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Diversity

Room to improve? New research from the University of Sydney has found that though many women have positive experiences in the investment management sector, sexual harassment/unequal treatment remains an issue and lack of flexibility remains a barrier for some.

As part of a broader study of women working in three highly male-dominated sectors and occupations (investment management, automotive trades, and pilots) researchers from the Women, Work & Leadership Research Group at the University of Sydney have released a report: *Non-traditional investors? The work and career experience of Australian women working in investment management.* The report presents the findings of their investigation into the experience of women in middle-ranking and senior positions in investment management.

Key Points

Mixed workplace experiences: some positive and some negative

- **Some survey results indicated a positive current experience:** a majority of respondents agreed that they were treated with respect in their workplace (88%), would recommend their employer to their female friends (84%), had supportive managers (80%), and had sufficient flexibility (79%). The researchers attribute this largely 'positive workplace experience of survey respondents' to the relatively 'high ranking positions' held by the participants and the benefits of those positions eg flexibility and autonomy attaching to more senior roles. In addition they note that the women in the survey sample are those who have 'stayed in the industry, suggesting that women who have had a positive experience are more likely to have longevity in the sector and possibly also that those who have left, may have had less positive experiences.
- **Some survey results indicated less positive experiences:** According to the report, 50% of respondents agreed that men and women were treated equally in their workplace, 13% of respondents said that they had experienced sexual harassment, 22% said that they had experienced gender-related offensive remarks and behaviours and 24% said that they had experienced gender-based exclusion from important workplace events in their current workplace. In addition, less than half of respondents indicated that they had access to mentoring or sponsorship (48%) and 59% said that they had access to career-advancing job assignments or development opportunities leading the researchers to conclude that for many, the 'opportunity structure' for advancement were absent.
- **Cultural issue for the sector?** Commenting on the negative experiences reported in the surveys, Professor Rae Cooper said: 'This is symptomatic of a broader workplace culture where women are disrespected and undervalued'. Dr Sarah Oxenbridge added that 'It's important that leaders in these firms establish 'tone from the top' in showing genuine commitment to improving gender diversity in the sector. But it's equally important that this commitment plays out in the actions and behaviours of direct managers'.
- **Lack of flexibility identified by respondents as a key barrier:** Participants identified the need for organisations to enable better work/life balance for parents working in investment management as the main barrier to women working in their occupation (52 of 116 women identified this as a critical issue). The report suggests that this points to the need for organisations to enable better work/life balance for parents. Dr Sarah Oxenbridge commented: 'Women in the sector are saying loud and clear that unequal treatment must stop. They need opportunities to advance and access to flexibility if they are to stay, and thrive, in these organisations'.

About the survey: Most of the survey participants were aged 35-54, held middle-ranking or senior roles, and had tenure in the investment management sector of more than 11 years. Almost two-thirds had children, and shared their care with a partner or other person (22% provided the majority of care to children). Most respondents worked full-time hours as analysts or portfolio/investment managers, earned over $150,000 per year, were the main household earner, and worked in Sydney or Melbourne.

[Sources: University of Sydney press release 28/08/2018; [registration required] The AFR 27/08/2018; Non-traditional investors? The work and career experience of Australian women working in investment management]

Remuneration

UK shareholders 'show their teeth': Significant shareholder revolts at FTSE firms jumped by over 25% in the year to 31 July, according to research by the Investment Association.

Analysis by the UK Investment Association (IA) (which represents the UK's asset management industry) into voting trends during the UK 2018 AGM season has found that shareholder 'rebellions' over FTSE 100 pay increased significantly this AGM season and also that opposition to director reelection increased.

Key Points

- **120 FTSE All-Share companies were added to the Public Register** (the public register tracks significant (over 20%) shareholder dissent), up to the end of July 2018, compared to 110 companies over the same period in 2017. In total, 237 individual resolutions were added to the Public Register in 2018, a jump of 25% from 2017. IA adds that in 2018, 29 'repeat offenders' appeared on the Public Register for the exact same resolution as last year (35 resolutions in total).
- **There was a sharp rise in objections to FTSE 100 pay in 2018:** 18 pay resolutions attracted over 20% shareholder dissent among FTSE 100 companies, double the number (9) in 2017. This resulted in the near doubling of FTSE 100 companies on the Public Register because of pay, up from 8 in 2017 to 15 in 2018 (88%).
- **Opposition to individual director re-election also increased.** The number of total resolutions more than doubling from 38 in 2017 to 80 in 2018. This rise was most marked in the FTSE 250, where rebellions more than doubled (106%) with 37 resolutions in 2018 compared to just 18 in 2017.

Commenting on the findings IA CEO Chris Cummings said:

- **'Shareholders have shown their teeth this year over FTSE 250 director re-election'.** Mr Cummings said that shareholders are 'using their votes to hold individual directors to account for decisions they made on issues such as executive pay and board diversity, as well as concerns that individual directors do not have the bandwidth to fulfil their roles as they spread themselves too thinly on too many boards'.
- **Number of 'repeat offenders' is 'disappointing'**: 'Shareholders clearly remain unimpressed with the approach to pay last year, and are frustrated the message is not getting through to some boardrooms. FTSE 100 companies must do more to ensure the pay packets of their top team align with company performance and remain at levels that shareholders find acceptable'.
- **The IA Public register is 'driving change and accountability'**: 'Now in its second year, the IA's Public Register is already driving change and accountability. Nearly two thirds (65%) of companies on the register in 2018 made a public statement at the time of their AGM, acknowledging the significant shareholder dissent and outlining how they plan to engage with shareholders, compared to only half (51%) last year. Shareholders now need to see companies acting on their pledges to deal with investor concerns or risk facing another backlash next year.'

[Sources: UK Investment Association media release 29/08/2018; BBC 29/08/2018]

United Kingdom | Shareholder revolt at Royal Mail: 70% of Royal Mail shareholders have reportedly rejected the company's remuneration report over new CEO's increased pay.

The Independent reports that 70% of Royal Mail shareholders, in line with recommendations from ISS and Glass Lewis, have rejected the organisation's remuneration report. The primary reason was reportedly new CEO Rico Back's pay. Reportedly Mr Back will receive £100,000 more per year than his predecessor Moya Greene, and also a £900,000 'golden parachute payment' though Royal Mail has reportedly said that his total fixed pay will be around the same as he will receive £88,000 less in pension contributions.

The Independent quotes a Royal Mail spokesperson as saying that the company will continue to engage with shareholders on the issue. The spokesperson also expressed disappointment at the result: 'We have worked hard since becoming a public company to take a highly responsible approach to executive pay and have enjoyed strong support from our shareholders on all remuneration matters until this vote'.

The Independent writes that MPs have written to the Royal Mail board requesting further explanation for the decision on Mr Back's pay. Rachel Reeves, chair of the Business, Energy and Industrial Strategy Committee (which is currently conducting an inquiry into executive pay) said: 'Grudgingly admitting to a failure of communication goes little way to justifying these pay arrangements. Executive pay needs to be fair and it should reflect the views of its shareholders.' Ms Reeves went on to say that it 'seems incredible that the [remuneration committee' chair would sign off on such a pay deal' given there are 'ever louder criticisms of hikes in executive pay'.

[Sources: The Independent 20/07/2018; 26/07/2018]

The AFR reports that newly listed fund manager Evans Dixon has paid 36% of underlying earnings in its first year to its top executives and board ($18.1m).

The AFR reports that Evans Dixon has paid 36% of underlying earnings in its first year to its top executives and board ($18.1m). Reportedly, $14 million of this, went to the business' founders, who hold shares worth $130 million. On top of their salaries, Evans and Dixon have signed on to a set $1.3 million bonus per annum paid to 2021. The AFR notes that before the IPO, the two founders each received $5.1 million for having signed non-compete agreements.

[Source: [registration required] The AFR 29/08/2018]

Shareholder Activism

In Brief | The BBC reports that under pressure from activist board member Nelson Peltz to attract millennial shoppers, Procter & Gamble has reportedly applied to trademark various digital acronyms including LOL, NBD and WTF with a view to using them for future marketing purposes.

