Governance News

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Boards and Directors

In Brief | Nissan to overhaul its board? Reportedly Nissan is expected to abolish the role of Chair and name an external director to head its board following recommendations that the company address the concentration of authority in the current structure and strengthen oversight in light of the financial misconduct allegations against former chief, Carlos Ghosn

[Sources: Nikkei Asian Review 27/03/2019; [registration required] The WSJ 27/03/2019; Bloomberg 27/03/2019]

Remuneration

50:50? In a recent speech APRA Chair Wayne Bures has said (among other things) that the regulator wants to 'see remuneration based on a genuine and even balance of financial and non-financial considerations'

In his address to the AFR Wealth Summit: *Building resilience in three dimensions*, Australian Prudential Regulation Authority (APRA) Chair Wayne Byres emphasised the importance of building operational and cultural resilience in addition to financial resilience. Among other things, Mr Byres highlighted the importance of boards identifying and addressing the 'root causes' of cultural failings within their organisations and flagged a stronger role for the regulator with respect to remuneration.

Some Key Points

- **Financial resilience — APRA to 'broaden' its focus:** Mr Byres said that financial resilience has been a focus for APRA over recent years and that the recent IMF assessment had endorsed APRA's efforts. Ultimately, he said that 'the Australian financial system is fundamentally sound' though this should 'never be taken for granted'. He added that the additional resourcing recently granted to APRA would allow the regulator to have a 'wider focus, rather than a different focus'. More particularly he said that APRA will 'be able to broaden and deepen the scope of our supervision, while not taking our eye off the core financial strength that we have spent the past decade building'.
- **Operational resilience — Information security management cannot be treated as 'optional' or 'nice to have' and will require 'continued investment'**: Mr Byres observed that having 'a robust balance sheet alone won't protect institutions from other dangers that can pose significant threats to their ongoing viability', and that operational resilience, including in relation to information security management is 'equally important'. Mr Byres said APRA's new prudential standard CPS 234 Information Security (see: Governance News 12/11/2019) and accompanying guidance (see: Governance News 27/03/2019) will assist entities to raise standards. Mr Byres added that given the 'evolving nature of potential vulnerabilities, it's an area where continued investment by banks, and continued attention by supervisors, will be essential. Unlike the build-up of capital, it is a task that has no end. Making sure critical systems are protected, continue to operate reliably, and can be quickly restored when disrupted is just as critical to the ongoing trust and confidence in the financial system as bank capital and culture'.

Building organisational and cultural resilience

- **CBA self-assessments:** After the prudential inquiry into the CBA, APRA asked all institutions to reflect upon APRA's report (see: Governance News 04/05/2018), and consider whether similar issues could exist within their own organisation. APRA also asked 36 of Australia's largest institutions to conduct formal self-assessments against the report's key findings, and submit those assessments to APRA at the end of 2018. Mr Byres said that APRA would shortly publish APRA's findings.
- **Mr Byres said that most organisations acknowledged (in their self-assessments) that a number of the issues outlined in the CBA report were present in their own organisations**, though not to the 'same extent or depth' and in addition, many reports included a 'lengthy' list of action items boards have committed to address. Mr Byres commented that though identifying the issues is 'a positive' identification of the root causes of the issues is key, 'they need to treat the cause and not the symptoms' he said. For example, many assessments identified complexity as an issue. Mr Byres commented that 'There are many simplification programs currently underway, but unless the root cause of the complexity

is tackled – the circumstances that allowed it to take hold in the first place – then what comfort do we have that it will not grow back to strangle businesses again?'

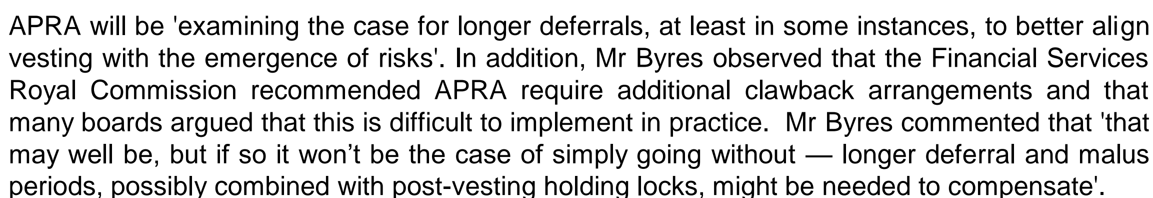
- **Mr Byres questioned the positive assessments of both board and executive performance (given other failings identified):** Mr Byres said that though there was a 'fair degree' of reflection and acknowledgement of issues most of the themes in the CBA Report, in two areas the picture was notably more positive: the self-assessments of Board and executive performance. He commented 'This, of course, begs the obvious question: how can boards and management give themselves a pass mark when they have identified a wide range of weaknesses in a number of key areas? Do Boards and management have a blind spot – that blind spot being themselves? It's a difficult but important question to ask'.
- **APRA's work program to strengthen organisational/cultural resilience:** Mr Byres said that the issues identified in self-assessments, the Financial Services Royal Commission and the CBA inquiry have 'crystallised a number of mutually reinforcing pieces of work' for APRA that will assist in strengthening organisational and cultural resilience Mr Byres said. Though, Mr Byres emphasised that ultimately 'regulators can't regulate good culture into existence' and that ultimately it will be 'boards and executives that do the heavy lifting'. APRA's work program includes work relating to the following issues:

  1. **Incentives** – in particular, 'work on executive remuneration designed to better align potential rewards with a holistic view of performance (capturing the 'how' as well as the 'how much')'.
  2. **Assurance and compliance mechanisms** – 'many problems have gone undetected too long, or been detected but not escalated quickly enough. Stronger and more effective compliance and assurance mechanisms are clearly needed'.
  3. **Accountability and consequences** – 'clear and sharp accountabilities lay at the heart of good governance, and ensure there can be appropriate consequences for poor outcomes'.
  4. **Governance and risk oversight** – 'overseeing all of this needs to be a stronger system of governance and risk oversight'.

Executive Remuneration

- **Greater prescription required:** With respect to executive remuneration Mr Byres said that 'attempts to move away from the conventional model of executive remuneration have not been wholly welcomed' industry and that consequently, as the Financial Services Royal Commission concluded 'regulatory intervention, and a greater degree of prescription, will be required to shift practices'.
- **Mr Byres reiterated that APRA will commence consultation on revisions to current prudential standards by the middle of the** year and that more detail will be provided over coming months.
- **Likely changes:**

  1. **Metrics:** Mr Byres said that the regulator wants to 'see remuneration based on a genuine and even balance of financial and non-financial considerations'. Though APRA is yet to 'reach a view as to the right mix' of financial and non-financial metrics, Mr Byres said that an 'obvious question for Boards is to ask themselves why 50:50 wouldn't be a good starting point'. Mr Byres added 'I'd argue there should be more than a single, share-price based metric. That would mean TSR [Total Shareholder Return] would go from the primary, if not sole, determinant of LTIs [Long Term Incentives] to something less than 25%'.
  2. **Board discretion:** Mr Byres said that given the 'complexity and nuance' involved in assessing whether executive remuneration is appropriate, boards need more discretion. 'That is, both more discretion in rewarding, and more discretion in judging whether rewards should ultimately vest. Totally formulaic approaches with high leverage that some investors seem to favour are not going to cut it in the future. That will also probably also require more transparency about decision-making, which is no bad thing' he said.
  3. **Malus and clawback:** Mr Byres said that it was 'disappointing' that industry largely appears to have viewed the minimum deferral requirements under the BEAR 'as the default'. He said that



APRA will be 'examining the case for longer deferrals, at least in some instances, to better align vesting with the emergence of risks'. In addition, Mr Byres observed that the Financial Services Royal Commission recommended APRA require additional clawback arrangements and that many boards argued that this is difficult to implement in practice. Mr Byres commented that 'that may well be, but if so it won't be the case of simply going without — longer deferral and malus periods, possibly combined with post-vesting holding locks, might be needed to compensate'.

[Source: APRA Chair Wayne Byres' speech at the Australian Financial Review Banking and Wealth Summit: Building resilience in three dimensions 27/03/2019]

Comments in response to Mr Byres' comments with respect to remuneration

- **Investors aren't against the use of financial metrics, they're against lack of pay consequences?** Writing in the AFR Ownership Matters questions Mr Byres' assumption that institutional investors are necessarily against non-financial metrics. Ownership Matters contends that the 'substantial votes against remuneration reports' in 2018 were not driven 'by shareholders concerned that executive pay outcomes were being driven by non-financial factors. Instead shareholders were angry that boards, when faced with the costs of executive failures on culture and oversight, found it impossible to reduce executive bonuses to zero'. The article goes on to argue that investors need to take a stronger stand, 'At the heart of boards' failures on incentives is the reluctance of institutional investors and those who advise them – us included – to use their votes to remove directors who get it so demonstrably wrong'.

