to the Financial Services Royal Commission Round 5 hearings into superannuation. See: Superannuation Closing Submissions at B2; for a high level summary of closing submissions: Governance News 27/08/2018]

ASIC is seeking declarations of contravention, pecuniary penalties and costs

- declarations of contravention of ss912(1)(a), 912A(1)(c) and 1041H(1) of the Corporations Act; ss12DA(1), 12DB(1)(g) and 12DB(1(i) of the ASIC Act and general law duties; and
- pecuniary penalties pursuant to s12GBA of the ASIC Act in respect of each declared civil penalty contravention; and
- costs.

ASIC investigation in relation to adviser service fees charged by NAB is ongoing: The ASIC media release also outlines the actions already taken relation to this issue and states that ASIC 'has ongoing investigation in relation to Adviser Service Fees charged by NAB entities in relation to personal advice services'.

Other investigations underway: ASIC states that the action against the NAB entities is part of a number of 'broad-ranging and significant investigations currently underway into fee for no service failures in the financial services industry'. ASIC adds that alongside these investigations ASIC is obtaining considerable remediation for impacted customers, currently estimated to exceed $850m.

[Sources: ASIC media release 06/09/2018; Concise statement – ASIC v NULIS Nominees; Originating Process]

ASIC Report into insurance cover in superannuation: poor complaints handling and inappropriate defaults highlighted as among the issues of concern for the regulator.

The Australian Securities and Investments Commission released a report on the provision of insurance cover through superannuation on 7 September: *Report 591 Insurance in Superannuation.*

The report was based on ASIC's review of 47 superannuation trustees and focused on: insurance claims and complaints handling, disclosures about insurance (including about cover ceasing); insurer rebates paid to trustees and defaults (whether members were defaulted into demographic categories that resulted in higher premiums).

Key issues identified in the report and actions for trustees

- **Insurance Claims Handling:**
  - **High volume of insurance related complaints:** According to the report, 27% of all complaints that trustees received were identified as being about insurance issues.
  - **Trustees are expected to undertake a review of their claims handling processes** (particularly given the number of complaints about insurance claims) ASIC writes. ASIC identifies the following as issues trustees should consider in reviews: the 'simplicity,

timeliness and transparency of the process for members' and 'feedback mechanisms for trustee oversight in relation to the role of administrators and insurers'.

  - **ASIC review in 2019:** ASIC adds that in 2019 it intends to 'see whether claims handling processes have been reviewed by trustees in the three years before this check'. This will involve testing a sample of these reviews to see if they have resulted in genuine improvements to consumers. ASIC goes on to say that it will 'also do further work to understand why the withdrawal rate for trustees using external administrators was higher than that of trustees that handle claims internally'.

- **Complaints handling:** ASIC identified provision of written reasons for decisions about complaints, and dealing with complaints within the required timeframes, as issues.

  - **Reasons for decisions:** Trustees should ensure that their arrangements for providing written reasons are working effectively and should also 'endeavour to provide reasons for all complaints even if not specifically requested' according to the report.

  - **Improve timeliness of processes:** ASIC found that 32% of claims relating to insurance (FY 2017–18) took over 90 days to finalise and 36% took between 45-90 days to finalise in the same period. ASIC states that 'Trustees that have complaints handling times greater than a 45-day average need to act now to improve the timeliness of their processes'.

  - **ASIC priority is to reduce complaints handling timeframes:** ASIC adds that its priority is to see that trustees with averages of over 100 days have reduced their complaints handling timeframes. ASIC cautions that if 'immediate action is not taken by trustees, ASIC will take further regulatory action, including considering enforcement options, against those trustees'. ASIC adds that after AFCA commences operation it also intends to consult on new internal complaints handling requirements. For superannuation complaints ASIC 'will propose shorter timeframes for dealing with complaints and stronger obligations to provide reasons for decisions on complaints'.

