Governance News

10 April 2019

Mark Standen
Partner

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

Siobhan Doherty
Partner

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

Kate Hilder
Consultant

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

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

Contents

Boards and Directors

'Overboarding': Is it time to cap the number of boards on which directors can sit?

Financial Standard reports that at the recent Financial Executive Women Leadership Conference, some governance experts questioned the ability of directors who sit on multiple boards to adequately discharge their duties.

BMFS Consulting managing director Sarah Brennan is quoted as commenting: 'The reality is, with all the work you need to do to understand the organisation, being on five, six or seven boards just isn't sustainable. You probably can't deliver'.

Governance Institute of Australia CEO Megan Motto also reportedly raised concerns questioning whether directors, no matter what their level of experience or expertise, are able to bring value if they lack time: 'It's not just about the board papers and sub-committee meetings. You're on a board because of your expertise and your experience, so if you're not keeping up to date with everything then you're probably not contributing appropriately to the board either' she is quoted as stating.

The article adds that Egan Associates estimates a non-executive director of one ASX200 company would need to commit at least 27-33 days per annum, meanwhile a minimum of 48-72 days would be required of an ASX200 chair each year.

[Note: The commentary to Recommendation 1.2 in the recently released fourth edition of the ASX Corporate Governance Principles and Recommendations states that 'candidates for appointment, election or re-election as a director should also provide details of their other commitments and an indication of time involved, and should specifically acknowledge to the listed entity that they will have sufficient time to fulfil their responsibilities as a director' but does not suggest any limit on the number of directorships a single director should hold (see: Governance News 04/03/2019). Similarly, the 2018 UK Corporate Governance Code suggests boards should take into account other demands on directors prior to their appointment and that non-executive directors should have sufficient time to meet their board responsibilities, but also places no limit on the number of outside directorships a director should hold (see: Governance News 23/07/2019)].

[Note: The Australian Institute of Company Directors (AICD) has flagged the issue of director 'overboarding' as an issue to be addressed (among others)(in its 'forward governance agenda'. The AICD has said it intends to issue guidance on the issue. See: (Governance News 06/03/2019)].

[Source: Financial Standard 08/04/2019]

Board changes announced at AMP

AMP Ltd announced that it has appointed Debra Hazelton as a non-executive director effective from 15 June.

Ms Hazelton is a non-executive director on the boards of Treasury Corporation of Victoria, Persol Australia Holdings and the Australia-Japan Foundation, and previously served on the board of Australian Financial Markets Association. She is also a Non-Executive Director of AMP Capital Holdings Limited and will continue in this position when she joins the AMP Limited Board.

AMP also announced that on completion of the sale of AMP Life to Resolution Life, Trevor Matthews will remain on the AMP Life Board as an AMP nominee and retire from the AMP Limited Board. Mr Matthews joined the board of AMP Limited in March 2014 and was appointed Chairman of AMP Life in May 2016.

[Sources: AMP ASX Announcement 08/04/2019; [registration required] The West Australian 08/04/2019]

Diversity

Equilar expects that Russell 3000 boards will achieve gender parity by 2034

According to Equilar, the percentage of women on Russell 3000 boards has consistently increased over the past four quarters increasing in Q4 2018 from 18% to 18.5%. At the current rate, Equilar expects that gender parity on Russell 3000 boards will be achieved by 2034.

Significant progress? Equilar comments that the Q4 2018 result represents significant progress from Q4 2016 and Q4 2017 when gender parity was expected to be achieved in 2015 and 2048 respectively.

In addition, Equilar comments that some companies have already achieved gender parity: currently 41 companies have achieved gender parity, with seven of those being in California. A slight increase from 37 companies that reached gender parity by Q3 2018.

What is driving the change?

1. **Pressure from proxy advisers and investors:** Equilar comments that 'various external factors', including pressure from proxy advisers and investors (eg BlackRock, Glass Lewis and ISS), have had/are likely to have a positive impact on driving change. More particularly, the potential reputational damage resulting from possible negative voting recommendations against directors is identified as a change driver.

2. **Likely impact of Californian legislation?** The State of California recently passed a piece of legislation—SB 826—that will require public companies headquartered in California to have a minimum of one female on its board of directors by December 31, 2019, increasing to at least two female board members for companies with five directors or at least three female board members for companies with six or more directors by December 31, 2021. Breaches of this requirement will have financial consequences. According to Equilar this is expected to have a material impact on driving change, 'It's safe to say that the percentage of public companies headquartered in California that do not have any women on their boards will decrease significantly' Equilar quotes a KPMG spokesperson as stating.

3. **Appreciation of the value of diversity?** Equilar comments that improvements in gender diversity is a 'sure sign' that companies appear to be placing greater value on diversity and argues that 'better alignment in director skill sets related to the new issues boards are looking at (cybersecurity, technology, corporate social responsibility)' will drive further improvements.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 05/04/2019]

Mixed results? Google's annual diversity report shows the company recruited fewer female leaders in 2018, though the proportion of female hires overall has slightly improved

Google recently published its fourth annual diversity report as part of its commitment to transparency and increasing diversity across the industry. According to the report there has been some progress, in terms of representation, though not with respect to leadership hires where the proportion of female hires decreased 3.5% globally in 2018.

Some Key Findings

Overall workforce representation: Women make up 31.6% and men make up 68.4% of Google's global workforce. In the US:

- 54.4% of the workforce is White+
- 39.8% is Asian+
- 3.3% is Black+
- 5.7% is Latinx+
- 0.8% is Native American+

A slight increase in female hires across the company:

- The percentage of female hires increased to 33.2% (globally) in 2018 (up 1.9% on last year).
- Asian+ and White+ women hires increased the most year-over-year, to 15.6% (+1.4%) and 16.2% (+1.8%) respectively. At the same time, Black+ women hires increased to 2.2% (+0.8%), Latinx+

women hires increased to 2.7% (+0.7%), and Native American+ women hires increased to 0.5% (+0.3%).

Consistent increase in (gender) diversity of tech hires: Google comments that over four years, the percentage of female tech hires has increased from 22.1% to 25.7%.

Less progress on leadership hires:

- The proportion of women leadership hires decreased in 2018 to 25.9% (-3.5%) globally, and to 26.0% (-2.4%) in the US. The report states that Google will prioritise this area in 2019 by ensuring all leadership searches 'include candidates representative of the available talent pool. We're expanding outreach to women leaders in Europe and Asia, and doubling the number of focused leadership events for women globally'.
- Latinx+ women leadership hires increased to 3.1% (+2.4%). Asian+ women leadership hires decreased to 7.1% (-2.8%), and Black+ women leadership hires decreased to 0.5% (-1.6%). Asian+ men leadership hires increased to 25.5% (+7.8%), while the proportion of leadership hires among men of all other racial groups decreased.

Attrition index (rate at which employees leave the company):

- 'Women are less likely to leave Google' than was the case previously: In 2017, women were 6% less likely to leave Google vs the average; in 2018, they were 10% less likely to leave than the average
- The greatest improvements in attrition were for Black+ employees. This was largely driven by Black+ men who saw improvements across both tech and non-tech roles.