[Sources: BBC 24/08/2018; The Guardian 25/08/2018]

Other Shareholder News

Corporate Governance with 'Chinese Characteristics': A new report from the Asian Corporate Governance Association gives an overview of corporate governance in China, including the findings of research into the differing perceptions of Chinese corporate governance from the perspective of China listed companies vs foreign institutional investors.

The Asian Corporate Governance Association (ACGA) recently released a report into corporate governance in China: *Awakening Governance: The evolution of corporate governance in China.* Published in English and Chinese, the 250 page report, describes in detail the history, nature and 'current trajectory' of Chinese corporate governance and is intended to explain, ACGA writes 'China's unique system of corporate governance (CG) to foreign investors and the relevance of emerging global CG best practices to China-listed companies and domestic institutional investors'.

In addition, the report summarises the findings of research conducted with foreign institutional investors and with China listed companies, into perceptions of corporate governance in China.

Corporate Governance (CG) with Chinese characteristics

The report describes features of the corporate governance system in China including corporate leadership structures (the role of Party Committees, boards of directors, supervisory boards, independent directors and audit committees) as well as the similarities and differences between state owned enterprises (SOEs) and privately owned enterprises (POEs).

Corporate leadership structures — Party Committees: Among other things, the report describes the role of 'party committees' also called 'party organisations' (which represent the Chinese Communist Party) within both state owned enterprises and increasingly in the private sector. The report explains that the Party Committee plays a leadership role in an enterprise, meeting on a regulator basis before the board of directors meets and discusses/approves major decisions.

The role of 'party committees' is identified in the report as 'one of the least understood aspects of corporate governance in China' with many foreign institutional investors (76%) indicating that they are either unclear or somewhat unclear on their role. The report adds that the role of party committees has also strengthened in recent years.

Commenting on this aspect of the report, Glass Lewis notes that party 'committees can influence boards of directors and/or supervisors and have greater access and are able to influence boards, more so than foreign shareholders or ”H-shareholders”'.

Research into perceptions of corporate governance in China: Chinese listed company perceptions vs foreign institutional investor perceptions

The report summarises the results of two surveys carried out by ACGA in Q3 2017, assessing the perceptions of respondents (foreign institutional investors and separately, China-listed companies) towards corporate governance in China.

Overall findings

- **Overall, both foreign institutional investors and Chinese company respondents were positive** about the investment potential of mainland China's A share capital market over the next 10 years.
- **Only 10% of foreign institutional investors said that they understand corporate governance in China**, with the vast majority admitting that they did not understand governance or only 'somewhat understand it'. The report recommends that foreign institutional investors spend more time 'on the ground in China' and invest in studying China's corporate governance system to develop a more 'nuanced' understanding of the opportunities and risks.
- **Significant communication gaps**: According to the report there are significant gaps in communication and understanding between foreign institutional investors and China listed companies.

Challenges for foreign institutional investors

Broadly speaking, challenges for foreign institutional investors identified in the report include:

- lack of understanding of the companies in which they invest; and
- difficulties in engagement with Chinese companies.

According to the survey, respondents gave a range of answers as to why the process of engagement was difficult and successful outcomes limited. These include the following.

- **Access to decision makers is sometimes difficult:** Access was identified as an issue with many companies stating that they can find it difficult to meet the right senior-level person.
- **Corporate Governance is viewed as 'compliance' by China-listed companies:** Foreign institutional investors indicated that they frequently found that China-listed companies view corporate governance as 'merely a compliance exercise' with some refusing to give 'detailed answers beyond the party line'.
- **Lack of responsiveness to shareholder suggestions:** The report quotes one investor as stating that there is a 'lack of responsiveness' to outside shareholder suggestions, adding that state owned enterprises 'wait for government to give the direction, not investors'.
- **There can be a significant gap in the awareness of CG and ESG principles.**
- **Language and communication difficulties:** The report also identifies lack of language skills as well as other communication difficulties noting that the communication problems are 'sometimes cultural' with foreign institutional investors feeling unable to clearly discern 'hidden messages'.

The report suggests the lack of an 'investor stewardship code' may also be a barrier to engagement.

Challenges for China listed companies

According to the report only 27% of respondents from China-listed companies believed there is a close correlation between good corporate governance and company performance and the majority (72%) believed that there was no correlation between strong governance and the ability of a company to list.

Ultimately, the report argues that China appears at a 'new turning point' in terms of corporate governance and that attitudes to the importance of corporate governance eg ESG issues are changing.

[Sources: ACGA media release 24/07/2018; 24/07/2018; Awakening Governance: The evolution of corporate governance in China [English]; Glass Lewis blog 20/08/2018; Glass Lewis blog 24/07/2018]

Related News: 5G ban on Chinese telecommunications companies?

On 23 August then Treasurer Scott Morrison and then Senator Mitch Fifield issued a media release announcing the government's decision to exclude certain companies from the 5G tender process. The announcement states that companies 'likely to be subject to extrajudicial directions from a foreign government that conflict with Australian law' would be excluded on the basis that these carriers may fail to 'adequately protect a 5G network from unauthorised access or interference'.

Reportedly Chinese carriers Huawei and ZTE were both notified by government that they had been excluded from the process subsequently. The decision has received wide media coverage both in Australia and reportedly in China, with a number of reports noting that the US is considering restrictions on Chinese carriers.

A question of security? Writing in The FT, Danielle Cave and Tom Uren (International Cyber Policy Centre, Australian Strategic Policy Institute) argue that the government's decision was motivated by 'several compelling and overlapping cyber and national security concerns that forced the Australian government's hand' including recent (alleged) instances of cyber espionage and intellectual property theft in Australia and elsewhere.

They go on to argue that in addition to the 'Communist party's tightening grip on its technology companies and the vulnerability of telecoms systems to subversion for espionage purposes,' China's 2017 Intelligence Law is problematic for the expansion of Chinese companies generally. The law states that 'Organisations and citizens shall, in accordance with the law, support, co-operate with, and collaborate in national intelligence work and guard the secrecy of national intelligence work they are aware of'. The writers argue that this is 'bad news' for the international expansion ambitions of China's companies as 'when weighing up the involvement of foreign companies in critical infrastructure projects, how can policymakers put forward credible arguments in support of companies whose international behaviour is bound by their domestic security laws?'

The writers suggest that in the long term, the Chinese Communist Party may have to 'make a tough call about how it sees its citizens and organisations. Which is more important — that they participate in espionage or participate in and benefit from the global economy? As Huawei's demise in Australia has shown, you can't have your cake and eat it too'.

Xenophobia was also a factor? The ABC reports that Huawei Australia Chair John Lord has suggested xenophobia was a factor in the government's decision. According to the report, Mr Lord rejected the suggestion that the government's announcement implies that Huawai is potentially 'an arm of the Chinese Government and its intelligence agencies'. 'I hope the Government didn't mean that. The Australian board of three independent directors and 700 employees would refute that and be quite upset by such an allegation, if that was made,' Mr Lord said adding that Chinese regulations do not cover Huawei's operations in Australia. 'we only obey and only listen to Australian laws' he is quoted as stating.

The AFR reports that the Chinese media reports have also suggested xenophobia is a motivating factor in the decision.

[Sources: Ministers for Commissions and the Arts Senator Mitch Fifield 23/08/2018; ITNews 23/08/2018; 24/08/2018; [registration required] The FT 30/08/2018; [registration required] The Australian 29/08/2018; Bloomberg 23/08/2018; The Mandarin 23/08/2018; The Guardian 27/08/2018; The SMH 28/08/2018; The ABC 29/08/2018; [registration required] The AFR 28/08/2018]

Disclosure and Reporting

ASIC action to enforce compliance with requirements around the use of restricted terms: ASIC has publicly named a financial advice firm for failing to comply with their obligations under s923A of the Corporations Act.

The Australian Securities and Investments Commission (ASIC) has required Morgan Stanley Wealth Management Australia Pty Ltd (MSWMA) to amend a claim, made in an ASX announcement released by Praemium Limited on 5 June 2018, that its services included an independent advice offering on the basis that it could 'mislead consumers and investors'.

MSWMA accepts volume-based payments and commissions from product issuers in relation to the provision of financial services and advice. However, under s923A of the *Corporations Act 2001 (Cth)* ASIC writes, a person who carries on a financial services business or provides a financial service is prohibited from using a number of restricted terms including the term 'independent', except where the person does not receive commissions, volume-based payments or other gifts or benefits, and operates without any conflicts of interest.