- **Insurance cover disclosure:** The review found that there is scope for many trustees to improve their disclosure and member engagement practices. In particular, ASIC highlights that there is scope to standardise information, and to use tools other than text based disclosure to engage members. ASIC states that it will monitor and assess industry initiatives to standardise definitions and terminology in relation to insurance in superannuation and will also undertake further work to promote better consumer decision making around insurance choices.

- **Managing conflicts of interest:** ASIC writes that insurance arrangements may be negotiated based on considerations other than members' best interests and that ASIC's expectation is that trustees are transparent about any rebates or benefits received from insurers and how receipt of these is consistent with acting in the best interests of by members. ASIC adds that 'this should not be burdensome because close monitoring by the trustees of these payments or other benefits should be part of the trustee's usual arrangements to deliver good member outcomes.'

- **Inappropriate default transfer arrangements:** The report found that some trustees automatically classify members as smokers or blue-collar workers when they are transferred from employer plans to personal plans within the same superannuation fund, which may result in higher cost insurance for members. ASIC writes that its expectation is that trustees should avoid applying defaults in this way and that it will seek confirmation from trustees that appropriate changes to default transfer arrangements are being made. More particularly ASIC states that it will expects that trustees: change arrangements for members who are already paying premiums based on inappropriate default settings, communicate the effect of these changes and review current and past practices to determine if they need to take any action regarding existing members.

Inappropriate defaults and complaints handling areas of immediate focus: ASIC Chair Peter Kell said: 'ASIC will be focused on ensuring that members do not experience adverse outcomes arising from poor complaints handling or inappropriate defaults in the coming months. He added that 'It is essential that trustees meet their obligations to deal with consumer complaints about superannuation in a timely manner and provide reasons for decisions as required'.

[Sources: ASIC media release 07/09/2018; Report 591 Insurance in superannuation 07/09/2018]

The arguments for limiting the 'best in show' funds to ten 'appear limited', and doing so may limit competition and deliver poorer returns to members according to ASFA: ASFA has released a discussion paper, critiquing the assumptions underpinning the Productivity Commission's draft report, and in particular the 'best in show' model.

The Productivity Commission released its draft report assessing the efficiency and competitiveness of the superannuation system on 29 May (see: Governance News). Among the recommendations in the draft report was the 'best in show' proposal. That is, that a single shortlist of up to 10 superannuation products should be presented to all members who are new to the workforce (or do not have a superannuation account), from which they could choose a product via a centralised online service (or nominate any other fund). The funds included in the list would be nominated by a 'panel of experts' and reviewed every four years, based on fund performance.

The Association of Superannuation Funds of Australia (ASFA) has released a discussion paper challenging the assumptions underpinning the recent Productivity Commission report recommendations, and more particularly the 'best in show' proposal.

Among other things, ASFA argues that:

- The arguments for limiting the 'best in show' funds to ten 'appear limited' as in practice, investment performance for the top 40 or more funds does not vary significantly.
- The proposal may also be lead to poorer member outcomes: 'A top 10 selection process may lead to behaviours that are not in the best interests of fund members, in particular in relation to risk and the pursuit of short-term rather than long-term returns…[There is a risk of an] unintended consequence of creating less competition among "secure" incumbent funds and excessive risk-taking by others.'
- The report gives an example of the limitations of the proposal, Berkshire Hathaway: 'Warren Buffett's Berkshire Hathaway has produced long-term returns of almost twice those of the US equity market as a whole, yet his fund would be knocked out of the top 10 in a bull market – the most recent period – simply because it tends to underperform in the short-term when markets are on the rise.'
- Australian superannuation funds do not have net investment returns that are much lower than pension funds overseas, and nor do they have relatively higher administration and investment costs according to ASFA.

The Productivity Commission has not yet released its final report.

[Sources: Association of Superannuation Funds of Australia (ASFA) report: Reflections on the Productivity Commission's analysis of superannuation returns and performance September 2018; [registration required] The AFR 02/09/2018]

Banking

Responsible lending | ASIC has announced that Westpac has admitted to breaching responsible lending obligations when providing home loans and has agreed to pay a $35 million civil penalty.