New demographic data: This year's report included data from employees who are differently-abled as well as those who identify as LGBTQ+. Of the 39% of global employees who have self-identified to date: 8.5% self-identified as LGBQ+ and/or Trans+; 7.5% self-identified as having a disability; 5.2% self-identified as being or having been members of the military and less than 1% identified as non-binary. Google states that it looks 'forward to improving our data collection so that we'll have a better picture of our workforce in 2020'.

[Sources: Google 2019 Diversity Report; Forbes 07/04/2019]

Remuneration

'Out of line with best practice'? Glass Lewis has expressed concern about the approach taken by both Fiat Chrysler and Ferrari to CEO pay

Glass Lewis has expressed concern about the approach taken by two companies to CEO Pay. Both companies, Fiat Chrysler and Ferrari are following similar approaches to structuring CEO pay, Glass Lewis observes. For example the two companies have taken similar approaches to:

1. proposed equity grants for their CEOs – roughly €1.9 million for Ferrari's Louis Camilleri, and US$3.2 million for Fiat Chrysler's Michael Manley
2. grants are split between performance-based and time-vesting awards
3. the 'at-risk' elements of both grants are based on what Glass Lewis terms, 'retrospective performance over the past few years'

The approach taken to 'at risk' elements is of concern Glass Lewis argues because 'both CEOs were only appointed as executives in late 2018'.

Glass Lewis observes 'It's a curious move that appears to reward Camilleri and Manley for results they had little (if any) control over…regardless of which market standard you employ, the proposed grants appear to be decidedly out of line with best practice'.

[Source: Glass Lewis Proxy Insider 02/04/2019]

Other Shareholder News

Governance concerns at Spotify? Glass Lewis has expressed concern about the 'growing list' of technology companies with dual-class structures

Glass Lewis has expressed concern about the 'growing list of tech giants' including Alphabet, Facebook, Snap, Broadcom and now Spotify — to have gone public with a dual class share structure.

In Spotify's case, 'beneficial certificates' mean that the company founders Daniel Ek and Martin Lorentzon, have 10 extra voting rights for every share they hold, giving them 77.9% voting power despite owning just 32.5% of the company itself. In addition, Glass Lewis writes that there 'appears to be a void' in terms of independent oversight as founder Mr Ek serves as both CEO and Chair and there is no lead director appointed.

Given this, Glass Lewis writes though the upcoming AGM is the first opportunity for institutions and other investors, to express 'concerns', the distribution of voting rights effectively eliminates any chance of board change.

[Source: Glass Lewis Blog 02/04/2019]

Disclosure and Reporting

United States | The case for quarterly reporting (as opposed to quarterly forecasted earnings guidance)? In a submission in response to the US Securities and Exchange Commission's request for comment, the Council of Institutional Investors (CII) has argued that investors, companies, and other market participants benefit from the current reporting frequency model

In response to the Securities and Exchange Commission's (SEC's) request for comment on earnings releases and quarterly reports (RFC), the Council of Institutional Investors (CII) has argued in favour of retaining the current quarterly reporting model.

'CII believes that investors, companies, and other market participants benefit from the current reporting frequency model... In our view, the requirement to report historical earnings on a quarterly basis is a key element of the timely and accurate information flow that underpins the quality and efficiency of our capital markets. The requirement helps ensure that important information is promptly and transparently provided to the marketplace allowing investors to assess concrete progress against strategic goals' CII writes.

Some Key Points

- **CII argues that quarterly reporting (ie quarterly earnings reports on actual performance as opposed to forward-looking guidance) is of value, as an 'important reality check' for investors.** 'The requirement for quarterly reporting is a key element in providing investors with prompt and reliable information on how a company actually is performing' CII writes. The submission adds that CII considers that less frequent reporting would 'likely lead to greater share price volatility, and more intense investor focus on short-term share price fluctuations, as investors expend more effort guessing how the company is doing'.
- **Quarterly reporting does not lead to excessive focus on the achievement of short term results (executive pay does):** 'We do not believe that requiring quarterly reporting leads public company managers to focus on short-term results to the detriment of long-term performance' the submission states. CII adds that this argument is 'outdated and generally not supported by empirical evidence'. CII also argues that if quarterly reporting leads company executives to focus on profits during the next three months, then a shift to semi-annual reporting might lead corporate executives to focus on profits during the next six months but not over the longer term and that as such SEC is focusing on the issue. Glass Lewis suggests that if regulators and politicians want companies to take a longer-term approach to investments, they should consider lengthening the duration of executive pay (and/or other broader issues).
- **The current form of quarterly reporting should be retained:** CII argues that the current reporting form (The Form 10-Q report) should not be replaced by an earnings release on the basis that the requirements attaching to the current form have value for investors for example, the requirements for

independent auditor review and management certification of the information (among other requirements) increase the quality and usefulness of the information for investors and also 'foster discipline and accountability of the company's reporting practices'.

- **Independent auditor review is valued by investors:** Commenting specifically on the value of independent audit, CII states that it considers that 'investors value the independent auditor review of quarterly financial information because they generally believe it will increase the quality, usefulness and reliability of the information and foster discipline and accountability of the company's reporting practices. We also believe that the auditor review requirement can lower the cost of capital for companies'.
- **Reporting less frequently would be a step backwards:** 'We live in an era where real time open general ledgers and distributed ledger technology are becoming a reality. In the modern world, capital flows at the speed of light. We believe that given today's dynamic and technology driven global business environment, permitting or requiring less frequent financial reporting would be a step into the past'.
- **Quarterly forecasted earnings guidance is an issue:** CII argues that if SEC wishes to encourage long term decision making by public company management, its focus should be on discouraging quarterly forecasted earnings guidance which CII terms 'predictive and speculative' and 'very different from historical reporting on what has actually taken place'. In addition, CII argues forecasted earnings guidance is a 'significant contributor leading managers to focus on short-term results to the detriment of long-term performance' and more specifically that it can 'incentivize companies to unduly focus on "making the numbers" at the expense of the long-term interests of the company and its long-term shareowners'. This is a view shared by Berkshire Hathaway Chair and CEO Warren Buffet and BlackRock founder and CEO Laurence Fink, CII writes.

[Sources: Harvard Law School Forum on Corporate Governance and Financial Regulation 06/04/2019; Council of Institutional Investors letter to the Securities and Exchange Commission 21/03/2019]

Regulators

Top Story | ASIC enforcement report July to December 2018 released

Overview: ASIC Report 615 ASIC Enforcement update July to December 2018

The Australian Securities and Investments Commission (ASIC) has released its biannual overview of enforcement outcomes, priorities and cases for the period 1 July 2018 to 31 December 2018. The report outlines the enforcement results achieved by ASIC during the period, highlights some important cases and decisions during this period and provides a high-level overview of some of ASIC's enforcement priorities.

Statistics should not be the sole measure of ASIC's success

In his foreword to the report, ASIC Deputy Chair Daniel Crennan said that as previously the report focuses on immediate enforcement statistics, themes and case studies but that ASIC's 'success as a regulator cannot and should not be measured solely on the outcomes of criminal and civil actions'. Rather, Mr Crennan said that ASIC wants to achieve 'a substantial improvement in culture and conduct — the willingness to act efficiently, honestly and fairly'.

Mr Crennan also noted the context in which the report is being released, and recent changes that will impact ASIC's regulatory approach going forward. These include: ASIC's focus on responding to the Hayne Commission's recommendations, the adoption of ASIC's new 'why not litigate?' approach to enforcement, the availability of new penalties under the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 and the announcement of additional funding to strengthen and expand ASIC's remit, including our ability to address misconduct in the financial services sector'.