[Source: [registration required] The AFR 01/04/2019]

- **Banks losing the ability to 'set bosses' pay'?** The ABC interprets Mr Byres' comments as an indication that 'banks could lose power to set bosses' pay'.

[Sources: The ABC 27/03/2019; [registration required] The AFR 27/03/2019]

APRA consultation on the application of BEAR variable remuneration requirements for medium/small ADIs

The Australian Prudential Regulation Authority (APRA) is consulting on a proposed legislative instrument to apply the Banking Executive Accountability Regime (BEAR) to variable remuneration arrangements for medium and small authorised deposit-taking institutions (ADIs) (irrespective of the corporate structure of the ADIs).

More particularly, APRA is consulting on a draft schedule of the kinds of remuneration that are not variable remuneration for the purposes of the BEAR.

Context: Under the BEAR, which came into effect for the big four banks on 1 July 2018, banks are expected to establish a remuneration policy requiring that a portion of executives' variable remuneration be deferred for a certain number of years and reduced commensurate with any failure to meet their obligations to act in the best interests of customers.

Some Key Points

- **APRA proposes that only remuneration that relates to a person's 'accountable person' role will be subject to BEAR deferral requirements:** APRA proposes that, irrespective of the organisational structure or whether the ADI is a locally incorporated ADI or foreign ADI, where an individual has both an accountable person role with an ADI (or subsidiary of an ADI) and another role, only the portion of the individual's variable remuneration that relates to the accountable person role would be subject to the deferral requirements under Division 4 of Part IIAA of the *Banking Act 1959 (Cth)*.
- **Consistency with BEAR:** The purpose of the proposed legislative instrument is to ensure that application of the deferred remuneration obligations across ADIs is consistent with the intent of the BEAR.
- **Not expected to impact large ADIs:** APRA expects the proposed legislative instrument will not result in any major banks/large ADIs initiating any changes to the amount of deferred remuneration, as the legislative instrument does not apply to their particular corporate structure

Timeline:

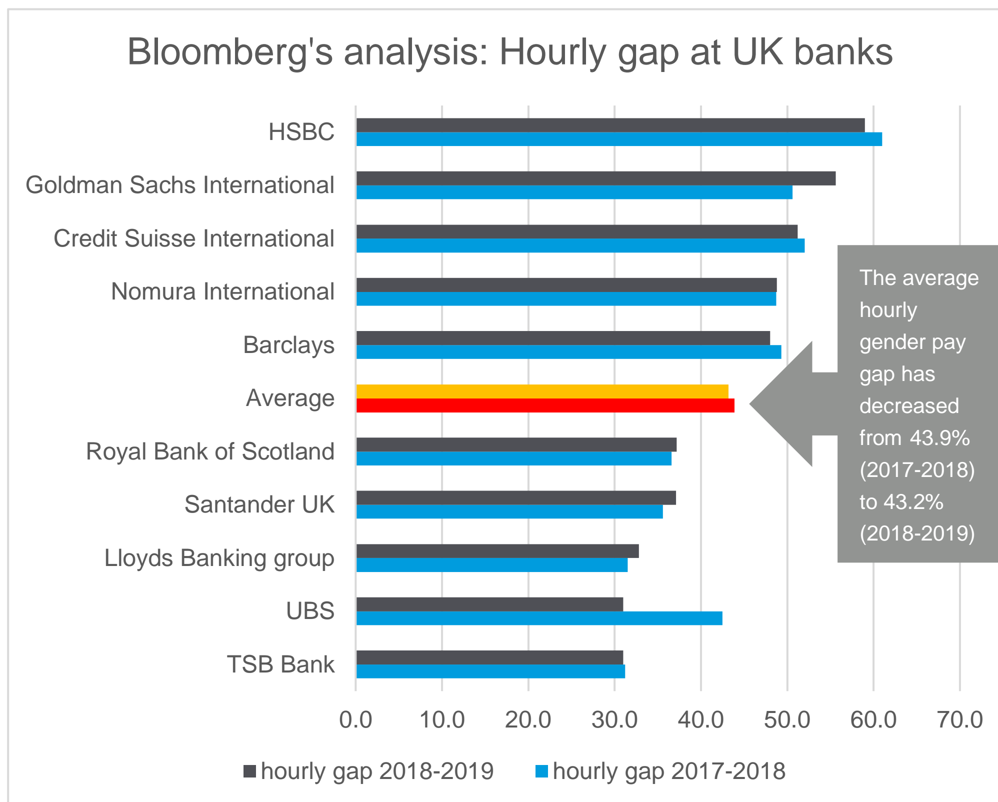
- Submissions are due on 30 April.
- The final legislative instrument will be released before the BEAR comes into force for medium and small ADIs on 1 July 2019.

[Sources: APRA Letter to all authorised deposit taking institutions 01/04/2019; Draft Schedule — kinds of remuneration that are not variable remuneration 01/04/2019; Mortgage Business 02/04/2019]

United Kingdom | Slow progress on narrowing the (gender) pay gap? According to Bloomberg's analysis, the gender pay gap at some of the UK's largest banks is 43.2% (an improvement on last year)

Bloomberg reports that based on its own analysis, progress towards narrowing the (gender) pay gap in the financial services sector remains slow and suggests that the figures reflect the imbalance that still exists at the biggest financial firms.

Some Key Points



Women at financial firms in the UK earn on average around 28% less than their male counterparts based on Bloomberg's analysis of the reports of nearly 100 companies in the financial sector that have reported so far this year. Bloomberg comments that this is more than double average pay gap across all industry sectors which is approximately 13%.

On average, the hourly (gender) pay gap appears to have slightly decreased. According to Bloomberg, the average is 43.2% (down from 43.9% in 2017-2018).

Lowest gaps? TSB Bank and UBS appear to have the lowest gaps at 31%, followed by Lloyds Banking Group (32.8%), Santander UK (37.1%) and Royal Bank of Scotland (37.2).

[Source: Bloomberg 25/03/2019]

United Kingdom | A UK Parliamentary Committee has called for action to address the 'huge differentials' between executive and employee pay, cautioning that failure to do so could 'foment hostility, accentuate a sense of injustice and undermine social cohesion and support for the current economic model'

Report Overview: *Executive Rewards: paying for success* report

The UK Business, Energy and Industry Strategy (BEIS) Committee has released its report into executive remuneration: *Executive Rewards: paying for success.* The report recommends a number of reforms to address issues with current pay structures.

The starting point for the report recommendations — some key findings

- **'Huge differentials' in pay persist** and companies 'continued to share the rewards of their success largely with their shareholders, in the form of dividends, and with the senior management in the form of multi-million pound pay packages, rather than sharing the proceeds more evenly amongst their workforce, who sustain the business, through pay and pension contributions'.
- **'Executive greed, fed by a heavy reliance on incentive pay, has been baked into the remuneration system' leading to public perception of 'institutional unfairness'.** If unaddressed, the report cautions, this could 'foment hostility, accentuate a sense of injustice and undermine social cohesion and support for the current economic model'.
- **'Remuneration committees have helped fuel the excessive levels of executive pay we see today'**
- **Failure of stewardship?** The report is critical of investors' role, 'we understand that investors can exert valuable influence behind the scenes but we believe that their stewardship role includes a wider responsibility to help set the boundaries of acceptable practice on executive pay and to promote long-term performance' the report states.
- **Changes to the Governance Code unsupported by pressure from the regulator will not drive change:** Though the report welcomes revisions to remuneration guidance in the Corporate Governance Code, including the requirements to consider the long-term remuneration across the whole workforce and potential reputational risks, the report states that the 'Code alone is unlikely to be an effective driver of change' without support from the (new) regulator (the Audit, Reporting and Governance Authority).