ASIC has announced that Westpac has admitted to breaching its responsible lending obligations under the *National Consumer Credit Protection Act 2009* (Cth) (the National Credit Act) and has agreed to a $35 million civil penalty to settle the case.

The litigation related to Westpac's home loan assessment process during the period December 2014 and March 2015. ASIC writes that Westpac should not have automatically approved approximately 10,500 of the 260,000 loans approved during the period because the lender did not correctly assess consumers' capacity to repay the loans.

The parties are seeking orders from the Federal Court that:

- Westpac used the Household Expenditure Measure (HEM) figure rather than using a customer's declared living expenses when assessing capacity to repay a home loan; and

- in the case of home loans to owner-occupiers which included an interest-only period, failed to use the higher repayments payable at the end of the interest-only period when assessing capacity to repay.

ASIC writes that Westpac agreed to submit to a $35 million civil penalty to resolve the proceedings and also to pay ASIC's litigation and investigation costs. Subject to Federal Court approval, ASIC states that this will represent the largest civil penalty awarded under the National Credit Act.

ASIC Chair James Shipton said, 'This outcome, and ASIC's actions in relation to responsible lending, reinforce that all lenders must obtain information from individual borrowers about their financial situation to ensure that they can properly assess the ability of the customer to repay the loan. Lenders must then verify the information to ensure that it is true, and then assess whether the loan is unsuitable for the borrower…This outcome is a warning to all lenders that they must comply with the responsible lending obligations. If they do not, ASIC will take action to enforce the law.'

Commenting on the announcement Treasurer Josh Frydenberg said that 'ASIC has successfully held Westpac to account for failing to properly assess whether borrowers could meet their repayment obligations before entering into home loan contracts… This kind of conduct is completely unacceptable and why we have laws in place to protect consumers from being put at risk of being in unaffordable home loans.'

Media reports

- **Investigations into other lenders for breaking responsible lending laws?** Media reports suggest that the ASIC is now investigating a number of other lenders for possible breach of responsible lending laws following the Westpac settlement.
- **An insubstantial penalty?** The ABC suggests that the penalty appears insubstantial given the profit many of the loans in question could continue to generate for the lender.
- **Minimal impact?** The Australian reports that Morgan Stanley analyst Richard Wiles has said the $35m fine will have an 'immaterial financial impact' and is a 'positive outcome' for the bank. Reportedly, Mr Wiles said that approximately half of the wrongly sold loans are still held by borrowers repaying their mortgage and are likely to be generating $45m worth of annual revenue and delivering a $20m profit to the bank each year. Overall, the ASIC fine is estimated to reduce Westpac's $8 billion annual profit by just 0.5%.

[Sources: ASIC media release 04/09/2018; Statement of agreed facts; Treasurer Josh Frydenberg media release 04/09/2018; [registration required] The AFR 04/09/2018; 05/09/2018; [registration required] The SMH 05/09/2018; [registration required] The Australian 09/06/2018; The ABC 06/09/2018;

Progress update on credit card reform | ASIC has prescribed a three year period for credit card responsible lending assessments following recent consultation.

As previously reported in Governance News 09/07/2018, ASIC recently released the findings of its review of credit card lending, together with a consultation paper and draft instrument proposing new requirements intended to strengthen responsible lending practices for credit cards.

Following this consultation, ASIC has set a three-year period to be used by banks and credit providers when assessing a new credit card contract or credit limit increase for consumers (ASIC Credit (Unsuitability-Credit Cards) Instrument 2018/753).

ASIC states that having considered the feedback received, the three year period strikes 'the most appropriate balance' between preventing consumers from being in unsuitable credit card contracts and ensuring that consumers continue to have reasonable access to credit. ASIC also states that though there were 'divergent views' about whether the period should be three or two years, the three year period was supported by most respondents. Most respondents were also supportive of the proposal that one period apply to all classes of credit card contracts ASIC notes.