'Looking forward, our message to corporate Australia is that ASIC is focused on enforcement. As the Royal Commission found, this is what Australians expect of their regulator and this is what ASIC will deliver' Mr Crennan said.

Some Key Points

Enforcement outcomes overall (July to December 2018)

Enforcement outcomes highlighted in the report include the following.

- Prosecutions: 9 individuals were charged in criminal proceedings and 76 criminal charges were laid. In 6 cases custodial sentences were given.
- Civil Penalties: $12.7 million in civil penalties was imposed by the courts.
- Infringement notices, compensation and court enforceable undertakings: There were 12 infringement notices issues and $500 thousand in infringement penalties paid. $3 million was paid in compensation and remediation for investors and consumers and $15.6m in community benefit fund payments. ASIC entered into 9 enforceable undertakings.
- Investigations: ASIC commenced 75 investigations and completed 57.

Overall enforcement priorities

Consistent with the priorities outlined in ASIC's Corporate Plan 2018–22: Focus 2018–19, ASIC plans to focus on the following areas.

1. potential harms from technology driven by the growing digital environment and structural changes in financial services and markets
2. poor culture and professionalism in financial services and credit, particularly in the provision of consumer credit and financial advice
3. culture, governance and incentives that can harm markets
4. practices that target financially vulnerable consumers
5. misalignment of retail product design and distribution with consumer needs.

Corporate Governance outcomes and enforcement priorities

- **Enforcement outcomes:** In the six months between 1 July 2018 and 31 December 2018, 30 corporate governance-related matters were resolved. The majority of these (18) were civil actions, 17 of which concerned 'other corporate governance misconduct'. In addition, nine administrative actions (six concerning auditors and 3 concerning directors); 2 criminal actions against directors; one enforceable undertaking; and zero negotiated outcomes were resolved.
- **Matters still ongoing as at 1 January 2019:** ASIC had 14 criminal and 17 civil corporate governance-related matters underway (including 10 criminal and 11 civil actions against directors) that had not achieved a final result (as at 1 January 2019). This is attributed in the report to the fact that the court/tribunal in each case was yet to reach a final decision.
- **Enforcement focus for the next six months:** In 2019, ASIC will continue its focus on gatekeeper conduct to ensure people are meeting the standards required by law. 'Gatekeepers' can include company directors and officers, auditors, insolvency practitioners and business advisers. In particular, ASIC states that it will focus on:
  - companies with poor corporate governance
  - undisclosed associations and substantial holdings in shares in public companies (including beneficial ownership tracing and corporate fraud)
  - related-party transactions involving public companies
  - poor financial reporting by listed companies and other public interest entities
  - the quality of audits of listed companies and other public interest entities
  - insolvency practitioners and others who facilitate illegal phoenix activity and improper transactions in the face of insolvency
  - debenture issuers and other companies exposed to risk because of a declining property market
  - company directors and officers who fail to stop their companies making illegal

payments to officials of overseas governments.

Financial Services Outcomes

- **Enforcement outcomes:** In the six months between 1 July 2018 and 31 December 2018, ASIC resolved 56 financial services-related outcomes. The majority of these were administrative actions (32 actions) most of which concerned 'Other financial services misconduct' (12 actions); followed by misconduct related to the provision of credit (11 actions); dishonest conduct, misleading statements (7 actions); misappropriation, theft and fraud (1); and licensed conduct (1). In addition there were 9 civil actions, 6 criminal actions, 6 court enforceable undertakings and 3 negotiated outcomes.
- **Matters still ongoing as at 1 January 2019:** As at 1 January 2019, ASIC had 15 criminal and 66 civil financial services-related matters underway that had not achieved a final result. These included: 15 criminal actions (including 7 actions concerning misappropriate, theft and fraud and 5 actions concerning dishonest conduct, misleading statements) and 66 civil actions (including 22 actions concerning dishonest conduct, misleading statements and 30 actions concerning 'other financial services misconduct').
- **Enforcement focus for the next six months:** ASIC identifies three areas of focus for the next six months:
  - misconduct involving AFS licensees, which ASIC notes is 'an area of particular interest to the Royal Commission'. ASIC states that 'where appropriate, ASIC will refer briefs of evidence of criminal breaches to the CDPP, or commence civil penalties or other civil action in the courts'
  - responsible lending breaches
  - the sale of inappropriate products to consumers

Market Integrity

- **Enforcement outcomes:** In the six months between 1 July 2018 and 31 December 2018, ASIC resolved 10 market integrity-related outcomes. Half of these (5) were administrative actions, the majority of which concerned 'other market misconduct' (3 actions).
- **Matters still ongoing as at 1 January 2019:** ASIC had nine criminal and 18 civil market integrity-related matters underway that had not achieved a final result as at 1 January 2019.
- **Enforcement focus for the next six months:** ASIC states that conduct risk and the integrity of financial benchmarks remain a high priority in 2019. In particular, ASIC plans to focus on:
  - poor conduct in fixed income, commodities and currency (FICC) markets, including retail OTC markets
  - misconduct in relation to initial coin offerings and cryptocurrency markets
  - serious and organised market misconduct with a focus on cross-border transactions
  - technology-enabled offending, including cyber related market misconduct.

Small business

- **Enforcement outcomes:** In the six months between 1 July 2018 and 31 December 2018, ASIC resolved 228 small business-related outcomes. The majority were criminal actions (185 actions). Seventeen of these concerned efficient registration and licensing and the remaining 168 concerned 'action against persons or companies').
- **Matters still ongoing as at 1 January 2019:** As at 1 January 2019, ASIC had 151 small business related criminal matters underway (143 of these are criminal actions) that had not achieved a final result.
- **Enforcement focus for the next six months:** In 2019, ASIC's small business focus will be on the following three issues.
  1. unfair terms in small-business contracts

2. credit lenders who do not lodge annual compliance certificates in accordance with the *National Consumer Credit Protection Act 2009 (Cth)*

3. illegal phoenix activity – addressing this activity and minimising its effects on companies suffering financial distress

ASIC states that it is also 'supporting compliance programs that inform credit providers of their obligations to lodge documents'.

[Sources: ASIC media release 09/04/2019; ASIC Report 615 ASIC Enforcement update July to December 2018]

The UK FCA and ASIC have agreed to strengthen cooperation post-Brexit

The UK Financial Conduct Authority (FCA) and the Australian Securities and Investments Commission (ASIC) have announced they have agreed two Memoranda of Understanding (MoU) to ensure there is continuity once the UK leaves the European Union. The MoUs cover trade repositories and alternative investment funds (AIFs).

ASIC states that the agreements will provide 'reassurance by ensuring arrangements are in place for cross-border cooperation between the FCA and ASIC. The FCA and ASIC also support the continuity of existing equivalence decisions to provide certainty to businesses post-Brexit'.

- **MoU on trade repositories:** A new MoU on trade repositories is required because the FCA will acquire functions and supervisory powers in relation to trade repositories, which are currently supervised at the European level by the European Securities and Markets Authority (ESMA). The MoU on trade repositories is intended to ensure that ASIC can continue to access data on derivatives contracts held in UK trade repositories, where the information is needed for ASIC to fulfil its responsibilities and mandates.