Some Key Recommendations

- **The simplification of pay structures:** The report advocates a structure based on fixed salary plus deferred shares that would vest over a long period (and subject to provisions designed to prevent 'rewards for failure')
- **Remuneration Committees:**
  - **Remuneration Committees should impose caps on executive remuneration:** The report recommends that 'remuneration committees should set, publish and explain an absolute cap on total remuneration for executives in any year'.
  - **Remuneration committees should engage 'early and meaningfully with major investors on executive pay**, be prepared to make the case for pay reform and restraint in the interests of avoiding reputational damage'.
  - **Employee representation on remuneration committees:** The report calls for the appointment of at least one employee representative to the remuneration to help ensure there is discussion of the link between executive pay and that of the workforce as a whole
- **Expansion of pay ratio reporting:** The report recommends that pay ratio reporting requirements be expanded to include all employers with over 250 employees and that the lowest pay band be included alongside the quartile data required
- **Stewardship Code should require investors to take a more active role on executive remuneration** and the Code itself should be 'be applied strictly and consistently by relevant regulators, including the Financial Conduct Authority'.
- **The report is supportive of the creation of the new Audit, Reporting and Governance Authority (ARGA)** (which will replace the Financial Reporting Council (FRC)) as a 'more empowered, aggressive and proactive regulator that has the ability to take decisive action, where necessary, on executive pay and its reporting' and many of the report recommendations concern the new regulator. These recommendations include that ARGA should (among other things):
  - engage with investors to develop guidelines on bonuses to ensure that they are 'genuinely stretching and a reward only for exceptional performance, rather than being effectively an expected element of annual salary'

- be more 'prescriptive and interventionist' in monitoring pay practices and publicly 'call out poor practice or behaviours'
- 'clarif[y] and strengthen its guidance on executive remuneration with a view to exerting significant downward pressure, avoiding unjustifiable payments and ensuring that, if they are made, they can be readily recovered'
- become responsible for monitoring the impact of the new Wates Principles of Corporate Governance for Large Private Companies (see: Governance News 17/12/2018).

[Sources: House of Commons Business, Energy and Industrial Strategy Committee: Executive rewards: paying for success; The Guardian 26/03/2019; The Times 26/03/2018]

Other Shareholder News

Treasury is consulting proposed changes which would impose caps on claims on the National Guarantee Fund

Context: *Under the Corporations Act 2001* (Cth), operators of financial markets must have an eligible compensation scheme to protect investors. The National Guarantee Fund (NGF) is a compensation scheme that applies to members of the Securities Exchanges Guarantee Corporation. The NGF provides compensation for retail and wholesale clients who incur a loss in their dealings with participants in four circumstances, as set out in the *Corporations Regulation 2001 (Cth).* Currently, only claims relating to an insolvent participant are capped, with the three other circumstances uncapped.

Consultation: Treasury is consulting on draft regulations: *Draft Corporations Amendment (National Guarantee Fund Payments) Regulations 2019 (Cth)*, which propose to amend the *Corporations Regulations 2001 (Cth) (the Corporations Regulations)* to cap compensation payments made out of the National Guarantee Fund (NGF).

To ensure the sustainability of the NGF, Treasury proposed to make three changes to the current regime:

1. introduce a cap of $1 million for claims made by the same claimant that relate to the same participant and the same event;
2. introduce a sub-cap of $250,000 in relation to cash held with a participant; and
3. amend the existing per participant cap which applies to the insolvent participant head of claim (15 per cent of the prescribed minimum size of the NGF) to cover all heads of claim in the event of an insolvency.

Timeline: The deadline for submissions is 2 May 2019.

[Sources: Treasury media release 03/04/2019; Draft Regulations: Corporations Amendment (National Guarantee Fund Payments) Regulations 2019; Draft Explanatory Statement]

Regulators

'Obey the law': In his address to the AFR Banking and Wealth Summit, ASIC Chair James Shipton called on industry to embed 'fairness' into every aspect of their business models in line with their legal obligations and cautioned that he does not 'want to have to relay this same message again in a year's time'

In a speech entitled *The Fairness Imperative*, at the AFR Banking and Wealth Summit, Australian Securities and Investments Commission (ASIC) Chair James Shipton said industry has 'not made as much progress' as the regulators (ASIC and the Australian Prudential Regulation Authority (APRA)) would have liked to see since last year on raising standards and called on entities to proactively implement the 'spirit' of the Financial Services Royal Commission's recommendations and ensure fairness is 'embedded into every aspect of' every entity's business model.

Mr Shipton said 'I do not want to have to relay this same message again in a year’s time. Now is the time for meaningful change. Now is the time to build a trusted and professional financial services sector. And now is the time to put fairness first'.

Some Key Points

- **The 'fairness imperative'**: Mr Shipton said that fairness is a core part of ASIC's work and that the concept is already 'embedded' in s912A of the *Corporations Act 2001 (Cth)* ie the obligation to act 'efficiently, honestly and fairly'. Mr Shipton added that the concept of fairness aligns closely with concepts of professionalism. 'The core statutory obligation on licensees to act "efficiently, honestly and fairly"…implies an element — not just of even handedness in dealing with consumers — but also the concept of sound ethical values and judgment in matters relevant to a consumer's affairs...In this…I hear echoes of professionalism' he said.

- **Reminder to organisations and their directors that penalties attach to breach of s912A**: Mr Shipton reminded industry that there is now a penalty for breach of (existing obligations) under s912A and that this is an 'important foundation' of ASIC's new 'why not litigate?' approach to enforcement. He said that ASIC's expectation is that:

  - 'financial institutions must respond responsibly to the challenge and not, as we have seen in some segments, with resistance and reluctance to the job we as a conduct regulator are expected to do'.

  - 'directors and officers (including of super trustees) are also on notice as to their directors' duties and responsibilities in relation to non-financial risks, including conduct risk and operational risks such as cyber resilience, privacy and data management'.

- **Directors and officers are advised to take a proactive approach:** Mr Shipton suggested that officers and directors in the finance sector '"lean into the future" as regards senior management and director responsibility and accountability'. More particularly, Mr Shipton suggests that work can commence 'immediately' by 'leveraging off' existing guidance coming from APRA's CBA inquiry, the Financial Services Royal Commission and ASIC's supervisory and corporate governance work. 'Given that there will be an extension of the Banking Executive Accountability Regime (BEAR) obligations to firms regulated by ASIC, with an additional focus on conduct, this leaning into the future is a very real and practical imperative' Mr Shipton said.

- **Push back contributes to an 'unhelpful culture of resistance and reluctance' and may suggest entities still have 'things to hide':** Mr Shipton said that ASIC's mandate — 'If the law is broken we need to enforce it' — is clear, and that ASIC's expectation is that entities 'don't break the law'. This, he said is in line with community expectations. Given this, he said that 'push back' is of concern to the regulator because it indicates:

  - 'most importantly, it suggests there are still things to hide'

  - 'there is resistance to a meaningful mindset change'

  - there is a fundamental misunderstanding of ASIC's broader fairness mandate and its statutory mandate to enforce the law.

  - there is a belief that would use its 'powers inappropriately, irresponsibly and without foundation to, it has been suggested, unfairly target particular names'

  Mr Shipton added that if firms 'are confident' about their 'governance, management and operational systems, as well as the way you [they] go about your [their] business, there is nothing to worry about'.

- **Clarification of ASIC's enforcement approach:** Mr Shipton clarified ASIC's 'why not litigate?' enforcement approach. He said, 'Again, let me be clear – our approach to the use of enforcement is that if we find evidence that the law has been broken we will investigate it. A breach of the law is the starting point. It is wrong, and unhelpful, to suggest that we would instead start with a name and work backwards with an enforcement action in mind'. He said that ASIC's focus is on deterrence and to address the 'community expectation that wrongdoing' is 'punished and denounced through the courts'. Mr Shipton observed that the new penalties available to the regulator will be 'of greater deterrence value and will make a meaningful difference'.

- **Update on ASIC's work:** Mr Shipton also provided an update on ASIC's work highlighting the regulator's focus on court based enforcement outcomes and ASIC's Close and Continuous Monitoring program.

It's not always clear what the law is? The AFR has queried whether ASIC's edict to 'obey the law' is as simple to apply in practice as it sounds. The AFR comments 'there's rarely anything simple about the law, including the definition of what constitutes Shipton's other stated imperative of "fairness"'. The article suggests that this, in combination with ASIC's more aggressive enforcement stance is contributing to uncertainty for financial institutions.