Additional guidance: ASIC also released a report (*REP 590: Response to submissions on CP 303 Credit cards: responsible lending assessments*) outlining the key issues to arise from the consultation and ASIC's response. In addition, the report provides further guidance on the assumptions that should be made by providers when assessing whether a consumer can repay the credit limit within three years. This includes guidance on: 'fees on credit card accounts; interest rates charged on credit card contracts held with other credit providers; the effect of the reform on responsible lending assessments for other credit products'.

Application: The revised obligations will apply to licensees that provide credit assistance and licensees that are credit providers for both new credit card contracts and credit limit increases under existing credit card contracts. ASIC states that it will monitor the prescribed period and our guidance to ensure that it is achieving the goals of the reform.

Timeframe: The new legal requirement commences on 1 January 2019. ASIC states that it expects credit provided to have systems in place to ensure that they meet the new obligations.

[Sources: ASIC media release 05/09/2018; ASIC Credit (Unsuitability-Credit Cards) Instrument 2018/753; ASIC Report 590: Response to submissions on CP 303 Credit cards: Responsible lending assessments September 2018]

In Brief | Time to break up the banks? The AFR reports that former ACCC Chair Allan Fels has said that Financial Services Royal Commissioner Kenneth Hayne should consider breaking up or 'ring fencing' the banks' guaranteed deposit taking and lending business from their financial advisory businesses and investment banking businesses. 'You can't just rely on the banks behaving better, you can't just rely on ASIC doing the job. It'll need to go further' he is quoted as saying.

[Source: [registration required] The AFR 03/09/2018]

In Brief | The Australian Banking Association has issued a media release calling on all lenders, whether or not they are ABA members, to adopt the new Banking Code of Practice to raise standards. 'While we fully expect further changes to be made to banking following the final report of the Royal Commission, it's important that all lenders, such as credit unions, building societies and others adopt the same rigorous standards to ensure there is consistency across the industry' ABA CEO Anna Bligh said.

[Source: ABA media release 07/09/2018]

Insurance

In Brief | APRA has released intermediated general insurance statistics for the six months to June 2018: APRA highlights that as at 30 June 2018, there were 1,686 intermediaries licensed to conduct general insurance business. Of these; 48% placed business directly with underwriters the six months to June, 2% placed all their business directly through other Australian intermediaries, and 51% did not place any general insurance business in the period.

[Source: APRA Intermediated general insurance statistics June 2018 05/09/2018]

Other developments

The Treasurer has confirmed Treasury portfolio arrangements following the recent change in the Liberal party leadership and consequent Ministry reshuffle.

Josh Frydenberg MP was sworn to the role of Treasurer in on 24 August 2018. On 3 September, the released a statement confirming the division of portfolio responsibilities.

- The Treasurer said he will be responsible for the budget, economic and fiscal policy, taxation and superannuation policy, responding to the Banking Royal Commission, major foreign investment decisions and international engagement through the G20 and APEC, International Monetary Fund and the World Bank. He will also have primary oversight of ASIC, APRA and the ACCC.
- Assistant Treasurer Mr Stuart Robert, will have responsibility for financial services and the day to day management of superannuation, competition and consumer policy, the Australian Bureau of Statistics, FinTech, crowd source equity funding and assisting across the portfolio on matters including taxation legislation and administration.
- Assistant to the Minister for Treasury and Finance, Senator Zed Seselja, will have responsibility for the not-for-profit and mutuals sector including the Australian Charities and Not-for-profits

Commission (ACNC). Senator Seselja will also assist the Treasurer with some aspects of foreign investment and housing policy, as well as assisting with matters across the portfolio.

[Source: Treasurer Josh Fydenberg media release 03/09/2018]

Accounting and Audit

The AFR reports that the Labor party has called for the ACCC to investigate the big four accounting firms over allegations of cartel-like behaviour.