ASIC states that MSWMA arranged for a clarifying statement to be published by Praemium Limited in an ASX announcement on 5 July 2018 and that MSWMA has also taken steps to update their marketing approval process and arrange staff training regarding appropriate descriptions of their products and services.

ASIC states that 'ensuring transparency and accuracy in disclosure are important components of ASIC's ongoing work to improve standards in the financial advice industry' and that 'ASIC will continue to publicly name advice firms who do not comply with their obligations under s923A of the Act and take action to enforce the obligations, where appropriate, so that consumers can confidently rely on statements or claims made about independence'.

[Sources: 18-247MR ASIC requires Morgan Stanley Wealth Management Australia to amend false claim of independence; Independent Financial Adviser 27/08/2018; Financial Standard 28/08/2018]

United States | Transamerica have agreed to pay $97.6 million in penalties and disgorgement to settle SEC allegations of misconduct related to faulty investment models/disclosure of the errors in those models.

The US Securities and Exchange Commission (SEC) has announced that four Transamerica Corp related businesses have been ordered to pay $97.6 million in penalties and disgorgement to retail investors for (alleged) misconduct related to faulty investment models. More particularly, SEC alleges that:

- The businesses made claims that investment decisions would be based on AEGON USA Investment Management LLC (AUIM) quantitative models, when they were developed 'solely' by 'an inexperienced, junior AUIM analyst, contained numerous errors, and did not work as promised'.
- When the businesses learned about the errors, they ceased using the models but did not tell investors or disclose the errors.

Separately, SEC also alleged that two former AUIM executives caused certain violations eg did not take reasonable steps to make sure the mutual funds' models worked as intended and contributed to AUIM's compliance failings related to the development and use of models. SEC writes that the two executives agreed to settle the SEC charges without admitting or denying the findings and pay respectively, $65,000 and $25,000 in penalties that also will be distributed to affected investors.

Co-Chief of the SEC Enforcement Division's Asset Management Unit said: 'Investors were repeatedly misled about the quantitative models being used to manage their investments, which subjected them to significant hidden risks and deprived them of the ability to make informed investment decisions'.

Settlement details: Without admitting or denying the SEC's findings, the four Transamerica entities agreed to settle the SEC's charges and pay nearly $53.3 million in disgorgement, $8 million in interest, and a $36.3 million penalty. The entities will also create and administer a fair fund to distribute the entire $97.6 million to affected investors.

[Sources: SEC media release 27/08/2018; Investment News 27/08/2018]

Markets and Exchanges

In Brief | SEC has announced further delays to the implementation of the Consolidated Audit Trail (CAT). The project is now expected to be rolled out in phases starting in November and ending in November 2021 (the project was due to be completed by November 2019). SEC has requested that stock and options exchanges to work together with industry members to complete the trading data base as 'promptly as practicable'.

[Sources: SEC public statement 27/08/2018; Reuters 28/08/2018]

Short and Long-Termism

In Brief | Move to 6 monthly reporting as opposed to quarterly reporting? The WSJ reports that President Trump has asked SEC to investigate moving to 6 monthly as opposed to quarterly reporting. According to The WSJ, investors and executives are divided on the possible move with some firms arguing the move would facilitate a longer-term focus and some investors concerned that it would result in less transparency.

[Source: [registration required] The WSJ 17/08/2018]

Regulators

Australian Prudential Regulation Authority (APRA)

APRA 2018-2022 Corporate Plan: broadening risk-based supervision and improving data-enabled decision making among the regulator's six strategic objectives.

The Australian Prudential Regulation Authority (APRA) released its 2018-2022 Corporate Plan on 24 August.

Approach to regulation: APRA states that its 'aim is to identify likely failure of an APRA-regulated institution early enough so that corrective action can be promptly initiated or orderly exit can be achieved' rather than pursuing a 'zero failure regime'. In other words, APRA seeks to maintain a 'low incidence of failure of APRA-regulated institutions while not impeding continued improvement in efficiency or hindering competition in the financial system.'

[Note: This appears to be consistent with recent statements by APRA at the Financial Services Royal Commission round 6 hearings. See: Governance News 27/08/2018.]

Strategic priorities

The plan includes six strategic priorities:

1. **Broaden risk-based supervision** through initiatives to: enhance APRA's ability to identify and respond to emerging risks; modernise APRA's supervision framework; and optimise the use of internal and external skills.
2. **Improve data-enabled decision making** through initiatives to: articulate a well understood data strategy and deliver the required infrastructure through Program Athena (APRA's strategic data transformation initiatives to build the platform and infrastructure required to modernise the way the regulator collects, stores and accesses data.)
3. **Build resolution capability to protect 'beneficiary interests by planning for an implementing prompt and effective responses to a failure or crisis in the financial system'** through initiatives to: build a strong prudential framework for managing failure; ensure internal readiness to respond to a crisis (resolve failure or near failure including the administration of the Financial Claims Scheme); and promotion of industry preparedness for a crisis.
4. **Strengthen external engagement and collaboration** through initiatives to: expand communication activity to promote improved prudential outcomes and demonstrate accountability and the adoption of a 'whole of system' mindset to collaboration with peer agencies. 'APRA will identify and manage

the approach, mechanisms, and relationships required for peer agency collaboration on a broader range of risks'.

5. **Enhance leadership, people and culture** within the regulator through initiatives to build strong and inclusive leadership, articulate and foster APRA's desired culture and improve APRA employee experience.
6. **Lift organisational capability** through initiatives to improve APRA's ability to manage organisational change, improve risk and performance management, measurement and reporting, create a dynamic, flexible and collaborate operating model and development of an innovation strategy.

Key risks to APRA's ability to achieve its mandate: A reduction in ability to execute strategy due to unanticipated priorities driven by external events; reputational risk; and failure to identify or respond appropriately to new or material risks in an individual institution or the financial system were the top three risks APRA identified to achieving its mandate.

[Source: APRA's 2018-2022 Corporate Plan]

Australian Securities and Investment Commission (ASIC)

Top Story | ASIC report on corporate finance regulation H1 2018: Disclosure, including disclosure of climate risk among the areas of focus for the regulator over the next six months.

Overview of *Report 589 ASIC regulation of corporate finance: January to June 2018*

Key Takeouts

1. **Climate Risk:** Despite regulatory uncertainty, disclosure of climate risk was highlighted as an area of focus for ASIC over the next six months. The regulator flagging (among other things) that a review of relevant regulatory guidance will be published by the end of the year and reiterating that the review of a climate risk disclosure across the ASX 300 is underway with the findings to be released later in 2018.
2. **'Boilerplate' disclosure remains an area of concern**. ASIC writes that corporate governance statements 'can be unhelpful and, in some cases, meaningless – entities often only disclose the existence of corporate governance policies rather than how the entity implements those policies in practice'.
3. **Financial Services Royal Commission - disclosure of potential impact to investors:** ASIC states if a financial services company raises funds through an IPO over the coming period, ASIC considers that 'investors should be given candid information about how the business may be affected by the issues being raised' at the Financial Services Royal Commission which may include: 'relevant historical and current interaction with regulators and possible outcomes, and the specific regulatory risks that the business may encounter including risks relating to the treatment of consumers'.
4. **Constructive engagement with proxy advisers:** ASIC reiterates that it expects firms to proactively engage with proxy firms outside peak periods.

On 31 August the Australian Securities and Investments Commission (ASIC) released: *Report 589 ASIC regulation of corporate finance: January to June 2018*. The report provides statistical data and includes guidance about ASIC's regulation of: fundraising transactions; experts; mergers and acquisitions; and corporate governance issues. It also outlines ASIC's key observations for the reporting period and identifies ASIC's areas of focus for the next six months.

[Note: For an overview of ASIC's previous report: *Report 567 ASIC Regulation of Corporate Finance: July to December 2017* for purposes of comparison, see: Governance News 02/03/2018.]

Corporate Governance

- **Establishment of the Corporate Governance Taskforce:** Referencing the government's 8 August announcement of an additional $70.1m in additional funding (see: Governance News 13/08/2018), ASIC reiterated that that the funding will be used to expand its enforcement and supervisory work, including through the creation of a new corporate governance taskforce to 'identify and pursue failings in large listed companies'. ASIC states that various teams across ASIC will contribute the taskforce and that it looks forward to providing updates on the initiatives. No timeframe or further detail was provided.