[Sources: Speech by ASIC Chair James Shipton at the AFR Banking and Wealth Summit, The Fairness Imperative 27/03/2019; [registration required] The AFR 27/03/2019; InvestorDaily 28/03/2019; [registration required] The AFR 29/03/2019; 27/03/52019]

In Brief | How will ASIC measure the success of its new enforcement approach? The success of ASIC's new 'why not litigate' approach will not be measured by convictions, but by 'seeing significant and measurable reduction in misconduct in the financial services industry and other industries' ASIC Deputy Chair Daniel Crennan has reportedly said

[Source: [registration required] The AFR 28/02/2019]

In Brief | Increased funding for ASIC and APRA in the Federal Budget has been welcomed by the Governance Institute (GIA) as 'vital to restoring trust' in the financial sector. The GIA also expressed disappointment that the Federal Labor Party has made no announcements around funding for the financial sector's regulators, or any mention of the Banking Royal Commission

[Sources: Governance Institute of Australia media release 02/04/2019; 04/04/2019; [registration required] The Australian 03/04/2019; [registration required] The Courier Mail 04/03/2019]

Corporate Social Responsibilty

2019-2020 Budget Measure: The government has announced $5 million for the establishment of a Social Impact Investing Taskforce

As part of the 2019-20 Budget, the government announced $5 million for the establishment of a Social Impact Investing taskforce.

The taskforce will be situated in Department of Prime Minister and Cabinet and will:

- examine the commonwealth's role in the Social Impact Investing market develop the next stage of the government's strategy for its role in this market, including how these investments can provide solutions for entrenched disadvantage
- take into account international, private sector and government experience in Social Impact Investing, drawing on the United Kingdom Government's 2013 approach of establishing an expert taskforce to catalyse the development of the Social Impact Investment market

Senate Economics Committee Chair, Senator Jane Hume will be assisting the Government in assembling and developing the scope of the taskforce's work.

Timeframe: The Taskforce will report to Government 'before the end of 2019'.

Three Social Impact Investment Trials in the social services sector: The 2019-20 Budget includes $14.1 million (over five years) to establish three Social Impact Investment trials in the social services sector.

- The trials will involve initiatives that seek to increase workforce participation of people who receive income support payments, and strengthen the wellbeing and self-reliance of families with children.
- The trials will involve a 'payment by outcome model' where organisations will be funded based on the social outcomes they achieve.

The Australian Banking Association (ABA) has welcomed the establishment of the taskforce as a 'welcome first step' and said it will work with the taskforce during its consultation. CEO of the Australian Banking Association Anna Bligh said 'social Impact Investing represents an innovative way to tackle entrenched disadvantage, with positive signs from this approach emerging from the United Kingdom…Banks look forward to playing their part in this new policy area to ensure it's a success in achieving its goals'.

[Sources: Ministers for the Department of Social Services media release 03/04/2019; ABA media release 03/04/2019]

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

The Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019 has passed both Houses with amendments

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019 passed both Houses with 9 Government amendments on 3 April.

Amendments: The Bill proposes to amend the *Corporations Act 2001 (Cth)* to introduce design and distribution obligations in relation to a broader range of financial products than was originally envisaged and gives more power to the Australian Securities and Investments Commission (ASIC) to respond to detrimental products.

The government amendments will implement part of the government's response to the Financial Services Royal Commission (see: Governance News 06/03/2019): In a statement announcing the passage of the Bill Treasurer Josh Frydenberg said that though Commissioner Hayne did not recommend the expanded powers and obligations included in the legislation, he did suggest that they ought to be extended to all financial products and credit products within ASIC's regulatory responsibility. In addition, Mr Frydenberg said that the changes also implement recommendations 21 and 22 of the Financial System Inquiry to strengthen product issuer and distributor accountability and introduce a product intervention power.

Recap of the legislation: some key points

1. **Design and Distribution obligations:** Schedule 1 introduces design and distribution obligations in relation to financial products.

   The new obligations only apply to primary or initial offerings of financial products to retail clients.

   The new obligations are intended, according to the revised explanatory memorandum, to 'improve consumer outcomes by ensuring that financial services providers have a customer-centric approach to making initial offerings of products to consumers'.

   Application:

   - The obligations generally apply to offers of financial products about which the offeror must make disclosure under the Corporations Act.
   - The obligations also apply to products that are not regulated under the Corporations Act, but are regulated under Division 2 of Part 2 of the ASIC Act.
   - The new design and distribution regime also applies to any financial product prescribed by the Minister in regulations.
   - Some products requiring disclosure are exempt from the new regime including: MySuper products, margin lending facilities, securities issued under an employee share scheme and fully-paid ordinary shares.

   Timeline: These changes will take effect two years after the Bill received Royal Assent.

2. **Product intervention power:** Schedule 2 introduces a product intervention power for ASIC to prevent or respond to significant consumer detriment. To ensure 'that the new power cannot interfere with existing arrangements between consumers and providers', ASIC may only intervene in relation to products that are made available for acquisition after the commencement of the new power. In addition, an order cannot apply to a product that has already been acquired or where a contract for the acquisition of the product has already been entered into.

   Timing: Schedule 2 takes effect the day after the Bill receives Royal Assent.

3. **ASIC enforcement powers:** The new law gives ASIC powers to enforce the new arrangements and civil and criminal penalties that apply to contraventions.

ASIC has welcomed the passage of the legislation: In a statement, ASIC welcomed the passage of the Bill and the amendments. ASIC Chair James Shipton commented that the amendments 'extended the reach of these reforms, providing a comprehensive framework of protection for most consumer financial products. It will also empower ASIC to intervene in relation to a wider range of products where ASIC identifies a risk of significant detriment to consumers'.

[Sources: Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019; Government amendments; ASIC media release 04/04/2019]

Update on the implementation of Hayne recommendation 2.4 (grandfathered commissions): Draft regulations released

The government is consulting on draft regulations outlining the requirement for financial product manufacturers to pass through to their clients the benefits of any previously grandfathered conflicted remuneration remaining in contracts after 1 January 2021. The regulations also propose to impose obligations on financial product manufacturers to keep records on the amounts to be passed through to clients.

Announcing the consultation, Treasurer Josh Frydenberg said that the regulations 'are designed to ensure that it is consumers, not industry, that benefit from the ban [on grandfathered commissions]'.

Timeline: Submissions are due by 25 April.

Context

- The Final Report of the Financial Services Royal Commission recommended that the grandfathering arrangements for conflicted remuneration in relation to financial advice provided to retail clients should be repealed 'as soon as is reasonably practicable' (recommendation 2.4).
- In its initial response to the Financial Services Royal Commission's Final Report, the government announced that it would end grandfathering of conflicted remuneration to financial advisers effective from 1 January 2021.
- The government has since released draft legislation: *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019* (released 22 February) for consultation, which proposes to remove grandfathering arrangements for 'conflicted remuneration and other banned remuneration from 1 January 2021'. The draft Bill also proposes to enable the regulators to provide for a scheme (the subject of the draft regulations) under which amounts that would otherwise have been paid as conflicted remuneration are rebated to affected consumers. It's also proposed that failure to pay an amount or monetary benefit in accordance with the Regulations will attract a civil penalty. Consultation on the draft Bill closed on 22 March. (See: Governance News 27/02/2019)
- The government has also issued a Ministerial Direction, requiring that ASIC undertake an investigation to monitor and report on industry behaviour in the period 1 July 2019 to 1 January 2021.
- The Federal Labor Party has said it is committed to 'fully implement' Recommendation 2.4 and has said that it would end grandfathering of conflicted remuneration effective from 1 January 2020. The statement adds that Labor has already tabled a Bill in the Parliament to give effect to this recommendation (see: Governance News 13/02/2019)

The Australian Banking Association (ABA) has urged swift action on grandfathered commissions (and the National Farm Debt Mediation scheme), but has cautioned other Hayne recommendations will take longer to implement

The AFR reports that ABA CEO Anna Bligh has called on the next federal government to enact legislation to implement certain of Commissioner Hayne's recommendations including: a) banning grandfathered commissions on financial advice which she suggests should occur within 100 days of the election; and b) enacting legislation to create a nationally consistent farm debt mediation scheme.

This might be accomplished, Ms Bligh reportedly suggested through a single Banking Reform Bill. The Bill might also include: the creation of a new regulator oversight body; a deferred sales model for add-on

insurance; a legal obligation to cooperate with the Australian Financial Complaints Authority; and more rigorous laws requiring financial advisers to disclose alignments to advice dealer groups.

Reportedly Ms Bligh has said that other recommended reforms will require extensive consultation (and therefore take longer to implement) for example: reform of mortgage broker fees, extensions of the Banking Executive Accountability regime, and making industry codes enforceable.

[Sources: Treasurer Josh Frydenberg media release 28/03/2019; Treasury media release 28/03/2019; Explanatory statement; Explanatory statement; Financial Standard 28/03/2019; [registration required] The Australian 28/03/2019; registration required] The AFR 27/03/2019]

Feedback sought on the merits/possible impacts of implementing Financial Services Royal Commission Recommendation 4.13 (Universal Terms Review)

The government has released an issues paper seeking feedback on the merits of legislating universal key definitions, terms and exclusions for default insurance cover within MySuper products. More particularly the government seeks feedback on the impact of implementing such changes on premiums as well as the merits of prescribing minimum, maximum or set levels of cover.