- **MoU on alternative investment funds (AIFs):** ASIC states that the MoU on AIFs has been updated to reflect the regulatory regime that will apply in relation to AIFs in the UK post-Brexit. The MoU will cover Australian managers that manage or market AIFs in the UK and UK managers that manage or market AIFs in Australia, as well as their delegates and depositaries. The existence of an MoU between ASIC and the FCA is a precondition of the UK's AIFM regime, for allowing managers from third countries access to the UK market.

- **Equivalence decisions:** HM Treasury has confirmed that existing equivalence decisions granted in respect of Australia by the European Commission (EC) before exit day, will generally be incorporated into UK law and will continue to apply post-Brexit. The UK will adopt existing EU equivalence decisions that relate to Australia's supervisory and regulatory regime for trading venues, OTC derivatives markets and credit rating agencies.

ASIC states that it also remains committed to take steps to provide, where appropriate, for continuing recognition post-Brexit of the equivalence of the UK's regulatory and supervisory regime in relation to UK-based foreign financial services providers and market operators that operate in Australia under licences and exemptions or are otherwise recognised for the purposes of the Australian regulatory regime.

[Sources: ASIC media release 08/04/2019]; Investment Week 08/04/2019]

ASIC has extended temporary disclosure related relief for product dashboards

Superannuation trustees are required to produce and disclose dashboards for MySuper products. However, as regulations required to give effect to the choice product dashboard disclosure requirements have not yet been made, ASIC has announced the start date on which superannuation trustees must disclose a dashboard for choice superannuation products has been extended to 1 July 2023. The existing class order (ASIC Class Order [CO 14/443] has been amended to reflect this.

ASIC has also amended a related instrument (ASIC Class Order [CO 13/1534]), which concerns disclosure of dashboard information in a periodic statement. The amendment continues to defer the requirement (until 1 July 2023) to include a dashboard in a periodic statement by allowing superannuation trustees to include a website address for the dashboard instead.

[Source: ASIC media release 08/04/2019]

In Brief | The Australian Prudential Regulation Authority (APRA) has released the approval form and instruction guide to apply for approval of merger and acquisitions of health benefit funds

[Sources: APRA media release 09/04/2019; APRA private health insurance forms and related guidance; Forms for private health insurers]

Financial Services

The Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2017 has received Assent

The *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2017* received Assent on 5 April 2019 as Act No 40 of 2019.

Among other things, the legislation

- gives the Australian Prudential Regulation Authority (APRA) more powers to deal with underperforming super funds.
- introduces an annual 'outcomes test' (which requires superannuation trustees to undertake an annual determination of member outcomes).
- implements 2 recommendations by the Financial Services Royal Commission dealing with civil penalties for breaches of the trustee's covenants and employer kickbacks on default super funds (see: Governance News 05/04/2019)

[Source: Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2019]

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 has received Assent

The *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* received Assent on 5 April 2019 as Act No 50 of 2019.

Among other things, the legislation introduces design and distribution obligations in relation to financial products and provides the Australian Securities and Investments Commission (ASIC) with a product intervention power (see: Governance News 05/04/2019)

Timing: ASIC's product intervention power commences on 6 April 2019. The design and distribution obligations will be phased in over 2 years.

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

COBA has welcomed the passage of the Mutual Reform Bill as an important measure in fostering competition in the banking sector

The Customer Owned Banking Association (COBA) has issued a statement welcoming the passage of the *Treasury Laws Amendment (Mutual Reforms) Bill 2019* (Mutual Reform Bill) (see: Governance News 20/02/2019; 05/04/2019).

COBA writes that the reforms will help create a more competitive banking sector and 'improve the capacity of Australia's customer owned banking sector to more easily raise capital and increase its ability to compete with the nation's major banks.

[Source: [registration required] The Australian 08/04/2019]

Treasury Laws Amendment (AFCA Cooperation) Regulations 2019: Regulations imposing a legal requirement for Australian Financial Complaints Authority (AFCA) members to provide 'reasonable assistance' to AFCA to allow it to 'promptly and fairly resolve complaints' commenced on 6 April

Regulations imposing a requirement for Australian Financial Complaints Authority (AFCA) members to provide 'reasonable assistance' to AFCA to allow it to 'promptly and fairly resolve complaints' — *Treasury Laws Amendment (AFCA Cooperation) Regulations 2019* — commenced on 6 April.

AFCA Chief Ombudsman and Chief Executive Officer, David Locke welcomed the regulations as an important 'step in ensuring consumers and small businesses have their financial complaints solved effectively and efficiently'. Mr Locke also noted that the passage of the regulations implements an important recommendation from the Financial Services Royal Commission (see: Recommendation 4.11)

Mr Locke added that 'If we see any failure to cooperate fully and honestly with AFCA we will call this out in the strongest possible terms and work with regulators to see appropriate regulatory action taken. AFCA already has the ability to draw adverse inferences where documentation is not provided and does so.'

[Sources: Treasury Laws Amendment (AFCA Cooperation) Regulations 2019; AFCA media release 06/04/2019]

Satisfaction with industry superannuation funds outstrips retail funds? Roy Morgan's Superannuation Satisfaction Report has found the satisfaction rating for industry superannuation funds has increased over the 12 months to February. The report also names the 15 'best performing' superannuation funds

According to Roy Morgan's latest *Superannuation Satisfaction Report* — which is based on face to face interviews with 50,000 consumers per annum — in the 12 months to February 2019, the satisfaction rating for superannuation funds:

- increased 0.9% points (to 62.1%) for industry superannuation funds
- industry superannuation funds have increased their lead over retail funds from 2.0% points a year ago, to the current lead of 6.4% points
- in the six months to February 2019, industry super funds had higher satisfaction than self-managed superannuation funds (SMSFs) among people with balances between $100,000 and $699,999 and were only narrowly behind SMSFs for balances over $700,000
- Roy Morgan observes that satisfaction with the financial performance of superannuation generally increases with the balance, the only exception being for industry funds where satisfaction dips marginally in the $700,000 and over segment.

Best performing funds?

- The report identifies the 15 'best performing' funds. The best performer is identified as Unisuper with a satisfaction rating of 71.2%, followed by HESTA with 68.3% and Cbus (66.6%). The best performer among retail funds was Macquarie in eighth place overall with a satisfaction rating of 63.2%, followed by Plum (62.2%) and Colonial First State (57.3%).
- Eight of the fifteen best performing funds showed improved satisfaction over the last year, with the biggest gains at HESTA (up 6.6% points), Plum and Sunsuper (both up 4.7% points) and Unisuper (up 3.4% points).
- According to Roy Morgan, the biggest losses were from Macquarie (down 10.7% points), Tasplan (down 10.2% points) and IOOF (down 9.7% points).

Commenting on the results, Roy Morgan Industry Communications Director Norman Morris said that the 'fact that retail funds now trail industry funds in terms of member satisfaction with performance across all segments, is a major challenge for them as they now face completion from both SMSFs for higher balances and industry funds across all segments'.

[Source: Roy Morgan media release 05/04/2019; Investor Daily 09/04/2019]

An ASBFEO report has found some large businesses are reluctant to disclose payment times and that most are late to pay, negatively impacting small business cashflow

A review of payment terms, times and practices was released by The Australian Small Business and Family Enterprise Ombudsman (ASBFEO).