- **Disclosure of actual corporate governance practices – 'boilerplate' disclosure remains a concern:** ASIC writes that the Financial Services Royal Commission has 'uncovered serious corporate governance failures within financial services entities' and that in this context, it is concerned that disclosures in entities' corporate governance statements 'can be unhelpful and, in some cases, meaningless – entities often only disclose the existence of corporate governance policies rather than how the entity implements those policies in practice'. ASIC states that entities should focus on 'how effective those policies are at ensuring entities engage in good corporate governance practices in the context of their operations'. ASIC notes that in its recent submission to the ASX Corporate Governance Council on the proposed fourth edition to the ASX Corporate Governance Principles and Practices, it proposed an alternate disclosure model aimed at addressing these issues (see: Governance News 13/08/2018.)
- **Climate Risk:** While acknowledging 'a level of uncertainty' due to the difficulties of anticipating regulatory response to climate risk, ASIC notes that companies have a statutory obligation to disclose material business risks (s299A *Corporations Act 2001 (Cth))* and encourages directors to consider the recommendations of the Task Force on Climate Related Financial Disclosures (TCFD). ASIC adds that over the next six months it plans to:
  - **Finalise a review of relevant regulatory guidance** to ensure that it continues to provide appropriate principles and high level guidance that stakeholders can apply in meeting their climate disclosure obligations by late 2018.
  - **Focus on impairment testing and asset values** in upcoming review of 30 June 2018 financial reports.
  - **A review of climate risk disclosure across the ASX300 is underway.** The purpose is to better understand current market practices. The findings will be released later in the year.
- **Proxy adviser practices:** The report reiterates that ASIC's expectation is that proxy advisers and companies constructively engage with each other as set out in *Report 578: ASIC Review of proxy adviser engagement practices* (see: Governance News 02/07/2018 date). In particular, ASIC states that when engaging with proxy advisers companies should: seek out information about the engagement practices of proxy advisors and engage proactively with them outside peak periods; release their notices of meeting to the market as early as possible; and ensure that the disclosure in those notices is 'clear concise and effective'.
- **Enforcement action against directors:** ASIC states that consistent with statements in *Report 568: ASIC enforcement outcomes: July to December* (see: Governance News 02/03/2018), ASIC has continued to focus on the conduct of gatekeepers including directors and auditors. The report highlights two examples of enforcement actions against directors: bringing proceedings in Federal Court against Rio Tinto Ltd, its former CEO and former CFO in relation to alleged misleading or deceptive statement in the company's annual report (see: Governance News 07/05/2018); and bringing civil proceedings against the former managing director of Quintis Ltd for (alleged) failure to discharge his duties as a director under *s180 Corporations Act 2001 (Cth)* (see: Governance News 18/06/2018).

Fundraising

In relation to fundraising ASIC reports that in the period:

- There were 229 original disclosure documents lodged with ASIC, seeking to raise approximately $6.7bn. This compares to 329 original disclosure documents last period seeking to raise $5bn. ASIC comments that fundraising by banks for regulatory capital purposes continue to 'dominate corporate finance'.
- ASIC intervention in fundraising: ASIC states the there were significantly more interim stop order than in the last period: 10.5% as compared with 1.8% during the July to December 2017 period.

- ASIC raised concerns with 19% of prospectuses. The top five most frequent disclosure concerns ASIC raised about prospectuses were:

    1. Business model not fully or adequately disclosed (raised 28 times). This was also ranked as the top concern (with risk disclosure) in the last report, though it only raised 14 times in that period.
    2. Use of funds – unclear of insufficient detail (raised 20 times).
    3. Misleading or deceptive disclosure – misleading or unclear statement (raised 18 times)
    4. Risk disclosure inadequate or insufficiently prominent or not tailored (raised 15 times). In the previous report, this issue was ranked equal first among the most frequent disclosure concerns, and was raised 14 times.
    5. Capital structure or substantial holdings not adequately disclosed (10 times).

- **Areas of focus - Leaked investor reports:** ASIC states that over the next six months it will continue to focus on the promotion of IPOS and more particularly on information about IPOS that appears outside formal disclosure documents. Noting the findings of Report 540: investors in initial public offerings, ASIC states that retail investors can be heavily influenced by this type of information and that notes that the law 'significantly restricts the promotion of IPOS outside the prospectus'. ASIC states that in its experience compliance with s734 'can be poor' eg for smaller IPOs ASIC has found some promotional material is misleading and for larger IPOs there is 'often a problem' with the media citing detail from investor education reports.
- **Royal Commission and IPOs – disclosure of potential impact to investors:** ASIC states that the possible implications of the Royal Commission should be 'carefully considered' for financial service business seeking to list. The report highlights the issues raised in recent speeches by ASIC Deputy Chair Peter Kell (see: Governance News 23/07/2018) and ASIC Chair James Shipton (see: Governance News 30/07/2018) as relevant in this regard. The report goes on to say that if a financial services company raises funds through an IPO over the coming period, ASIC considers that 'investors should be given candid information about how the business may be affected by the issues being raised' which may include: 'relevant historical and current interaction with regulators and possible outcomes, and the specific regulatory risks that the business may encounter including risks relating to the treatment of consumers'.
- **Pre-commitment by institutional investors:** ASIC states that retail investors may interpret statements about a large pre-commitment by institutional investors as a sign the IPO is a good investment and follow suit on this basis and notes that there is a risk, that these statements could be misleading and/or cause issues for market integrity.
- **Omission of comparative half year information:** ASIC notes that 'on rare occasions' it has permitted companies to omit comparative information where it was either difficult to compile in the circumstances or not material and gives examples of these circumstances.
- **Initial Coin Offerings/Cryptocurrency:** ASIC states that over the last six months, a number of ICOs have been withdrawn or significantly modified due to ASIC action in relation to misleading or licensed conduct. ASIC states that if advising on an ICO, the 'legal character of the coin or token being offered' and Australian Financial Services licensing requirements should be considered. In addition, ASIC notes that regardless of whether the coin or token offered is a financial product, any promotional material must not be misleading.
- **Issues relating to Chinese Company Seals or chops:** Each company incorporated in the People's Republic of China (PRC) is required to have a Company Official Chop which is registered with the public security bureau. The chop represents the company towards third parties and is binding even without a signature. ASIC notes that 'Poor controls can result in very adverse consequences' and adds that it will look for disclosure about what chops a PRC company has and how their security is managed. In addition, ASIC notes that the prospectus should explain the procedure for the use of the chops and whether logbooks are kept to record transactions and whether the chops are stored with third party custodians ('reputable accountants or lawyers').

Experts

- **The Independence of experts will be an area of focus for ASIC over the next six months** including geologists and technical specialists due to recent problems highlighted in the area. When considering the independence of an expert, ASIC states entities should have regard to the considerations set out in *Regulatory Guide 112 Independence of Experts*.

Mergers and acquisitions

- **'Truth in takeovers':** ASIC states that 'truth in takeover' statements have become 'commonplace' in Australian takeovers with statements by bidders and target holders the most frequent. Over the last six months, ASIC states that it has intervened on numerous 'truth in takeovers' statements by market participants and sets out the steps that should be taken when making truth in takeovers statements. ASIC adds that it intendsto review Regulatory Guide 25, due to the frequent reliance on the policy and market practices that have emerged since the guidance was published in 2002. ASIC will consider how the guide could be updated to provide greater certainty to the market about the application and enforceability of 'truth in takeovers' policy.
- **Commenting on target value:** ASIC states that it has been 'concerned' by the approach of some bidders when commenting on expert reports of the value of target securities and writes that bidders need to 'take care' when commenting on the value of target securities, including when challenging an expert's valuation of a target.
- **Other issues:** Other issues highlighted in the report include: bid conditions, the need to approach ASIC when changing terms during the scheme meeting and disclosure of relevant agreements relating to a substantial holding among others.

[Source: 18-251MR ASIC reports on corporate finance regulation – January to June 2018]

Australian Competition and Consumer Commission (ACCC)

Changes needed to business-to-business unfair contract term law according to ACCC Chair Rod Sims.