Context: The Final Report of the Financial Services Royal Commission recommended that Treasury determine, in consultation with industry, the practicability and likely pricing effects of legislating key definitions, terms and exclusions for default MySuper group life policies (recommendation 4.13).

The consultation paper seeks stakeholder views on the issues raised by Commissioner Hayne in his Final Report including: the merits of setting standard terms and definitions; the merits of prescribing minimum and maxim or set levels of cover; the impacts on premiums; measures to improve consumers' understanding of insurance in superannuation.

Timeline: The deadline for submissions is 26 April 2019.

[Sources: Treasurer Josh Frydenberg media release 28/03/2019; Treasury media release 28/03/2019; Universal terms for insurance within MySuper Issues Paper March 2019; [registration required] The AFR 28/03/2019]

Consultation on superannuation binding death benefit nominations and kinship structures

The Financial Services Royal Commission Final suggested that the government explore, in consultation with relevant Aboriginal and Torres Strait Islander peoples, difficulties they face making binding death benefit nominations. In his Final Report, Commissioner Hayne wrote: 'I urge consultation with relevant Aboriginal and Torres Strait Islander peoples about whether they, as the relevant users of the system, see difficulties about binding death benefit nominations that should be met'.

In line with Commissioner Hayne's suggestion, the government has announced the release of a discussion paper for consultation, focusing on the difficulties that Indigenous people face when making superannuation binding death benefit nominations.

The discussion paper explores the law surrounding the distribution of superannuation death benefits, Aboriginal and Torres Strait Islander peoples' kinship structures and how these kinship structures are accommodated elsewhere in the law.

The purpose of the consultation is to identify whether law changes are required to address how kinship structures of Aboriginal and Torres Strait Islander communities are treated by laws applying to superannuation death benefits.

Announcing the consultation, Treasurer Josh Frydenberg said that the consultation is an example of the government going further in response to the Commission's recommendations. Mr Frydenberg added that 'the Government is focused on putting the interests of superannuation members — not superannuation funds — first'.

Timeline: Consultation will close on 24 May 2019

[Sources: Treasury media release 29/03/2019; Discussion paper: Superannuation binding death benefit nominations and kinship structures 29/03/2019; Treasurer Josh Frydenberg media release 29/03/2019; Financial Services Royal Commission Final Report, Volume 1 (at p254)]

AFCA Chair Helen Coonan has called on financial institutions to cooperate with AFCA or risk being 'called out in the strongest possible terms'

Speaking at AFR Banking and Wealth Summit, Australian Financial Complaints Authority (AFCA) Chair Helen Coonan has said that AFCA will 'push the banking sector to undertake a cultural transformation as part of a "fairness revolution" by the new one-stop-shop ombudsman set up to deal with financial complaints'.

Ms Coonan observed that AFCA data indicates that the financial services sector has 'a long way to go' to reduce and resolve disputes with their customers, which she attributes to 'poor culture' and 'indifference to regulatory and compliance risk'.

Ms Coonan said AFCA was not going to 'sit by passively' while firms adopt a casual and unresponsive approach to resolving customer disputes but expected firms to be responsive. 'Some of the large institutions have responded appropriately and are engaging − but many are failing to scale up their internal dispute resolution functions and settle issues that should be settled earlier or are raising technical issues on jurisdiction rather than seeing AFCA as a facilitator to the resolution of these disputes and to restore some semblance of confidence and trust in the process' she said. She added that where firms fail to cooperate, AFCA would 'be calling this out in the strongest possible terms' Ms Coonan said.

[Note: The Financial Services Royal Commission's Final Report recommended (Recommendation 4.11) that Section 912A of the Corporations Act should be amended to require that AFSL holders take reasonable steps to co-operate with AFCA in its resolution of particular disputes, including, in particular, by making available to AFCA all relevant documents and records relating to issues in dispute.]

[Source: AFCA media release 27/03/2019]

In Brief | ASIC has reportedly found no evidence of insider trading ahead of the release of Commissioner Hayne's final report, despite Labor speculation to the contrary

[Source: [registration required] The AFR 27/03/2019]

Other Developments

Top Story | MinterEllison Foreign Bank Tracker 2019

MinterEllison's annual Foreign Bank Tracker 2019 has been released. The report maps capital flows into Australia – drawing upon 10 years of APRA data to unveil trends with foreign bank operations in Australia.

Now in its fourth year, the report shows foreign banks are continuing to expand their reach in Australia.

Foreign banks operating in Australia have now recorded three consecutive years of positive growth. While admittedly off a lower base, they have recorded a stronger growth in total resident assets than the big four Australian banks.

The full text of the report can be accessed on MinterEllison's website here: https://www.minterellison.com/articles/foreign-bank-tracker

APRA is consulting on draft rules to provide clarity to new entrants to the financial services sector

The Australian Prudential Regulation Authority has commenced an eight week consultation on proposed draft rules intended to provide clarity for new entrant financial sector companies on whether they are likely to be approved under *the Financial Sector (Shareholdings) Act 1998 (Cth)* (FSSA).

The FFSA was amended in 2018 to introduce a new streamlined 'fit and proper' test for shareholders of new or recently established authorised deposit-taking institutions and life insurers with assets below $200 million, and general insurers with assets below $50 million. The draft rules outline:

1. the matters that must be considered to determine if a person is 'fit and proper' under the FFSA.
2. the calculation used to determine if an entity's assets are within the relevant threshold; and
3. the information to be reported to APRA annually if an application under the "fit and proper" test is approved

Timeline: Submissions are due by 27 May 2019.

[Sources: APRA media release 02/04/2019; [registration required] The Australian 04/03/2019]

Assistant Treasurer Stuart Robert has announced that the government plans to establish a superannuation consumer advocate as recommended by the Productivity Commission

Assistant Treasurer Stuart Robert has announced that the government plans to establish a superannuation consumer advocate and has called for expressions of interest.

The consumer advocate will be an 'independent consumer body with specialist knowledge' and will be 'an important voice in providing input on behalf of members in policy discussions, and working to educate and assist members navigate the superannuation system' Mr Robert said..

Mr Robert said that Treasury has been asked to recommend: a potential provider or providers from the field of expressions of interest; the potential scope of the advocate's activities; and to formulate accountability, governance and funding arrangements.

Mr Robert said that this is a first step towards implementing Recommendation 28 of the Productivity Commission's report, *Superannuation: Assessing Efficiency and Competitiveness* (see: Governance News 16/01/2019) which called for or an independent, adequately resourced superannuation members' advocacy body.

[Source: Assistant Treasurer Stuart Robert media release 02/04/2019]

Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2019 has passed both Houses

Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2019 (Member Outcomes Bill) passed both Houses on 4 April.

The legislation provides the Australian Prudential Regulation Authority (APRA) with both: a directions power; and the power to take civil penalty action against trustees and their directors for breaching their obligations to members (including the duty to act in the best interests of members).

APRA has also been granted new powers to:

- refuse authority for a change in ownership or control of an RSE licensee
- to give a direction to a person to relinquish control of an RSE licensee
- to remove or suspend an RSE licensee where it is subject to the control of its owner
- power to collect data on expenses relating to the management and operation of a fund on a look-through basis

Regulatory impact? The Australian Prudential Regulation Authority (APRA) has welcomed the passage of the legislation

In a statement welcoming the passage of the legislation, APRA said that:

- the new powers significantly strengthen its ability to 'drive trustees' towards improved outcomes for members and to address underperformance at an early stage. 'Previously, APRA could only direct a superannuation trustee after a contravention of the law had taken place, or where APRA believed there was an urgent, material threat to members' interests. The new directions power gives APRA the ability to intervene at an early stage before members suffer significant harm' Deputy Chair Helen Rowell said.
- new civil penalties (for breaches of s52 and 52A duties) which attract both civil and criminal consequences, combined with the broader directions power, gives the regulator 'much greater leverage to influence trustee behaviour from the outset and to push trustees to meet their obligations to members under the law'

- the changes will enable APRA to' better understand whether trustees are spending members' money in line with their obligations under the *Superannuation Industry (Supervision) Act 1993*, particularly the best interests duty and sole purpose test'.

New Annual Outcomes Assessment requirement: APRA is considering the extent to which guidance will need to be amended

The legislation also requires trustees to conduct an annual outcomes assessment, and 'enhances APRA's power' to refuse, or to cancel, a MySuper authorisation.