Some Key Findings

- Small businesses reported significant delays in receiving payment which is negatively impacting cashflow — large businesses that offer payment terms of 30 days or less, rarely pay on time
- Construction, mining, retail, state governments, manufacturing and large multi-sectorial businesses have poorer payment practices
- Though the Business Council of Australia's (BCA) Australian Supplier Payment Code (BCA Code) was designed to encourage industry self-regulation for ensuring small business supplier invoices were paid within a 30-day period, the Code has had limited success with the average number of days to be paid still outside of the 30-day target
- Despite having small business supplier definitions, some large businesses could not identify how many of their suppliers were small businesses
- Despite having small business supplier payment terms, some large businesses do not have systems to monitor payment time performance and cannot identify how many payments meet or are outside contract terms. Few report performance on their policy to the CEO or board
- There are calls from some large businesses for a centralised register to identify small businesses
- Some large corporations are reluctant to reveal the timeframes in which they pay their small business suppliers

Report Recommendations

The report makes seven recommendations for improving the late payments problem.

1. ASBFEO to develop an independent annual reporting framework, requiring businesses with over $100 million turnover, which will capture foreign companies and government entities, to publish their payment practices
2. ASBFEO to work with the government on its initiative to modernise business registers to enable the identification of small business suppliers
3. Review small business supplier terms and conditions under the unfair contract terms legislation: ASBFEO to work with the ACCC to review supplier terms and conditions including extended payment terms, termination clauses and non-disclosure agreements
4. Government industry codes to state payment terms: Where appropriate, mandatory government industry codes that regulate business-to-business transactions to include minimum small business supplier payment terms
5. ASBFEO to review the impact of supply chain finance strategies offered by large businesses to offset extended payment times, such as invoice factoring, on the cash flow of small businesses.
6. Adoption of e-invoicing to improve invoice processing: ASBFEO to review the costs, benefits and impediments to the uptake of e-invoicing and other technology solutions to improve the efficiency and accuracy of invoicing.
7. Deemed statutory trusts in the construction sector: The government to mandate the use of deemed statutory trusts in the Australian Building and Construction Building Code for all public works and construction projects. To be effective this must cascade down the supply chain.

Commenting on the report ASBFEO Ombudsman Kate Carnell said that one of the key learning to emerge is the 'hesitancy of some of Australia's most well-known companies to be open about their payment terms and, more importantly, how often they actually meet those terms. Despite having small business supplier definitions, some large businesses could not identify how many of their suppliers were small businesses'.

Ms Carnell added that the finding 'underlines' both: a) the need for an independent annual reporting framework that tracks the performance against payment terms of large Australian and multinational corporations and government entities; and the need for the government to modernise business registers so small business suppliers can be more easily identified.

Mr Carnell also noted the government's announcement in November of 2018 that its suppliers will be paid within 20 days for contracts up to $1 million by 1 July 2019 and its commitment to develop an annual reporting framework requiring large businesses over $100 million in turnover to publish their payment information.

[Source: ASBFEO media release 08/04/2019; Review of payment terms, times and practices; [registration required] The Age 09/04/2019]

Accounting and Audit

Top Story | Audit sector reform? An FRC review of the adequacy of auditor disciplinary functions has recommended 18 reforms (17 of which the government supports) to strengthen existing disciplinary and enforcement processes

Snapshot: A review of the adequacy of auditor disciplinary functions by the Australian Financial Reporting Council (FRC) — *Auditor Disciplinary Processes: Review* — has recommended 18 reforms (17 of which the government supports) to strengthen existing disciplinary and enforcement processes. The review follows concerns raised about the quality of audit, for example in both an earlier Parliamentary Joint Committee report and the most recent ASIC Audit Inspection report.

Introduction

On 5 April, Assistant Treasurer Stuart Robert released the Australian Financial Reporting Council's (FRC's) report: *Auditor Disciplinary Processes: Review*. The Review assessed the processes available to discipline Registered Company Auditors (RCAs) with the aim of identifying how they could be improved to ensure they effectively address cases of alleged misconduct. More particularly, the report examined the RCA discipline process, the effectiveness of the Company Auditors Disciplinary Board (CADB), The Australian Securities and Investments Commission's (ASIC's) Audit Inspection Program, and the professional accounting bodies' disciplinary processes for audit misconduct.

The report makes 18 recommendations (17 of which the government has said it supports or agrees with in principle) concerning enforcement or discipline of registered company auditors (RCAs) who do not meet the standards expected of them. An overview of some of the key findings, the recommendations and the government and ASIC's response is below.

Some Key Findings

- **Australian Securities and Investments Commission (ASIC) systems:** The report is critical of ASIC procedures to monitor disciplinary issues, commenting that ASIC's records about surveillance, investigation, and enforcement activities are managed in a number of different systems, and that there were 'difficulties in gathering and reconciling relevant data'.
- **ASIC has only referred six matters to CADB in the last eight years and only commenced one matter in court.** The Review found that this was due to: 1) RCAs voluntarily cancelling their registration prior to a CADB referral or decision (with no publicity associated with that voluntary cancellation); and 2) ASIC's preference for negotiated outcomes. The report comments that 'ASIC's enforcement approach 'has limitation in its reduced transparency and lack of denunciation'.
- **ASIC's audit inspection work is geared towards education (not enforcement):** Though ASIC's Audit Inspection Program is acknowledged to be an important part of the regulator's surveillance work in relation to RCAs, the outcomes of this program were observed to be generally focused on educative efforts rather than being enforcement-oriented or imposing disciplinary consequences on firms. The report states that 'While these general goals are laudable, the FRC suggests that the outcomes from the Audit Inspection Program be more directly linked to ASIC's enforcement goals of deterring and punishing misconduct, as this may help to improve audit quality'.
- **The professional accounting bodies' disciplinary processes were observed to be limited** in their application because they lack the power to fully investigate RCA misconduct.

- **Court action more likely in future?** The report notes that ASIC anticipates that recent reforms to penalties (with the passage of Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019), as well as ASIC's new approach to enforcement will mean court action will be considered appropriate in more cases.

Recommended reforms

The report includes 18 recommendations, all of which the government has said it supports/agrees with in principle with the exception of recommendation five.

Recommendation not supported by government? Recommendation five recommends that barriers to ASIC naming RCAs who are under investigation (where they voluntarily cancel their registration' be 'addressed'). The Government states that it disagrees with the recommendation because naming RCAs while they are under investigation 'could cause reputational damage to the RCA without due process'. On this basis, the government states that it 'only supports ASIC publishing such a notice where a RCA consents to this announcement.' The government adds that it considers that expanding the CADB's disciplinary powers and remit to include auditors that have been deregistered, will strengthen the disciplinary process and ensure disciplinary action can still take place even where an auditor voluntarily cancels his or her registration.

Seventeen recommended reforms (supported by government)

A high level overview of the remaining recommendations, the government's response and ASIC's response (where available) is below.

- **Naming firms? ASIC to publish more detailed information in audit inspection reports:** The report includes a recommendation (recommendation 11) that ASIC publish the results of audit inspections in greater detail, including naming firms. ASIC has said that it is considering publishing more detailed information including 'whether to disclose results for named audit firms' but has not confirmed that it will do so. The government has said it supports ASIC acting on the recommendation should 'it choose to do so'.