Shadow Assistant Treasurer Andrew Leigh and Labor member Julian Hill have reportedly written to the Australian Competition and Consumer Commission (ACCC) requesting that it examine the structure of the auditing market given the dominance of the big four firms (Deloitte, EY, KPMG and PwC).

Reportedly, the request highlighted the fact that the CEOs of the big four firms have met for private dinners, as potentially of concern.

The AFR reports that EY has 'emphatically' rejected any suggested of collusion or cartel behaviour and that all firms reportedly deny that any commercially sensitive matters were discussed during the meetings.

The AFR adds that the ACCC has said that 'competitors are not precluded from meeting or talking with each other' but that the regulator has provided no comment on the request for an investigation.

[Source: [registration required] The AFR 03/09/2018]

Risk Management

Climate

In Brief | The significant financial benefits of transitioning to a low-carbon economy are vastly underestimated? A new report from the Global Commission on Economy and Climate has found 'bold action' on climate change within the next 2-3 years could yield a direct economic gain of US$26 trillion through to 2030 as compared with business-as-usual. Whereas failure to transition to a new low-carbon economy will trigger various costs including, significant financial costs arising from extreme weather events, a surge in climate migrants and increased risk of adverse health outcomes.

[Sources: Global Commission on the Economy and Climate media release 05/09/2018; Unlocking the inclusive growth story of the 21st Century: accelerating climate action in urgent times]

In Brief | Australia is not yet on track to meet its emissions reduction targets under the Paris Agreement but the window hasn't closed according to research by ClimateWorks Australia. According to the report, current and proposed policies would see emissions at 11% below 2005 levels in 2030, which is less than half the progress needed to meet the government's current 2030 target of 26-28% and one third of the abatement needed to reach the net zero pathway.

[Sources: The Conversation 06/09/2018; ClimateWorks Australia media release 06/09/2018; Tracking progress to net zero emissions September 2018]

Whistleblowing

MPs have reportedly called for Assistant Treasurer Stuart Robert to take action on proposed whistleblowing protections currently 'on hold' due to the recent upheaval in parliament.

The Australian reports that Assistant Treasurer Stuart Robert is facing calls from Labor MPs and Senators (Deb O'Neill, Terri Butler, Chris Ketter and Matt Keogh) to formally respond to the Parliamentary Joint Committee (PJC) report into whistleblower protections which was released in 2017 (see: Governance News 15/09/2018). In addition to noting that the government was required to formally respond to the proposals within three months of the report being tabled, Labor has reportedly cited the role played by whistleblowers in revealing misconduct being investigated during the Financial Services Royal Commission hearings in support of their calls to take action to strengthen whistleblower protections.

The Australian writes that though an expert advisory panel was convened last year to oversee the response to the report, it has not yet done so.

Progress of the whistleblower Bill? As previously reported in Governance News, former financial services minister Kelly O'Dwyer introduced a Bill aimed at enhancing whistleblower protections in December 2017 but the Bill has so far progressed no further than the Senate.

The Australian comments that there has also been criticism of the proposed Bill on the basis that it falls short of the PJC recommendations which included a reward scheme for corporate whistleblowers, a single Whistleblower Act and a dedicated whistleblower protection agency which are not provided in the Bill.

[Source: The Australian 06/09/2018]

In Brief | SEC has announced that it has awarded $54m to two whistleblowers ($39m to one whistleblower and $15m to another) whose 'critical information and continued assistance helped the agency bring an important enforcement action'. The award is the second largest in the history of SEC's whistleblower program SEC writes.

[Source: SEC media release 06/09/2018]

Anti-money laundering

Top Story | AML and international sanctions – €1.1 billion lesson

Earlier this week, it was reported that French bank Société Générale expects penalties of €1.1 billion (AUD 1.9 billion) by US authorities for violating international sanctions. The bank is alleged to have acted on money transfers for entities based in countries that were subject to international economic sanctions.

This is a timely reminder for Australian businesses with international activities that sanctions laws in other countries (as well as Australian laws) may apply and impose restrictions to their activities.