Commenting on this, APRA states that the new requirement is 'generally consistent' with the recently released prudential standard (Prudential Standard SPS 515 Strategic Planning and Member Outcomes) (see: Governance News 17/12/2018) and that the regulator will provide guidance to the industry 'as soon as possible' on the extent to which the guidance will need to be amended to accommodate the new legislation.

[Sources: Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2019; APRA media release 04/04/2019]

Review of the 'sole purpose test': APRA has written to superannuation funds outlining its areas of supervisory focus and expectations of licensees for 2019

The Australian Prudential Regulation Authority (APRA) has published a letter outlining its expectations of how superannuation licensees can better protect their members' interests over the next year. In the letter, APRA Deputy Chair Helen Rowell identifies APRA's areas of supervisory focus for the coming 12 months, including improving superannuation member outcomes, lifting board capabilities and managing conflicts of interest. The letter also details APRA's plans for enhancing the quality and reliability of superannuation data; updating guidance around the sole purpose test; and updating requirements on remuneration.

Some Key Points

Areas of supervisory focus

Assessing and improving member outcomes: APRA's new prudential standard *SPS 515 Strategic Planning and Member Outcomes* is effective from January 2020. Ms Rowell said that trustees should now be preparing to meet the new requirements, and prepared to share their plans with their APRA supervisors. In parallel to trustees conducting their own outcomes assessments, Ms Rowell said that APRA will continue to target areas of persistent underperformance across the industry, 'in an expanded and more intensive manner'. Ms Rowell also said that APRA is prepared to use the 'potential stronger directions powers', where needed, to compel trustees to take appropriate action where necessary.

[Note: Ms Rowell appears to be referring to directions powers in *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2019* which passed both houses on 4 April, having been amended in the senate (see: Governance News 20/02/2019). The passage of the Bill, and APRA's statement welcoming its passage is covered in a separate post of this issue of Governance News.]

Trustee capabilities and board culture: APRA expects to see trustee boards making independent and objective decisions that are demonstrably in the best interest of their members. More particularly, APRA expects trustees to identify and take steps to address any barriers to lifting trustee capabilities and meeting their resourcing needs and APRA supervisors will work with trustees on improving practices in these areas including:

- being able to clearly demonstrate how the governance and mindset of the board facilitates acting in the best interests of the members
- ensuring that the trustee board has an appropriate mix of skilled and experienced directors who are able to bring sufficient independence and objectivity to decision making
- effectively managing board renewal
- critically assessing board performance, capability and outcomes achieved and implementing measures to address any shortfalls or weaknesses
- 'avoiding or effectively managing actual or perceived conflicts of interest', particularly in

dealings with related or connected persons or entities

- conducting more robust, forward-looking and outcomes-focused business and strategic planning and risk assessment
- 'fully embedding a fiduciary mindset across all decision-making', including with respect to decisions about executive remuneration and fund expenditures, to ensure these are in the best interest of members and meet statutory obligations including the sole purpose test

Risk governance

APRA is considering more closely aligning some of the key requirements in SPS 220 with those in Prudential Standard CPS 220 Risk Management. The states that 'APRA expects that trustees for larger and more complex institutions' to 'consider why they should not meet CPS220 requirements in areas such as the independence and prominence of the risk function'. APRA adds that it does not see any rationale for a modern and mature financial institution not to have an independent and well-resourced risk function, including a Chief Risk Officer with a direct reporting line to the CEO and regular access to the board and board risk committee.

Conflicts of Interest

- **Responding to the Commission's recommendation concerning 'inherently conflicted structures':** The letter states that 'The government has indicated that it will adopt the Royal Commission's recommendation regarding inherently conflicted structures, such as dual regulated entities, and all trustees should now be planning for this change where relevant to them'.

[Note: This appears to be a reference to Recommendation 3.1 of the Financial Services Royal Commission's Final Report which recommends that 'The trustee of an RSE should be prohibited from assuming any obligations other than those arising from or in the course of its performance of the duties of a trustee of a superannuation fund'. Commissioner Hayne comments that 'the trustee of an RSE should not be permitted to assume any obligations other than those arising from or in the course of its performance of the duties of trustee. A prohibition of that kind would prevent a trustee from acting as a dual-regulated entity. But it would go further. It would prevent a trustee from undertaking any obligation that does not arise out of its holding the office of trustee. The wider prohibition is desirable because it deals directly with the fundamental issue'. See: Financial Services Royal Commission Final Report Volume 1 at p229]

- **APRA is planning an in-depth review of outsourcing commencing later in 2019.** The review will be conducted in stages, initially focused on a small number of larger superannuation entities with material related party arrangements. However, APRA will also gather information on the terms and costs of outsourcing arrangements across the broader population of trustees, with a view to undertaking further phases of work on outsourcing across a wider set of entities. APRA intends to publish the results of this review, and will consider how to provide greater transparency on the findings across entities covered and the assessment of their practices.
- **Trustees also need to ensure that there is robust assurance around any amounts charged to members on behalf of third parties** (whether or not those parties are associates). APRA and ASIC will be providing a joint communication to superannuation entities on expectations for oversight and review in this area.

Data and Reporting

- **APRA is undertaking a review of the superannuation regulatory data reporting se**t, with the aim of providing 'greater coverage, enhanced consistency and better quality data through clarifying and revising definitions, as well as increased granularity in some areas, such as expenses'. In particular, APRA will focus on upgrading visibility across the 'choice' segment of the market.
- **APRA will be issuing periodic data collection requests for trustees.** APRA intends to progress these on an informal basis and expects appropriate responsiveness to these requests from trustees.
- **APRA expects trustees to be assessing/improving their own data quality:** APRA states that 'Trustees will need to invest in compiling appropriate internal and external data to perform their regular assessments of the outcomes provided to members and in anticipation of this enhanced reporting regime'. APRA adds that it expects that trustees will be 'assessing and improving their own data quality and breadth, and have in place data management plans and appropriate accountabilities'.

Accountability and Remuneration

- **'Prudent' to commence developing BEAR accountability statements:** Given the Financial Services Royal Commission's recommendation that the Banking Executive Accountability Regime (BEAR) be extended to the superannuation sector, the letter states that it would be a 'prudent and indeed a worthwhile exercise' for trustees to commence the process of developing accountability statements.
- **Remuneration review:** The letter states that APRA's updated prudential requirements on superannuation to be released in 2019 will apply to superannuation trustees as well as banking and insurance entities. Though the use of substantial variable remuneration is not as widespread in the superannuation industry, APRA observes, APRA"s expectation is that where performance-based remuneration is used, 'it is truly performance-based and takes into account risk, long-term financial soundness and outcomes for members' and also ensures pay is adjusted where misconduct/conduct not in members' best interest is identified.

Sole Purpose Test

- **Review of the Sole Purpose Test:** APRA will undertake a review, involving the Australian Securities and Investments Commission (ASIC) as appropriate, of particular cases or circumstances where compliance with the sole purpose test has been called into question. The aim of this review, APRA writes, is to develop clear principles to inform updated guidance and its implementation, as well as identifying potential breaches where appropriate action should be taken. The review may also lead to recommendations as to whether the law could be clarified to better meet the intent of the sole purpose test.

Insurance and Inactive accounts

- **Trustees should review insurance arrangements:** To comply with the covenants in the *Superannuation Industry (Supervision) Act 1993 (Cth)* — which require trustees to only offer insurance if the cost does not inappropriately erode the retirement income of beneficiaries — and as part of meeting the member outcome assessment requirements, trustees must regularly review and undertake an assessment of their insurance arrangements. APRA states that its expectation is that this assessment would include assessing whether the insurance cover they provide to members is in their best interests and is providing appropriate outcomes and considering trade-offs between coverage, design, terms and conditions and premiums across different demographic cohorts.
- **Trustees should be actioning changes under the Protecting Your Super package:** APRA also notes that the recently passed Protecting Your Super legislation requires trustees, among other things, to cease default or 'opt-out' insurance cover, where the member's account has been inactive for a period of 16 months or more. APRA states that 'implementing this requirement will require potentially significant operational activities and member communications that trustees need to be actioning immediately'. In addition, APRA advises that trustees should 'proactively' consider what further implementation steps may be needed should the pending legislation that would change insurance requirements for members under age 25 be passed by Parliament.