- **ASIC to be given power to compel remediation for defective audits:** Recommendation 12 of the report recommends that ASIC be given the power to compel remediation of defective audits along with the power to publish notices when this occurs. The government has said it agrees in principle with the recommendation and will consult on reforms to empower the regulator to compel remediation. ASIC has said it is supportive of the recommendation.

- **Past issues reviewed for 'possible enforcement action':** The report includes a recommendation (recommendation 10) that issues identified in ASIC Audit Inspection Program reports (eg potential breaches of the law/failure by RCAs to meet their obligations) should be reviewed for possible enforcement action. The government has expressed support for ASIC acting on the recommendation.

- **Strengthening/improving ASIC's detection, investigation and enforcement processes:** The report includes a number of other recommendations concerning ASIC's processes (which the government has said it supports). These include recommendations that ASIC should: a) adopt a more 'structured and consistent approach' to preliminary investigations of RCA matters (recommendation 1); b) improve its record keeping and data management systems to make tracking matters easier across the organisation (recommendation 2); c) evaluate whether resourcing requirements for enforcement action are appropriate (recommendation 3); and d) outline how the 'why not litigate' enforcement strategy will apply to misconduct by RCAs (recommendation 4).

- **Stronger disciplinary powers for the Companies Auditors Disciplinary Board (CADB)?** Recommendation 8 recommends (and the government has said it 'agrees in principle') the CADB should be granted additional disciplinary powers to suspend registration during a disciplinary proceeding and to impose fines on individuals or the firms that employ them. In its response to the report, the government said it will consult on reforms to enable the CADB to impose sanctions against individuals even where an RCA is no longer registered, to ensure disciplinary action cannot be avoided by RCAs by voluntarily cancelling his/her registration.

- **Other recommendations to strengthen CADB processes:**

- The government should consider making the necessary changes to enable the CADB to publish the commencement of proceedings including naming the RCA subject to the proceedings and his or her firm. The government has said it agrees with the recommendation but also said it will consider revising provisions to ensure that proceedings are 'publicised only when it is appropriate to do so'.

- The CADB and ASIC should work to adopt a 'less formal and more timely' approach to the carriage of CADB matters (including a review of CADB's practice and procedures manuals) (recommendation 6). ASIC has said it supports this recommendation and will work with the CADB on a less formal approach to disciplinary matters to help ensure more timely outcomes through CADB processes.

- The government should consider whether the CADB requires additional administrative support if a greater number of applications are made as a result of the reforms (recommendation 9)

- **Tracking audit quality over time:** The report includes a recommendation (recommendation 14) that ASIC and the FRC work together to implement the Parliamentary Joint Committee recommendation to devise a study that would track audit quality over time. The government has expressed support for ASIC and the FRC to action the recommendation. In its response to the report, ASIC committed consistent with the recommendation and the PJC recommendation, to track audit quality over time.

- **Professional accounting bodies:** The report includes a number of recommendations (all of which are supported by the government) concerning professional accounting body processes. These include that professional bodes should: a) refer potential breaches of the law by RCAs to ASIC (recommendation 15); b) that professional bodes should improve the quality of their record keeping with respect to disciplinary actions (recommendation 16); c) formalise communication (particularly regarding RCAs) between themselves and the FRC with respect to their disciplinary proceedings (recommendation 17); and d) publicly report statistics on the number of complaints they receive, and the number of complaints that do not proceed (recommendation 18).

ASIC's response

In a statement welcoming the release of the report and the government's response ASIC also outlined its support for certain recommendations (some of which have already been flagged above).

- **New workflow system will improve transparency:** ASIC states that its new workflow system for regulatory and enforcement activities will facilitate a more structured approach to audit surveillance, and deliver improved transparency as the system is common across all ASIC teams. ASIC adds that the system 'will capture processes, documents and decision points in a common structured way using consistent terminology across ASIC'. The new workflow was introduced on 1 June 2018.

- **Re-evaluate criteria for taking enforcement action:** ASIC will re-evaluate its criteria for taking auditor enforcement actions, and the types of outcomes that it may seek, including the use of enforceable undertakings and referrals of matters to the CADB as part of its implementation of the new Office of Enforcement.

- **Ensuring sufficient resourcing?** With respect to resourcing of audit inspection and financial reporting surveillance, ASIC states that resources will continue to be 'dynamically allocated within the team to achieve the best outcomes for quality financial reporting supported by quality audits'.

- **Releasing more detailed information in audit inspection reports, including naming firms?** As flagged above, ASIC is yet to determine whether it will name firms. ASIC states that is 'already considering whether to publish the percentage of findings for named audit firms in its next audit firm inspection report for the 18 months to 31 December 2019'. ASIC adds that it is currently reviewing 'when it would be appropriate to name entities more broadly across all our surveillance and compliance reports before deciding whether to disclose results for named audit firms.'

[Sources: Treasury media release 04/04/2019; Financial Reporting Council's Auditor Disciplinary Processes: Review; Government response to the Financial Reporting Council's Auditor Disciplinary Processes: Review; ASIC media release 09/04/2019; Accountants Daily 08/04/2019]

[Note: Context

- A parliamentary committee report, released in February raised concerns about the quality of audit and the approach taken to regulation. Among other things, the report queries whether 'deep-rooted problems in the audit market can be resolved by more robust practices' and suggested that the structure of the audit industry should be reviewed (pending the findings of the Financial Services Royal Commission) with a view to addressing issues of market dominance and conflicts of interest. (See: Parliamentary Joint Committee on Corporations and Financial Services: Oversight of ASIC, the Takeovers Panel and the Corporations Legislation No.1 of the 45th Parliament Report 13/02/2019)

- ASIC's latest audit quality inspection report (**ASIC Report 607 Audit inspection program report for 2017-2018)** identified, that that though efforts had been made by audit firms to improve audit quality, further improvements are required. For example, the report identified 20% of reviewed audits (ie reviews of audit files of the six largest firms for the period 1 January 207 to 30 June 2018) lacked reasonable assurance that the financial reports were free from material misstatement. (see: Governance News 30/01/2019)

- In the UK, audit quality and the regulatory/enforcement approach adopted by the regulators has also been called into question. Most recently, UK parliamentarians released report — entitled the Future of Audit — recommending a range of audit sector reforms including a possible 'structural split' between audit and non-audit functions, or potentially 'a full structural break-up of the Big Four into audit and non-audit businesses' (see Governance News 05/04/2019)]

Risk Management

Climate Risk

Engagement on climate issues has led to the withdrawal of a climate resolution at Shell (but hasn't headed off pressure from other climate activists)?

Key Point: A shareholder resolution calling on Shell to align itself with the goals of the Paris agreement has reportedly been withdrawn ahead of the shareholder meeting to 'give Shell time' to make changes. Shell is reportedly still being targeted by another lobby group, Climate100+.

- Bloomberg reports that climate activist Follow This has withdrawn a climate resolution at Royal Dutch Shell Plc — asking that the company align itself with the goals of the Paris agreement — ahead of the shareholder meeting following 'intensive discussions' between Shell and investors.

- Reportedly, though Follow This and Shell continue to disagree on whether Shell's strategy is already in alignment with the Paris Agreement, Follow This has said that the resolution was withdrawn to 'give Shell time' to bring its broader ambitions into alignment, and in recognition of 'positive' steps made by the company eg concrete targets to cut its carbon footprint and said it will take responsibility for reducing its customers' emissions.