In a speech to the Council of Small Business Organisations Australia's (COSBOA) Small Business Summit Australian Competition and Consumer Commission (ACCC) Chair Rod Sims has outlined the limitations that the ACCC has identified in the business-to-business unfair contract terms (UCT) law (and the industry codes of conduct) and the changes the regulator would like to see made.

ACCC approach to enforcement

- **Focus on systemic issues**: Mr Sims said that the ACCC's enforcement model 'does not seek to address every matter that comes to our attention, as we do not have the resources to do so, but rather to identify important and systemic issues, make targeted strategic interventions, with a view to leveraging off these to drive broader compliance'.
- **Unfair contract terms provisions have been an area of focus over 2017**. This has led to a number of enforcement actions including three court proceedings which he described. Mr Sims commented that while these are 'positive outcomes, the existing unfair contract term model has some severe limitations that greatly reduce its effectiveness'.

Changes needed to business-to-business unfair contract term law

Noting that the Government has committed to commence a review of the unfair contract term law before the end of this year, ACCC Chair Rod Sims said that the ACCC would be 'making the case for significant strengthening of the law'. In particular, Mr Sims identified two 'fundamental' issues (among other limitations).

- **'Unfair contract terms are not illegal. They should be!'** Mr Sims said. Currently, the Australian Consumer Law (ACL) allows a potentially unfair contract term to be challenged in a court so it can be declared void but it does not prohibit such a term being included in a contract.

- **Limited powers:** The ACCC cannot seek civil pecuniary penalties when a term in a contract is declared unfair and void by the court, or issue infringement notices for contract terms that are likely to be unfair Mr Sims noted. 'By making unfair contract terms illegal, the ACCC would be able to seek pecuniary penalties and issue infringement notices'.

In addition, Mr Sims said that the current 'threshold' for determining whether a contract is a 'small business contract' sometimes excludes businesses that the regulator believes 'should be protected from unfair contract terms' eg motor dealers fall outside the current thresholds because of the high value of the products sold and perhaps also the number of employees. He added that currently there is little incentive to comply with industry codes of conduct.

The case for 'prohibition and penalties': Changes advocated by the ACCC

- **'Penalties and infringement notices should apply if unfair contract terms are included in standard form contracts.** Otherwise, no real incentive exists for businesses to ensure their standard contract do not contain such terms'.
- **Inconsistent with *Competition and Consumer Act 2010*:** 'Given unfair contract terms are not illegal or attract penalties, current unfair contract term laws are not in line with other provisions of the CCA.'
- **Civil pecuniary penalties (and thereby infringement notices)** be introduced for all breaches of all mandatory industry codes of conduct.
- **The amount of civil pecuniary penalties available under the *Competition and Consumer Act 2010 (Cth)* for a breach of a prescribed industry code be increased** to at least reflect the penalties currently available under the ACL.

[Source: ACCC speeches: Speech by ACCC Chair Rod Sims at the COSBOA National Small Business Summit, Major changes needed to get rid of unfair contract terms 31/08/2018]

Financial Services

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

Financial Services Royal Commission Round 6 Insurance Hearings: Schedule of topics and case studies released.

Round 6 of the Financial Services Royal Commission into Insurance will be commence on 10 September and run until 21 September.

The public hearings will consider the appropriateness of the current regulatory regime for the insurance industry. The hearings will also consider issues associated with:

- the sale and design of life insurance and general insurance products;
- the handling of claims under life insurance and general insurance policies; and
- the administration of life insurance by superannuation trustees.
- The hearings will also consider

Schedule of case studies and topics

As previously, the Commission will proceed by way of case studies including the natural disaster case studies that were originally to have been examined in Round 4.

Topic	Case Study
Life Insurance	▪ AMP ▪ ClearView

Topic	Case Study
	▪ CommInsure ▪ Freedom Insurance ▪ REST ▪ TAL
General Insurance	▪ AAI (Suncorp) ▪ Allianz ▪ IAG ▪ Youi
Regulatory Regime	▪ Code Governance Committee ▪ Financial Services Council ▪ Insurance Council of Australia

Four new background papers released:

- Background Paper 29: Life insurance (Enright, Mann, Merkin, Pynt, Traves)
- Background Paper 28: Group life insurance (Enright, Mann, Merkin, Pynt, Traves)
- Background Paper 27: Reforms to general and life insurance (Treasury)
- Background Paper 26: Some features of the general and life insurance industries (FSRC)

[Sources: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Round 6 hearings; Background Paper 26: Some features of the general and life insurance industries 28/08/2018; Background Paper 27: Reforms to general and life insurance 28/08/2018; Background Paper 28: Group life insurance 28/08/2018; Background Paper 29: Life insurance 28/08/2018]

Treasury background paper 27: Treasury has flagged plans to review product disclosure requirements for general insurers.

In a background paper released ahead of the upcoming Financial Services Royal Commission hearings into Insurance: *Background Paper 27: Forms to general and life insurance*, Treasury has (among other things) indicated that it will review product disclosure requirements for general insurers. 'Clear, concise and timely disclosure of relevant product information is crucial to consumers' ability to make well informed purchasing decisions on insurance products. In response to the Senate Economics References Committee's 2017 report into general insurance, the Government has tasked Treasury with reviewing product disclosure regimes for general insurance' Treasury writes.

As part of the review, Treasury writes that it will be considering the need to:

- 'enhance the transparency of general insurance pricing to require insurers to disclose the previous year's premium on renewal notices;
- amend the Corporations Act to provide component pricing of premiums to policyholders;
- initiate a review of current disclosure requirements for standard cover;
- enhance comparability of insurance products through standardising definitions for key terms; and
- review the effectiveness of the Key Facts Sheet (KFS) as a means of product disclosure in improving consumer understanding of home building and home contents policies, and the merit of extending the use of KFS to other forms of general insurance'.

[Sources: [registration required] The AFR 29/08/2018; Background Paper 27: Reforms to general and life insurance 28/08/2018]

Insurance

Top Story | ASIC's review into the sale of direct life insurance products has found that sales practices and product design are leading to poor consumer outcomes. The regulator has called on industry to improve, or face possible enforcement action.

Overview of the ASIC review into the sale of direct life insurance products: *Report 587: The sale of direct life insurance* and *ASIC Report 588 Consumers' experiences with the sale of direct life insurance*.

Introduction

The Australian Securities and Investment Commission (ASIC) has released the findings of its review into the sale of direct life insurance products in the form of two reports: *(ASIC) Report 587: The sale of direct life insurance* and *ASIC Report 588 Consumers' experiences with the sale of direct life insurance*. Ultimately, ASIC found that sales practices and product design are leading to poor consumer outcomes and has outlined its expectations of industry to improve.

About the review

- The purpose of the review was to explore whether, and how, the way direct life insurance products are designed and sold contributes to poor consumer outcomes.
- The review included term life, trauma, total and permanent disablement (TPD), income protection, and accidental death insurance. ASIC states that though it did not specifically look at consumer credit insurance (CCI) or funeral insurance, the findings and recommendations are also applicable to the direct sale of these products.
- The review covered 11 firms, including six insurers selling directly to consumers and three distributors selling on behalf of two insurers. They are CommInsure, ClearView Life Assurance, NobleOak Life, Suncorp Life & Superannuation, TAL Life, and OnePath Life (part of ANZ Banking Group), St Andrew's Life Insurance and its distributor Select AFSL, Hannover Life Re and its distributors Greenstone Financial Services and Auto & General Services.

Report 587: The sale of direct life insurance

Key Findings

- Consumers are cancelling their policies in very high numbers: One in five of all policies taken out were cancelled in the cooling off period in four of all policies that remained in force beyond the cooling off period were cancelled within 12 months Three in five of all policies sold were cancelled within three years.
- Life insurance sold direct compares poorly with other channels when it comes to claims: 15% of claims are declined, with 27% of claims withdrawn.
- ASIC identified a 'failure by all firms to provide adequate information about important aspects of the cover, including key exclusions and future premium increases'.
- Four firms were also found to engage in pressure selling techniques, including refusing to send out paperwork unless a consumer committed to buy.
- More than half the firms had incentive schemes which encourage sales staff to prioritise closing a sale ahead of the needs of the customer, including bonus payments heavily focused on value or volume of sales.
- Sales of accidental death insurance were identified as 'particularly problematic' with a claims ratio of only 16.1% over the 2015-17 financial years.