For businesses subject to AML laws, the AML/CTF regulator, AUSTRAC expects Australian reporting entities to review their AML/CTF programs to accommodate their obligations under the sanctions regime.

While the sanctions regime operates in parallel to the AML/CTF regime, an AML/CTF Officer needs to be alert to the sanctions regime. A similar analogy is the interaction of AML/CTF rules with the privacy law requirements.

Below is a brief summary of the Australian sanctions regime.

Serious penalty

It is a serious criminal offence to contravene a sanctions measure or a condition of a sanctions permit. For example, the fine for a contravention by a company is the greater of A$2.1m or three times the value of the transaction.

Note this type of offence is a strict liability offence for a body corporate, meaning that it is not necessary to prove fault (eg intent, knowledge) to show the offence has been committed.

Types of sanctions measures

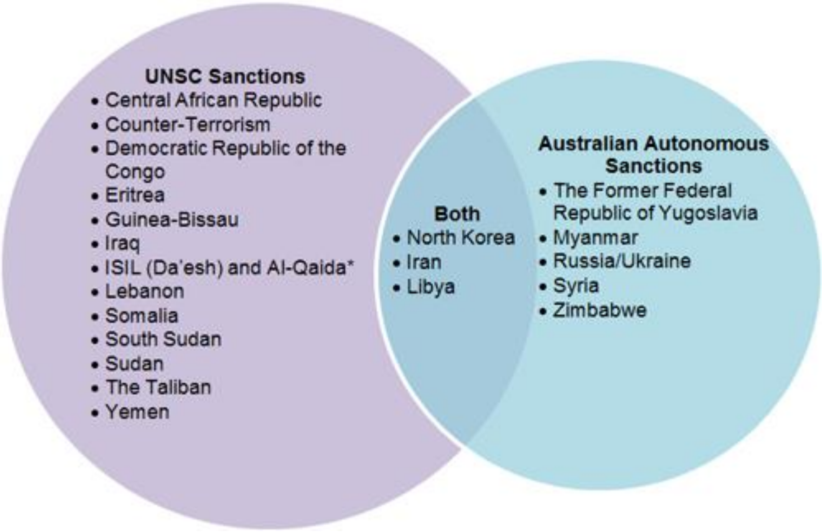
Australia implements United National Security Council sanctions regimes and Australian autonomous sanctions regimes. The different sanctions regimes impose different sanctions measures.

The sanctions measures include general prohibitions on:

- making a 'sanctioned supply' of 'export sanctioned goods';
- making a ‘sanctioned import’ of ‘import sanctioned goods’;
- providing a ‘sanctioned service’;
- engaging in a ‘sanctioned commercial activity’;
- dealing with a ‘designated person or entity’;
- using or dealing with a ‘controlled asset’; or
- the entry into or transit through Australia of a ‘designated person’ or a ‘declared person’.

List of sanctions

The sanctions regime currently implemented under Australian sanctions laws prohibit or restrict certain dealings with various countries and organisations, and includes sanctions imposed through the United Nations Security Council and under Australia's own regime. The Australian Department of Foreign Affairs regularly reviews and updates the regime countries and organisations [link] and currently it comprises:



Source: Department of Foreign Affairs

Sanctions permits

A business which is at risk of contravening an Australian sanctions measure may be able to apply to the Minister of Foreign Affairs to obtain a permit authorising an activity which would otherwise contravene an Australian sanctions law.

[Source: MinterEllison FS update: 08/09/2018]

In Brief | ING Groep has reportedly agreed to pay €775 million ($1.3 billion) to settle money-laundering allegations brought by Dutch public prosecutors. Reportedly, ING failed to properly vet the beneficial owners of client accounts and did not effectively monitor accounts for unusual transactions, thereby enabling customers to use the accounts for criminal activities from 2010-2016 'virtually undisturbed'. According to media reports, the penalty is the largest ever imposed on a company by the Dutch public prosecution service.

[Sources: [registration required] The FT 06/09/2018; [registration required] The AFR 05/09/2018]