- According to Bloomberg, Follow This will persist with similar shareholder resolutions it filed with companies including BP Plc, Equinor ASA, Woodside Petroleum Ltd, Exxon Mobil Corp, Chevron Corp. and Santos Ltd, this year.

Climate 100+ still targeting Shell? According to Bloomberg other shareholders, such as the Church of England, that previously aligned themselves with Follow This have started lobbying Shell separately through a climate coalition called the Climate Action 100+ (which was behind Glencore's decision earlier this year to limit coal investments see: Governance News 27/02/2019).

[Source: Bloomberg 08/04/2019; CNBC 09/04/2019]

In Brief | Under-pricing the impact of climate risk? BlackRock has released a report outlining how climate change poses tangible risks to investment portfolios now (not just in future) and calling on investors to reassess their approach. 'While the physical manifestations of climate change are clear, including rising sea levels, and more intense hurricanes, wildfires and droughts, how investors incorporate these risks into their analysis is not' BlackRock cautions

[Sources: BlackRock media release 04/04/2019; BlackRock media release: Getting Physical: Assessing climate risks 04/04/2019; Getting Physical: Assessing climate risks April 2019; BusinessGreen 05/04/2019]

In Brief | Supply Chain Transparency: The AFR reports that in acknowledgement of increased consumer demand including from consumers of copper-intensive products (eg people buying electric vehicles), the BHP is moving to improve supply chain transparency. 'Consumers care and they speak with their wallets...Sooner or later, the owner of an electric vehicle will want to know exactly what is in their car, and be guaranteed that it meets certain environmental standards. This is what the concept of "green copper" is all about' a BHP spokesperson is quoted as stating

[Sources: The SMH 08/04/2019]

In Brief | The UK Financial Reporting Lab announced that the project to improve climate change and workforce disclosures is progressing since it was commenced late last year. In-depth interviews with participants to identify how climate and workforce disclosures can be reported most effectively are now 50% complete

[Source: UK Financial Reporting Law Newsletter Q1 2019 04/04/2019]

Other Developments

Top Story | A better way for boards to manage non-financial risk? The Actuaries Institute has released a report outlining a proposed approach for financial services entities to better oversee, document and manage non-financial risk

Overview: Actuaries Institute Report, The Social Condition Report — A suggestion for Financial Services Businesses

The Actuaries Institute has released a report outlining a proposed approach for financial services entities to better oversee, document and manage non-financial risk which it suggests may be of particular relevance in light of issues identified by the Financial Services Royal Commission and the CBA Prudential Inquiry.

Key Takeouts

- **'Pedalling a lot harder' won't work:** In light of issues identified by both the Hayne Commission and the CBA Prudential Inquiry, many organisations will be increasing their focus on management of non-financial risk, but doing more of the same thing is unlikely to work.
- **New approach to identifying, managing and overseeing non-financial risk:** The discussion paper outlines a proposed alternative approach to managing and overseeing non-financial risk and makes the case for financial services entities to commission annual, internal 'Social Condition Reports' written by a 'social risk officer' (or other suitably qualified person).
- **Benefits of the proposed approach?**

1. a means of responding to the issues identified by both the Financial Services Royal Commission and the CBA Prudential Inquiry;
2. a means of identifying 'root causes' of issues
3. a means to deliver better information to boards (through a more structured and systematic process)
4. a means to streamline reporting and risk management processes
5. potentially benefit regulators in overseeing culture (as well as boards)
6. potentially of benefit in the context of integrated reporting

Introduction

The Actuaries Institute has released a discussion paper entitled: The Social Condition Report — A suggestion for Financial Services Businesses making the case for financial services entities to commission annual, internal 'Social Condition Reports' (SCRs). The report suggests that the adoption of annual SCRs could help boards and management teams to better identify, manage and respond to 'non-financial risks' of the kind identified by the Hayne Royal Commission and the CBA Prudential Inquiry as well as be of potential use for financial regulators in the context of overseeing non-financial risk.

The starting point

'The basic premise underlying this paper is that relationships with key groups in society are so fundamental to the success of a financial services business, and of such great value, that there should be a systematic approach to the management of those relationships, including assessment of their quality, their value, and associated risks. We propose a disciplined and structured ongoing process to report on the business's social condition, and to recommend actions' the report states.

In addition, the paper suggests that this would be a means of better managing and overseeing non-financial risks of the type identified by both the Australian Prudential Regulation Authority (APRA) CBA Prudential Inquiry and the Hayne Royal Commission.

What is a Social Condition Report (SCR)?

An SCR would be a comprehensive, internal, annual report to the board about the quality and value of the relationships with key groups in society. More particularly the report would:

1. Identify key groups in society with whom the business has a relationship.
2. Assess and measure the quality of the relationships with each key social group and how they have changed.
3. Assess the risks to those relationships, including against the board's risk appetite.
4. Review the approach taken to manage those relationships and risks.
5. Review social relationship incidents and responses.
6. Review implementation of past SCR recommendations and their success or otherwise.
7. Make new recommendations.

The proposed approach envisages use of a number of methodologies (which the writers observe may be new to a organisations) as part of this process to deliver richer information, eg Relational Analytics and Signal Analysis.

[Note: Recommendation 5.6 of Commission Hayne's final report recommended that all 'financial services entities should, as often as reasonably possible, take proper steps to: assess the entity's culture and its governance; identify any problems with that culture and governance; deal with those problems; and determine whether the changes it has made have been effective'.]

The paper includes an example SCR to illustrate what information might be included/level of detail.

'Social risk officer' (or other qualified person) should be responsible for the report

- To ensure adequate time, attention and expertise are brought to bear on the process, the paper envisages that an appropriate skilled person have 'clear and sole ultimate responsibility for the SCR'.
- The paper envisages that the SCR would be written by a 'social risk officer' within the organisation, or by another appropriately qualified person eg an actuary. That is, a person who is 'numerate' with a 'good understanding of the business, its products, strategy, and risk management, and not least the importance of social and cultural issues'. The paper notes however that it is unlikely that the person initially assigned will have all the skills needed.
- The paper suggests that were the financial regulators the Australian Securities and Investments Commission (ASIC) or the Australian Prudential Regulation Authority (APRA) to impose a requirement for an SCR, 'one can imagine them specifying the credentials of the person responsible for the SCR'.

Why doing 'more of the same' won't work? The benefits of adopting SCR reporting

The paper observes that 'most organisations will be thinking very intently about how to best respond to the Royal Commission and the CBA Inquiry' but expresses doubt about the likely responses, suggesting organisations are likely to continue what they are already doing: 'While it is likely that wide-ranging programs will be implemented, many responses are likely to involve being more diligent, working harder, applying more resources, improving reporting etc – basically pedalling a lot harder. We are sceptical about the effectiveness and efficiency of such approaches'.

In this context, the paper identifies a number of benefits to adopting SCR reporting. These include the following.

1. **A means of identifying 'root causes'?** The report would function, the paper suggests, as a means of addressing 'root causes of poor behaviour'. 'In the wake of the Royal Commission…because of the discipline and insights the SCR would provide, it could prove of great value to management and boards in identifying and addressing root causes of poor behaviour and unacceptable customer outcomes' the paper states.