Areas of concern highlighted in the report

'Life insurance is a long-term product but cancellation rates and poor claim outcomes show that people are being sold products they don't want, can't afford, or don't perform as they expected,' ASIC Chair James Shipton said. More particularly, ASIC identified three areas of concern: consumer outcomes, product design and sales practices (training and scripts, quality assurance and incentives).

1. **Consumer Outcomes — outbound sales associated with ongoing conduct issues:** ASIC found that outcomes for consumers who buy direct life insurance are often poor and that 'firms engaged in sales conduct that is likely to lead to consumers buying a product they do not want or cannot afford, or that does not meet their needs'. Further the report draws a connection between sales conduct and poor consumer outcomes stating that there is a 'clear link between sales conduct and poor consumer outcomes'.

2. **Product Design:** ASIC found that some 'products or product features provided little value to consumers, while others were difficult to understand and therefore may not perform as expected'.

3. **Sales practices (Training and scripts, quality assurance and incentives):** The report found that training and scripts 'did not always set clear and professional standards for sales conduct' and that quality assurance frameworks were 'not always effectively designed to detect and address poor sales conduct'. In addition, the report found that 'conflicted incentive schemes were linked to inappropriate point-of-sale conduct' and that a review of sales culture had demonstrated that there 'can often be a disconnect between firms' ”target culture” and what happens in practice'. ASIC notes that changes being made in response to recent reforms (the Life Insurance Framework (LIF) reforms which came into force on 1 January 2018) should mitigate this risk and improve conduct.

ASIC Report 588 Consumers' experiences with the sale of direct life insurance

Report 588 summarises the findings of consumer research (including review by ASIC of more than 540 recorded sales calls) conducted as part of review. It found that consumers struggle with the direct life insurance sales experience and the complexity of the products and consumer understanding of key features is often poor.

ASIC's expectations of industry to address issues identified in the review

Review of the Life Insurance Code of Practice

The Life Insurance Code of Practice 'needs to set higher standards and raise professionalism across industry' ASIC writes. ASIC adds that it expects that the revised code will set 'rigorous standards' to address the findings in the report, including imposing additional requirements for providers to:

- provide adequate explanations of key exclusions and future cost;
- 'stop' (clearly define and prohibit) pressure selling;
- introduce a deferred sales model for downgrades (if a consumer is not eligible for a policy and the firm offers a downgraded option, they should provide a clear warning upfront about the product's extra restrictions or limitations. Firms should also provide the Product Disclosure Statement and schedule a call back at a later date, after a set number of days);
- stop using techniques that frame consumers' choices (firms must allow consumers to make their own choices about cover type and sum insured and must not engage in techniques that reduce informed decision making, such as bundling cover into a quote without seeking explicit consent from the consumer upfront);
- establish a clear target market for limited value products and only sell these products where there is genuine consumer need.

Cease selling accidental death insurance unless they can demonstrate value/meet 'genuine' consumer need

- Accidental death insurance was identified as 'particularly problematic' by the regulator on the basis that it is 'unlikely to meet consumer needs'. For this reason ASIC writes, 'Firms should cease selling this product except where they can demonstrate that it provides value and meets a genuine consumer need'.
- In addition, ASIC said that firms should also review other product features and not include them if they do not serve a clear purpose and offer value in terms of consumers managing risk'; strengthen protections for vulnerable consumers (eg set clearer expectations about how sales staff should behave when dealing with vulnerable consumers, including when it will be appropriate to end a call);

ensure that automatic cover increases do not exceed what the consumer can claim; implement training and quality assurance frameworks that establish standards, monitor sales conduct, and resolve poor consumer outcomes (implement frameworks that specifically test sales staff against the Code obligations).

Review of internal policies and procedures in light of the report findings: firms must take action to ensure they are meeting their licensing obligations

ASIC writes that it expects firms to review their internal policies and procedures against the report findings to ensure they are sufficient to meet AFS licence obligations, including obligations to: provide financial services efficiently, honestly and fairly; ensure that representatives are adequately trained and competent to provide financial services; ensure that representatives comply with financial services law; and have adequate arrangements in place for managing conflicts of interest.

Timeframe: 'We expect that firms selling direct life insurance will not wait for the Code to be updated but will review the findings and recommendations in this report and implement changes as required to improve consumer outcomes'.

Broader implications: While we did not cover sales of consumer credit insurance and funeral insurance as part of this review, consumers will be facing similar challenges when being sold those products. We expect firms selling consumer credit insurance, and in particular funeral insurance, to act on our findings and recommendations.

ASIC actions

- **Outbound sales:** ASIC states that it intends to restrict outbound sales calls for life and funeral insurance and is considering what regulatory tools it will use to implement this reform. 'In the meantime, the small number of firms who are still engaged in outbound sales will need to move away from this practice' ASIC writes.
- **ASIC will intervene if industry does not stop selling poor value accidental death insurance:** ASIC states that it will monitor consumer outcomes for accidental death insurance, including rates of cooling-off cancellations, short-term lapses, and claims outcomes and if there is no improvement, 'will use our current and/or proposed future powers, including product intervention powers, to intervene'.
- **Monitoring and possible intervention in the absence of improvement:** ASIC states that it will monitor outcomes, and if there is no improvement, 'consider what further regulatory interventions will be necessary, using the full range of our powers'.
- **Enforcement action already on foot:** ASIC states that remediation has already commenced:
  - Clearview has commenced refunding approximately $1.5 million to 16,000 consumers ASIC writes.
  - ASIC is 'reviewing what further remediation is required by other firms to address consumer harm': ASIC states that 'Any firms who have engaged in the inappropriate sales conduct identified in this report must review past sales of direct life insurance and remediate consumers appropriately. This includes any firms selling direct life insurance who were not subject to this review. We are assessing the conduct of individual firms to determine whether enforcement action is required'.
- **Follow-up work on LIF reforms and incentives:** As part of our 2021 review to test whether the LIF reforms have achieved their objective of improving the quality of advice, we will also assess whether a reduction in conflicted remuneration has led to better consumer outcomes in the direct life insurance channel.

ASIC Chair James Shipton commented: 'Aggressive selling practices and products that don't pay out when consumers expect undermine trust in the industry. However, selling direct life insurance can be done well and we have seen this where firms have moved away from riskier business models, such as outbound sales and reliance on products with broad exclusions.' Mr Shipton added that 'ASIC will use all of its regulatory tools to address failures in this market – including through enforcement action and policy reform. We have several investigations underway.'

The AFR reports that ASIC senior executive leader Michael Saadat said in an interview:

- **Cold calling and telemarketing to customers to sell them life insurance should stop:** 'We haven't landed on a concrete method for doing this… but we don't think there is a role for cold calling consumers' ASIC's senior executive leader Michael Saadat is quoted as saying.
- **Enforcement action expected: '**There absolutely will be enforcement action on the back of some of these [report] findings….We are investigating a number of firms that were in the review and not in the review.'

Industry response to the review

- TAL CEO Brett Clark reportedly welcomed the release of ASIC's findings and has said that the his firm no longer sell accidental death insurance as a standalone product. The AFR quotes Mr Clark as stating: 'Outbound sales represent one channel in our direct life insurance business, and we intend to engage further with ASIC to understand their recommendations in more detail…We are committed to continually improving our business for our customers in line with and to exceed community expectations.'
- ClearView Wealth CEO Simon Swanson has reportedly called on the industry to 'collectively implement' change to improve customer outcomes.
- Freedom Insurance has reportedly said it would 'evaluate any actions' it may take to ensure sales practices and product design aligned with regulatory and community standards.

[Sources: 18-250MR ASIC's review of direct life insurance finds high cancellation rates and poor claims outcomes; REP 587 The sale of direct life insurance; REP 588 Consumers' experiences with the sale of direct life insurance; ABC 30/08/2018; [registration required] The AFR 30/08/2018]

APRA has released guidance for general insurers to complete reporting. Among other things, APRA provides guidelines for explaining data, noting that 'APRA will not accept an entity's explanation of data that is insufficient, inaccurate or incomplete'.