[Note: This appears to be a reference to *Treasury Laws Amendment (Putting Members' Interests First) Bill 2019* which was introduced by the government into the House of Representatives on 20 February and is at second reading stage. See: Governance News 27/02/2019]

- **Trustees should review group life insurance arrangements (delivered by a related party) :** APRA notes that the Financial Services Royal Commission recommended that states RSE licensees that engage a related party to deliver group life insurance, provide APRA with independent certification that the related party arrangement is in the best interests of members. APRA states that it plans to consult on the necessary changes to its prudential standard and guidance to implement this recommendation later in 2019, in conjunction with consultation on other changes to the prudential framework. In the meantime, APRA advises that 'it would be good practice for trustees for which this recommendation is applicable to commission such a review as soon as practical'.

[Note: This appears to be a reference to Financial Services Royal Commission Recommendation 4.14 (Additional scrutiny for related party engagements)]

- **Trustees should review 'member status' :** Review The Royal Commission also recommended that APRA should amend its prudential standard on insurance to require RSE licensees to review their approach to attributing certain status to members under life insurance policies. APRA will also action this recommendation. APRA states that tis expectation is that trustees 'take steps to ensure that practices in relation to attributing particular status to members for insurance purposes are appropriate and likely to meet community expectations'.

[Note: This appears to be a reference to Financial Services Royal Commission Recommendation 4.15 (Status attribution to be fair and reasonable)]

[Source: Australian Prudential Regulation Authority Letter: Putting members first: expectations and areas of focus for the year 27/03/2019]

Related News: First State Super CEO Deanne Stewart has reportedly called for an 'updated' sole purpose test

The AFR reports that CEO of First State Super Deanne Stewart has called for a debate about whether the sole purpose test needs updating/clarification to address the fact that industry and public superannuation have branched into banking, property development, life insurance, financial advice and online news. Ms Stewart would reportedly like greater clarity on the types of activities that super funds can engage in without risking falling foul of the 'sole purpose test'

'I think it is time to look at the sole purpose test and update it for 2020 onwards in terms of modern-day super funds and really noting that retirement is as important as accumulation…Otherwise we will continue to stretch further and further and not know where the guide rails are' Ms Stewart is quoted as saying.

Other funds have reportedly suggested that additional clarification on the scope of the test from the Australian Prudential Regulation Authority (APRA) would be helpful, but stopped short of supporting reforms of existing legal obligations.

[Source: [registration required] The AFR 29/03/2019]

ASFA has called for the superannuation guarantee rate to be raised to 12% as soon as possible

The Association of Superannuation Funds of Australia (ASFA) has issued a statement calling for the Superannuation Guarantee (SG) rate to be increased to 12% 'as soon as possible' rather than from 2021.

ASFA said that according to its modelling, an average income earner aged 30 today, and on a $70,000 salary would have $71,600 less when retiring at 67 if the SG stays at 9.5%. For this person, bringing forward the timetable for lifting the SG rate by 2 years could boost their retirement savings by an additional $7,000.

ASFA CEO, Dr Martin Fahy said 'For all income earners, even those very close to retirement, moving to 12 per cent will mean a more comfortable standard of living in retirement'.

In the lead up to the Federal Election, ASFA has also released a proposed toolkit for the Government, Strengthening Australia's Superannuation System, proposing other measures for consideration such as:

- stabilising tax settings for superannuation over the course of the next parliament;
- boosting superannuation balances of women and low-income earners;
- lifting the bar for MySuper in order to deliver the best possible outcomes for fund members;
- ensuring appropriate insurance in superannuation default arrangements are in place;
- facilitating investment in affordable housing by superannuation funds; and
- providing SG for gig economy workers.

[Source: ASFA media release 28/03/2019]

Open Banking | Draft CDR rules released for consultation: The ACCC has released draft rules for the Consumer Data Right in banking covering issues 'central to implementation' (ahead of the passage of enabling legislation)

The Australian Competition and Consumer Commission (ACCC) has released draft consumer data right (CDR) rules covering issues 'central to the implementation of the CDR in banking'.

The draft rules cover issues including:

- product data requests
- consumer data requests that are made by CDR consumers
- consumer data requests that are made by accredited persons on behalf of CDR consumers
- how persons can become accredited persons
- dispute resolution
- privacy safeguards
- data standards
- other issues eg review of decisions, reporting, record keeping and audit, and civil penalty provisions

The consultation will inform the continued development of the rules and the future Privacy Impact Assessment of the Rules.

Rules released ahead of the enabling legislation? The ACCC states that while there are a 'range of matters' eg the passage of the enabling legislation, which are yet to be finalised, the draft rules have been released now to: assist the ACCC to develop best practice rules, and allow potential CDR participants to begin planning and move towards the start of the CDR in banking.

Feedback encouraged, including from privacy advocates: ACCC Commissioner Sarah Court said that 'the draft rules for the Consumer Data Right allow companies working in the banking sector to begin planning and move towards the start of the consumer data right in banking, with some greater detail and guidance as to how it will work. We also know there are a number of privacy advocates, consumer organisations and others who will be very interested to see these draft rules, and we welcome views.'

Timeline: Submissions are due by 10 May 2019.

[Note: *Treasury Laws Amendment (Consumer Data Right) Bill 2019* was introduced into the House of Representatives on 13 February and has progressed to second reading stage. It was referred to the Senate Economics Legislation Committee for report by 21 March, and the Committee recommended that the Bill be passed without amendment. However, in a dissenting report, Labor Committee members flagged that they would seek changes to the legislation prior to its passage. See: Governance News 27/03/2019]

[Sources: ACCC media release 29/03/2019; Draft Consumer Data Right Rules]

Review of the Four Major Banks: ANZ and NAB CEOs have recently appeared before the Standing Committee on Economics and (among other things) have provided updates on implementation of the FSRC recommendations

[Note: For coverage of the 8 March Committee hearing (CBA and Westpac) see: Governance News 13/03/2019]

ANZ CEO Shayne Elliott's opening statement to the Committee

In his opening statement to the House of Representatives Standing Committee on Economics ANZ CEO Shayne Elliott said the Financial Services Royal Commission was a 'profoundly humbling experience for ANZ'. He said that the bank is focusing on implementing the lessons of the Commission and highlighted four actions.

1. **Accelerating remediation efforts:** Mr Elliott said that ANZ has invested in more staff and 'better technology so that we can get money back to customers faster'.
2. **Accountability:** ANZ has been reviewing the issues raised during the Financial Services Royal Commission and is exploring whether the 'the consequences for executives were strong enough and, if not, what else we need to do'. Mr Elliott said that as a result of this ongoing work, 'pay has been cut or clawed back'.
3. **Proactively implementing changes (without waiting for new laws):** Mr Elliot referenced a 'series of initiatives' announced in response to the Commission that ANZ is implementing without waiting for 'new

laws' eg the bank's new 'model litigant standards' (see; Governance News 27/02/2019). Mr Elliott said that ANZ will publicly report on these initiatives,

4. **'Acting further' to resolve customer disputes and complaints:** ANZ is working to resolve the Royal Commission cases involving ANZ customers.

   - ANZ representatives are meeting with customers around the country and making recommendations to Mr Elliott as to how complaints can be resolved. Mr Elliott said that since he last appeared before the Committee, 90% of the customer complaints emailed to him had been resolved, and the others are a 'work in progress'.
   - ANZ has also written to the Australian Financial Complaints Authority offering 'immediate support for its 10 year look back of customer disputes'.

Mr Elliott commented that 'while there are more laws to pass and more bank-driven reforms to go, we believe that we are changing to better serve society'.

Availability of credit: Mr Elliott also commented on the issue of the availability of credit which he said is 'on the minds of many'. He said that 'ANZ is ready to lend, especially for housing and small businesses. Higher standards, based in the law, do apply, and some will find it harder to borrow than before. Our challenge is finding the right balance of prudence and availability within the regulatory framework. After a period of perhaps being too cautious, ANZ is easing back towards a sensible equilibrium. If we are to serve society, we must support the economy by lending responsibly, and that is what we're aiming to do'.

NAB CEO Philip Chronican's opening statement to the Committee

In his opening statement to the House of Representatives Standing Committee on Economics NAB CEO Philip Chronican apologised to 'everyone who has been impacted' by NAB's 'failures'. He said that the 'Final Report of the Royal Commission was right when it said there was a gap between where we are, and where we need to be'.

Mr Chronican noted the leadership changes at the bank (resignation of the former CEO, and the announcement of the Chair's intention to step down later in the year see: Governance News 27/02/2019) and outlined the bank's areas of focus since his appointment as interim CEO from 1 March.