2. **An antidote to 'flying blind'? Streamline reporting and deliver better information to boards:** The paper observes that management in most companies will be heavily stretched in the current environment and that a fragmented approach, based on present practices will likely be inefficient. In addition, existing practices have not served boards well. Given recent experiences, it is likely that many boards feel that they are 'flying blind' with respect to relationships with various members of society and associated risks. The paper argues that adoption of the SCR will provide a 'fresh approach built on a disciplined process and new methodologies'. It will provide a 'comprehensive and integrated assessment, and propose specific actions for management, with defined objectives. In addition, the methodologies proposed will give insights that will never come from existing practices'.

3. **It would assist ASIC (as well as the board)?** ASIC is being asked to be a much more active regulator, and this suggests a need to closely monitor organisations and their treatment of other parties. This will demand skills and resources which will be difficult to obtain and deploy effectively. A comprehensive SCR produced by a well-credentialed person and supported by appropriate resources could be of real value to ASIC in identifying issues and areas of regulatory focus – both for the particular institution and for the industry. 'One could imagine ASIC imposing a requirement on financial services businesses for an annual SCR that meets prescribed standards' the paper opines.

4. **Helpful in the context of Integrated Reporting?** Though the paper envisages that the SCR would be an internal document, it suggests that is could feed into Integrated Reporting (which is aimed at external reporting) as it would give valuable assessments of Integrated Reporting categories of social and relational capital.

5. **The link between relationship management and the concept of the 'social licence to operate':** The paper also links relationship management to organisation's 'social licence' which the writers define as 'the idea that certain institutions are effectively given approval to operate by society, with certain expectations being placed on the organisation'. Though the terminology is controversial, the writers note, at the heart of the concept is the idea of trust, 'the real issue is whether society implicitly trusts the organisation and there is mutual respect in society's dealings with the organisation' the paper states. The paper argues that 'it is the quality of relationships that is fundamentally important, and that an organisation should focus on managing its relationships. Any social licence is inevitably a consequence of this. That is, the stronger the relationship – in particular the trust and mutual respect it engenders – the more "licence" society provides'.

The arguments for and against the proposed approach

The discussion paper also anticipates and responds to arguments against the proposed approach, and why, on balance, the paper writers consider 'a well-produced SCR by an appropriately skilled person' would deliver value to boards and management.

- **The proposed approach is not 'overkill' given that current approaches have failed**: In anticipation of the argument that the proposed approach is 'overkill', the authors argue 'that assessment and management of relationships currently is nowhere near adequate for most financial services organisations' as evidenced by both the CBA inquiry and the Financial Services Royal Commission. Given this, they are, the proposed approach could be a 'very effective and efficient way' of responding and could in time become 'essential work for financial services organisations'.

- **The proposed approach is not too complex:** The writes suggest that some boards may object to the proposed approach on the basis that it is too involved. The writers acknowledge that the SCR as proposed does include multiple new concepts but suggest that 'it would be quite possible to adopt the basic SCR concept and stage the adoption of the more comprehensive approach'.

- **The SCR would not impose undue burden and/or distract management from running the business:** The writers anticipate that some boards may object to additional reporting and the associated processes on the basis that it could be a distraction/place additional burden on organisations. The authors argue that currently businesses are 'primarily focused on their financial profit and loss accounts and their financial capital, and are distracted from understanding the less tangible drivers of long-term value and risk'. As such, the SCR would be a 'foundational step towards correcting the balance of management and board attention'. They write: 'We believe producing a comprehensive SCR would actually be more efficient and effective over time than a piecemeal approach, and would likely results in better management and board decisions. Additionally, weak and poorly understood relationships often create friction that diverts management resources. Assuming that the SCR leads to better relationships, this will free up management attention to focus on key issues'.
- **Relationships are already managed using the existing net promoter score (NPS)?** The authors suggest one objection to the proposed approach may be that the proposed methodologies (Relational Analytics and Signal Analysis) are unproven while the Net Promoter Score (NPS) is already in use and is simple. They argue that though the NPS is a simple and easy to understand measure, its limitations are being increasingly realised. For example: a) the fact that it is 'backward looking' is unhelpful in flagging emerging issues; b) the NPS (including the 'relationship' NPS measure) is more focused on customer experience and service, rather than the broader underlying foundational conditions of the relationship; and c) NPS is also a 'one-way measure', and therefore ineffective in identifying organisational 'blind spots'. By contrast, the authors argue that the proposed methodologies address a number of these concerns. They also note that there are also a variety of other relationship survey methodologies that could be considered.
- **The proposed approach places too much emphasis on the average?** The authors note that one criticism that could be made of the proposed approach is that it places excessive emphasis on the 'average' position. They observe that the Hayne Commission gave 'ample evidence of how poorly some customers can be treated while the average was unremarkable'. The authors acknowledge that this is a limited in the mock/example SCR but note that 'future work would involve analysis of the distribution of results, including assessment of the weakest relationships'.

[Sources: Actuaries Institute media release 09/04/2019; The Dialogue: Leading the Conversation —The Social Condition Report — A Suggestion for Financial Services Businesses; [registration required] The AFR 09/04/2019]

Japan | Japanese leaders are more pessimistic about the economy than at any time since December 2016? A quarterly survey of Japanese Business Leaders has found that one quarter expect a global downturn over the next six months

A quarterly survey of Japanese business leaders – the presidents, chairmen and other corporate heads of 145 Japanese companies — conducted by Nikkei Asian Review has found that business leaders are more pessimistic than at any time since December 2016. .

More particularly the survey found:

- 25% of Japanese business leaders expect the global economy to worsen over the next six months (an increase of more than twofold on December 2018).
- 24.9% said the economy will 'falter', up 13.9% points from December's poll
- Confidence that the global economy would expand fell 18 percentage points to 37.2%.
- When asked about the risks facing the global economy this year, 77.2% of respondents cited the Chinese economic slowdown, with 39.3% of participants indicating that they expect the Chinese economy to worsen over the next six months, compared with 20.7% saying it will grow. This marks a shift from previous multiple-response polling in which trade friction emerged as the top concern.
- Trade negotiations with the US were also identified by 70% of participants as having a negative impact on the economic outlook.
- According to the survey, around 20% of companies said they are changing manufacturing locations or suppliers, or discussing tariffs and other cost burdens with business partners to try to mitigate against the impact of the expected economic downturn.

[Source: Nikkei Asian Review 27/03/2019]

Microsoft CEO has reportedly met with employees to discuss (alleged) cultural issues including alleged gender discrimination

Wired reports that a group of more than 100 Microsoft employees attended a meeting with Microsoft CEO Satya Nadella (with others watching via live stream) demanding to know how the CEO is planning to address allegations of misogyny and sexism at the company. Reportedly, the meeting following the posting of an email and discussion thread in which employees shared stories of abuse, harassment, and being passed over for advancement. Among other things, the employees are reportedly hoping for more data on bonuses and promotions.

[Source: Wired 04/04/2019]

Other News

Top Story | MinterEllison's Federal Budget Highlights 2019-2020

MinterEllison has released an overview of the 2019-2020 Budget highlights.

The full text of the article can be accessed on the MinterEllison website here: https://www.minterellison.com/articles/federal-budget-highlights-2019