[Source: APRA media release: Information to assist general insurers to complete reporting forms 31/08/2018]

Superannuation

In Brief | Superannuation reforms: The AFR reports that a Bill that would have mandated new independent director requirements for superannuation boards has been abandoned by the Government for lack of support, but that the passage of the Protecting your Super Bill looks certain following the revelations at the Financial Services Royal Commission.

[Sources: [registration required] The AFR 28/08/2018; 28/08/2018; Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017; Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018]

In Brief | APRA has released quarterly superannuation performance statistics and quarterly MySuper statistics for June 2018: As at 30 June 2018, superannuation assets totalled $2.7 trillion (an increase of 7.9% from $2.5 trillion in June 2017). Total assets in MySuper products totalled $675.6 billion at the end of the June 2018 quarter (an increase of 13.6% from June 2017). There were $34.1bn of contributions in the June 2018 quarter, down 16.7% from the June 2017 quarter ($40.9bn). Total contributions for the year ending June 2018 were $109.4bn.

[Sources: APRA Quarterly MySuper Statistics 28/08/2018; Quarterly Superannuation Performance Statistics 28/08/2018; [registration required] The Australian 28/08/2018]

Other Developments

No more volume based commissions for mortgage brokers: The Combined Industry Forum has released an interim report on progress towards implementing reforms of remuneration and governance practices across the mortgage broking industry.

The Combined Industry Forum (which consists of representatives from banks, customer owned lenders, aggregators and brokers, consumer groups, and industry associations) has released an interim report on progress towards the implementation reforms developed to: 'ensure better customer outcomes, preserve and promote competition and customer choice, and improve standards of conduct and culture in mortgage broking'. The reforms take into account, CIF writes, both the findings of ASIC's 2016 Review of Mortgage Broker Remuneration and also the third-party recommendations of the Australian Banking Association's 2016/17 Retail Banking Remuneration Review (Sedgwick Review).

Key Points

The report provides an update on progress towards the achievement of specific reforms including the following (among others).

- **The mortgage broking industry has ended the use of volume-based bonus commissions**, campaign-based commissions, and other volume-based bonus payments.
- **Development of a mortgage-broking industry code is in progress** and the report notes that the development of the code will follow the processes that would support an application for ASIC approval.
- **The CIF is currently considering how it can incorporate a 'conflicts priority rule' to be known as a 'Customer First Duty'.** This duty is still under development by the CIF, but the intention is for it to be based on the principle of 'putting the customer's interests first and matching the needs of the consumer with the right home loan product and lender'.
- **The report states that industry is currently 'moving away from soft dollar benefits':** In recognition of the fact that the provision of 'high value' entertainment/hospitality (among other 'soft benefits' could raise the risk of 'lender choice conflicts' the report states, by the end of 2018 lenders will not 'provide entertainment or hospitality to mortgage brokers which goes above the amount

Timeline for completion: The CIF states that it is 'committed' to keeping Treasury and Regulators information about progress in responding to ASIC Report 516: *Review of Mortgage broker remuneration*. More particularly, the report states that CIF has committed to the following timeline for implementing ASIC's proposals.

ASIC proposal	(Proposed) implementation
Changes to the standard commission model	End of 2018
Moving away from soft dollar benefits	End of 2018
Clearer disclosure of ownership structures	End of 2018
Establishing a new reporting regime	End of 2018
Improved governance and oversight of brokers	End of 2020
Move away from bonus commissions and bonus payments	End of 2017

CIF states that it intends that a Mortgage Broking Industry Code is in place by the end of 2018.

Next steps: The next progress report will be released in December 2018.

[Sources: ABA media release 28/08/2018; Combined industry forum progress report: Working towards a better mortgage broking industry for customers July 2018; [registration required] The Australian 28/08/2018]

Consumer credit | ASIC review has found that reverse mortgages are allowing older Australians to achieve their immediate financial goals, but that 'lenders can do more to improve long-term customer incomes': Report 586 Review of Reverse Mortgage Lending in Australia released.

The Australian Securities and Investments Commission (ASIC) has released a review of reverse mortgage lending in Australia: *REP 586 Review of reverse mortgage lending in Australia* which summarises the findings and recommendations from ASIC's review of lending practices for reverse mortgages. Overall, ASIC found that reverse mortgages are 'playing this role, but that lenders can do more to improve long-term consumer outcomes and help potential borrowers make informed decisions about their immediate and future financial needs'.

Key Findings

- **Reverse mortgages helped older Australians achieve their immediate financial objectives:** Each of the 30 borrowers in the research sample indicated that their reverse mortgage enabled them to achieve their original objectives for the loan eg the loan enabled borrowers to: maintain their current living arrangements ('age in place') with less financial stress, obtain short term finance, have a general safety net for living expenses or afford a better quality of life.
- **The 'enhanced consumer protections' have eliminated the risk of negative equity**: The no negative equity guarantee (NNEG) was introduced to protect borrowers form the risk of eventually owing more on their loan than they could recover from selling the secured property. ASIC found that 'the intended objectives of the NNEG have been achieved'.
- **Borrowers often had a poor understanding of the risks and costs of their loan:** ASIC found that despite the introduction of the NNEG, borrowers still face a risk of being left with insufficient equity in their homes to pay for their future financial needs. ASIC analysis found that a substantial proportion of borrowers 'may be at risk of being left with substantially less home equity if the interest rate on their loan rises, or if property prices grow more slowly than expected. ASIC cautions that failure on the part of borrowers to consider their future needs/poor awareness of the risks of could lead them to take out larger reverse mortgages/withdraw money more quickly from a line-of-credit facility in a reverse mortgage leaving them with reduced capacity to pay for 'important future expenses, such as aged care accommodation, medical treatment, and day-to-day living expenses'.
- **Lenders need to better consider the long-term needs of the borrower in reverse mortgage applications**. ASIC Deputy Chair Peter Kell said 'Reverse mortgage products can help many Australians achieve a better quality of life in retirement…But our review shows that lenders and brokers need to make inquiries that would lead to a genuine conversation with customers about their possible future needs, not just a set of tick boxes on a form.'
- **Lenders also need to be aware of the problem of elder abuse and take 'extra care'** with potentially vulnerable customers such as the elderly. ASIC notes that under the new Code of Banking Practice, recently approved by ASIC, banks will be required to take extra care with customers who may be vulnerable, including those who are experiencing elder abuse.

[Sources: 18-248MR ASIC publishes a review of reverse mortgage lending; REP 586 Review of reverse mortgage lending in Australia; [registration required] The AFR 28/08/2018; [registration required] The Australian 28/08/2018]

In Brief | APRA to approve three new banks? The AFR reports that the Australian Prudential Regulation Authority (APRA) is preparing to approve three new banks: Volt Bank, 86400 and Judo Capital following the streamlining of application procedures. Though timing of APRA approval is uncertain, there is a 'prospect' that the challenger banks will be operating under unrestricted licences by the end of the year, the AFR writes.

[Source: [registration required] The AFR 27/08/2018]

Accounting and Audit

United Kingdom | The FT reports that the ICAEW is considering a proposal to place temporary limits on the number of listed audit clients the Big Four accounting firms can have as a way of staving off a formal competition review.

The FT reports that the UK Institute of Chartered Accountants in England and Wales (ICAEW), is in talks with nine UK audit firms (KPMG, PwC, EY, Deloitte, BDO, Grant Thornton, Mazars, Moore Stephens and RSM) in an attempt to reach agreement on a common proposal to present to the Competition and Markets Authority (CMA) to stave off a new investigation into the industry. The CMA has reportedly been under pressure from both the Financial Reporting Council (FRC) and politicians to reassess whether to break up the Big Four or to ban audit firms from offering consulting services, which the FT reports, is opposed by many executives.

According to The FT, the details of the proposal are yet to be confirmed. However, ICEAW CEO Michael Izza has reportedly said that his organisation would support a temporary cap on market share for the big four firms (80% of the FTSE 350 as opposed to the 97% the big four currently have), if 'constructed in the right way'. A temporary cap would give 'challenger firms the chance to get the expertise to convince the demand side — which is specifically audit committees and investors that they can do a good job' he is quoted as stating. Reportedly, Mr Izza identified a number of 'practical difficulties' in persuading clients to switch from a big four practice to a challenger firm, though he suggested that this issue could be potentially be overcome if the big four agreed to share their technology platforms with challenger firms and/or if the big four firms would allow challenger firms to jointly audit some of their big clients over a period of years. The FT adds that some executives from the nine firms have 'privately expressed doubts' about the proposal.

According to The FT, if adopted the new cap would require PwC to give up approximately 40 audits while KPMG and EY would reportedly be 'largely unaffected at their present size'.

[Source: [registration required] The FT 24/08/2018]

United Kingdom | Grant Thornton fined £3,000,000 for audit misconduct: The FRC has announced sanctions against Grant Thornton, a former senior partner and three executives following admissions of misconduct in relation to the audits of Nichols Plc and the University of Salford over 4 years.

The Financial Reporting Council (FRC) has announced that it has fined and reprimanded Grant Thornton UK LLP (Grant Thornton) and three senior statutory auditors following their admissions of misconduct in relation to the audits of the financial statements of Nichols Plc and the University of Salford for the years ending 2010, 2011, 2012 and 2013. In addition, the FRC has fined and excluded a former senior partner in Grant Thornton from the UK Institute of Chartered Accountants in England and Wales (ICAEW) for a period of five years.

The misconduct relates to a former senior partner in Grant Thornton (Mr Healey) joining the Audit Committees of Nichols and the University, while he was also engaged by the firm to provide services under a consultancy agreement. 'This created serious familiarity and self-interest threats and resulted in the loss of independence in respect of eight audits over the course of four years. The case also revealed widespread and serious inadequacies in the control environment in Grant Thornton's Manchester office over the period as well as firm-wide deficiencies in policies and procedures relating to retiring partners' the FRC states.

Settlement details:

- Grant Thornton to receive a 'Severe Reprimand' and a fine of £4,000,000 (discounted for settlement to £3,000,000). In addition, Grant Thornton will pay £165,000 in respect of the entirety of the Executive Counsel's costs.
- Former senior partner in Grant Thornton (Mr Eric Healey) will receive a fine of £200,000 (discounted for settlement to £150,000) and be excluded from the ICAEW for a recommended period of five years.

- Three senior statutory auditors to receive reprimands and fines in accordance with their admissions of misconduct ranging from £60,000 (discounted to £45,000 for settlement) to £100,000 (discounted to £75,000 for settlement).

[Source: FRC media release 29/08/2018]

Problems are endemic and unlikely to be solved by breaking up the big 4, but a prohibition on consulting work should be considered instead? Commenting on the recent action against Grant Thornton, and noting recent actions against a number of other firms, The FT argues that the issues being identified are not 'a small firm problem nor a Big Four problem. They are endemic — at least, where auditors offer clients other services'. On this basis, The FT argues that breaking up the Big 4 is unlikely to be effective in that it may only 'create eight firms of highly qualified auditors who would not know a conflict if it kicked them in the impairments'. The FT suggests that instead, there may be a case for consideration of the Dutch model where accounting firms are prohibited from taking on any consulting work for their clients.

[Source: [registration required] The FT 30/08/2018]

In Brief | SMSF audits: BDO partner Paul Rafton has reportedly written to Federal Treasurer Josh Frydenberg and Assistant Minister for Treasury and Finance Zed Seselja outlining his concerns around the proposal to increase the SMSF audit cycle to three years warning that if implemented the proposal could mean it could take close to five years before a breach is detected in an SMSF.

[Note: Treasury recently released a discussion paper on the proposal to allow certain self-managed superannuation funds (SMSFs) a three-yearly audit cycle. Consultation closed on 31 August.]

[Source: Accountants Daily 30/08/2018]

In Brief | Royal Commission into audit? Accountants Daily reports that one association body (Institute of Certified Management Accountants (ICMA)) is calling for a royal commission into the auditing profession, citing lack of independence and expertise leading to a number of examples of poor corporate behaviour.

[Source: [registration required] Accountants Daily 30/08/2018]

Risk Management

Supply Chain Risk

In Brief | ACCC has reauthorised the Homeworkers Code of Practice — the Code for the ethical treatment of clothing workers — for a further ten years. The Code imposes obligations on participants in the supply chain to demonstrate that they provide award wages and conditions to textile, clothing and footwear workers. The ACCC states that it 'considers that the Code is an important tool for incentivising businesses to observe their obligations to vulnerable workers in the TCF industry and take steps to manage legal and reputational risks in their outsourced supply chains'.

[Source: ACCC media release 30/08/2018]

Technology

Trust and regulatory uncertainty the top two barriers to blockchain adoption globally according to PwC report.

A new PwC report entitled: *Blockchain is here. What's your next move?* surveyed 600 executives in 15 countries and territories (including Australia, China, Denmark, France, Germany, Hong Kong, India, Italy, Hapan, Netherlands, Singapore, Sweden, The UAE, UK and the US) on their development of blockchain and views on its potential.

Key Points

- **Fear of being left behind?** PwC found that the majority of respondents (84%) said that their organisations have some involvement in blockchain technology. However, progress towards implementation of projects was varied: 20% said that they are currently researching blockchain projects, 32% said that they are in development; 10% said that they are piloting projects and 15% said that the project was live. PwC concludes from this 'organisations fear…being left behind as blockchain developments accelerate globally opening up opportunities including reduced cost, greater speed and more transparency and traceability'.
- **Australia perceived as being amongst the top three leaders in blockchain development (for now):** The US (29%), China (18%), Australia (7%) are perceived as the most advanced in developing blockchain projects. However within three to five years, respondents believe China will have overtaken the US (30%), shifting the early centre of influence and activity from the US and Europe.
- **Financial Services is the area of most activity:** The survey reflects the early dominance of financial services developments in blockchain with 46% identifying it as the leading sector currently and 41% in near term (3-5 years) PwC writes. Sectors identified by respondents with emerging potential within 3-5 years include energy and utilities (14%), healthcare (14%) and industrial manufacturing (12%).
- **Main barriers to adoption?** Despite the technology's potential, 48% of respondents identified regulatory uncertainty and 45% identified trust the biggest 'blockers' to adoption. Concern about trust amongst users was found to be highest in Singapore (37%); UAE (34%) and Hong Kong (35%) which PwC attributes to the dominance of financial services in blockchain development. Concern about regulatory uncertainty was highest in Germany (38%); Australia (37%) and the UK (32%). The third barrier identified was ability to bring networks together (44%).

[Source: Blockchain is here. What's your next move? PwC's Global Blockchain Survey 2018; PwC media release 27/08/2018; Coin Telegraph 28/08/2018]

Other Developments

United States | SEC has announced that Legg Mason has agreed to pay $33m to settle charges in connection with payment of bribes to Libyan officials.

The Securities and Exchange Commission has announced that Legg Mason Inc will pay over $34 million to resolve SEC charges that the company violated the Foreign Corrupt Practices Act (FCPA) in a scheme to bribe Libyan government officials in order to secure business with the Libyan government.

[Note: On 4 June Legg Mason also agreed to pay $33 million to the US Department of Justice in sanctions resulting from the firm's involvement in the Libyan bribery scheme. See: Governance News 12/06/2018]

According to SEC, Legg Mason (allegedly) violated the internal accounting controls provision of the *Securities Exchange Act of 1934*. More particularly, according SEC between 2004 and 2010, a former Legg Mason asset management subsidiary, Permal Group Inc, partnered with a French financial services company to secure investment business from Libyan state-owned financial institutions by paying bribes to Libyan government officials though a Libyan middleman. As a result of the scheme, Legg Mason (through Permal) earned net revenues of approximately $31.6 million SEC writes.

Settlement details: Legg Mason agreed to disgorge approximately $27.6 million of 'ill-gotten gains' plus $6.9 million in prejudgment interest to settle the SEC's case.

[Sources: SEC Media release 27/08/2018; FCPA blog 27/08/2018]

Other News

In Brief | A new Productivity Commission Report has found that inequality has risen slightly in Australia over the past 30 years, and some Australians experience 'entrenched economic disadvantage,' but overall that sustained economic growth over the period has delivered significantly improved living standards for the average Australian.

[Source: Rising inequality? A stocktake of the evidence August 2018]