- **Broad internal reform program:** Mr Chronican said that NAB's internal reform program is 'bringing greater rigour, discipline and a stronger focus on customers' through: greater board oversight of customer outcomes and holding executives accountable for their performance on financial and customer metrics as well as the management of non-financial risks'.
- **Mr Chronican reiterated that NAB 'agrees' with 72 of 76 recommendations** and will 'work with the Government and regulators on giving effect to the intent of the remaining four'. Mr Chronican was asked a number of questions in relation to this. He explained that 'With the four that we have not agreed to, I would stress that we have agreed to the underlying issue at stake here'. With respect to changes relating to mortgage broker pay, he said that NAB is not supportive of 'any quick change'. Despite the potential short term benefits for the bank, Mr Chronican said that NAB would like to see the 'mortgage broking industry continue to thrive'.

[Note: In an earlier statement NAB said that it supports 72 (of 76) Financial Services Royal Commission recommendations and that it will work with the government and regulators with a view to taking positive action as quickly as possible on the 'remaining areas' which relate to mortgage broker arrangements (Recommendations 1.3 (Mortgage broker remuneration) and Recommendation 1.5 (Mortgage brokers as financial advisers), definition of small business (Recommendation 1.10 (definition of small business in the Australian Banking Association Code of Practice)) and BEAR accountabilities (Recommendation 1.17 (BEAR product accountabilities)). See: Governance News 20/03/2019]

Mr Chronican said that NAB has 'taken action, or are in the process of taking action, on 26 of the recommendations.

- **Mr Chronican also highlighted changes made ahead of the release of the Financial Services Royal Commission's Final Report** including: a) the decision not to charge default interest to agricultural customers impacted by the drought; b) the announcement of a Board Customer Committee

to better oversee NAB's processes and to ensure fair products and service outcomes and to evaluate customer feedback and complaints; and c) removing grandfathered commissions for NAB Financial Planning advisors.

- **Actions to raise standards:** In addition, Mr Chronican highlighted a number of other actions the bank is implementing to raise standards. These include:
  - **Accelerating remediation:** Mr Chronican said that NAB has about 350 people (which will increase to 500) working on making sure our customers are compensated as quickly as possible. Since June, we have repaid $110 million to 310,000 customers.
  - **Extending protections under the Banking Code:** NAB will extend the protections of the code of banking practice to small businesses with less than $5 million in total borrowings, up from less than $3 million.

[Note: At the 8 March hearings, Westpac CEO Mr Hartzer and CBA CEO Mr Comyn were asked for their views on Recommendation 1.10 in the Financial Services Royal Commission's final report which recommended expanding the definition of small business in the Australian Banking Association (ABA) Code of Practice. Both Westpac and CBA expressed support for the recently revised definition in the ABA Code of practice to remain unchanged at $3m (See: Governance News 13/03/2019). Separately, the ABA has committed to implementing recommendations 1.8,1.13 and 1.15 (which relate to amendments to the ABA Code of Banking Practice) but that it 'has not yet reached a view' on whether to implement recommendation 1.10. The reasons given in the ABA's statement, for the need to further consider their position, appear to be similar to/consistent with those provided by Mr Hartzer and Mr Comyn. See: Governance News 06/03/2019]

  - **NAB has also formally adopted a model litigant policy** which is based on the Commonwealth's Model Litigant Policy.
  - **Accessibility of services in regional communities — decision to keep branches open:** Mr Chronican said that ANZ has pledged to keep our 316 NAB branches in regional and rural Australia open until at least January 2021. Regional and rural communities are facing serious challenges of their own and it's an important role for banks to be there for them.
  - **Abolition of the 'introducer' payment program**: 'We want customers to be referred to us for the features of our products and the quality of our service, not because someone is going to be paid a fee to recommend us' Mr Chronican said.
  - **Review of remuneration and incentives:** Mr Chronican said that the bank knows 'we need change to get the best outcomes for customers and to meet community expectations – and we are changing'.

Mr Chronican observed that these actions are 'just the start. There is a lot more to do – and that we must do – to build a bank that our customers, our employees and the community deserve'.

Accessibility of credit: With respect to accessibility of credit, Mr Chronican said that 'NAB lends more to small and medium business than any other Australian bank' and added that he 'met with the bank's top 100 leaders in Melbourne on Monday and emphasised to them that NAB stands ready to lend to good quality propositions for both businesses and home buyers'.

[Sources: House of representatives Standing Committee on economics: Review of the four major banks, transcript 27/03/2019; ANZ media release: Shayne Elliott, opening statement to the Parliamentary Committee 27/03/2019; NAB media release: NAB CEO Philip Chronican opening statement 27/03/2019; [registration required] The AFR 27/03/2019; 27/03/2019;

Consultation on options to strengthen unfair contract terms protections for small businesses announced

In a joint statement, Assistant Treasurer Stuart Robert and Minister for Small and Family Business, Skills and Vocational Education Michaelia Cash have announced that following the 2018 review of the existing legislative protections provided to small businesses in relation to unfair contract terms, the government (subject to the outcomes of a Regulation Impact Statement (RIS) process), plans to introduce amendments to strengthen protections for small businesses.

The government will consult on the following options.

- Making UCTs illegal and attaching civil penalties to breaches
- Redefining small business for the purposes of the protections as a business that employs fewer than 100 persons at the time the contract was entered into or had an annual turnover less than $10 million
- Broadening the coverage of small business contracts by removing the value threshold
- Further clarifying the definition for a standard form contract
- Extending the UCT protections to government contracts
- Considering exempting 'minimum standards' prescribed by state and territory law

In addition to these options, stakeholder views on a number of technical amendments will be sought.

Insurance contracts? The statement notes that the government has committed to extend UCT protections to insurance contracts. The consultation will also seek views on whether it is appropriate to apply any 'enhanced protections for small business to consumers and insurance contracts'.

Request for regulators to revise UCT guidance: Following the finalisation of the consultation process, the government plans to ask regulators to revise UCT guidance and work with industry to improve awareness of the provisions where possible.

[Source: Assistant Treasurer Stuart Robert and Minister for Small and Family Business, Skills and Vocational Education Michaelia Cash media release 28/03/2019]

Not confident that appropriate risk frameworks are in place (in every instance)? The first annual review of industry compliance with the Life Insurance Code of Practice suggests there is room to improve risk and compliance frameworks

The Life Code Compliance Committee has released its first annual review of industry compliance with the Life Insurance Code of Practice. The report presents an overview of the life insurance industry and its compliance with the Life Insurance Code of Practice (the Code) covering the period from 1 July 2017 to 30 June 2018 (the year).

The Report is based on data provided to the Life Code Compliance Committee (the Committee) by Code subscribers.

Some Key Points

- Code subscribers reported 15,106 complaints from consumers in the year to 30 June 2018.
- Most complaints concerned issues related to the consumer's policy (48%) or to claim related issues (20%).
- There were 164 'breach events' — 'events resulting in multiple breaches of a Code section' — reported and nearly 8,000 isolated breaches, each affecting a single consumer
- In total, 1,766,803 consumers were actually or potentially impacted by these 'breach events'. Isolated breaches mostly related to claims (60%) and were caused by people related issues (99%), rather than systems related issues
- According to the report, 1,624,131 or 92% of the consumers potentially impacted by breach events came from transition issues, where subscribers were not able to update legacy policies and IT systems to be fully Code compliant by the time they adopted the Code. The report comments that 'Given that subscribers had nine months to transition to the Code, the number of events and consumers potentially impacted by transition-related breaches was disappointing'.

Room to improve risk/compliance frameworks: The report comments that though subscribers generally reported that they were satisfied with their Code risk and compliance frameworks, the 'Committee is not confident that all subscribers have robust frameworks in place. The quality of subscribers' processes appears to be inconsistent and in some instances, poor'. The report adds that, the Committee believes that subscribers may not be accurately capturing all isolated breaches. There is room for improvement and the Committee has made several suggestions to improve the robustness of individual subscribers' compliance frameworks'.

The Financial Services Council (FSC) has released a statement welcoming the release of the report. FSC Senior Policy Manager, Nick Kirwan commented that the report shows that said the overwhelming majority of all claims received are paid (92%) 'in a timely manner, helping customers when they need it most'.

Mr Kirwan added that 'We don't shy away from the fact that there is more to be done. The LCCC's inaugural report provides an important baseline to measure the industry against in future years, and insights into areas that the industry should focus its attention'.

Mr Kirwan went on to say that the FSC has been working with ASIC, consumer advocates, mental health groups, GPs and geneticists to develop the next iteration of The Code, and has proposed more than 30 significant additional protections for consumers to lift standards.

The AFR suggests that the report is shows that self-regulation of the industry has been unsuccessful.

[Sources: FSC media release 28/03/2019; Annual Industry Data and Compliance Report 2017-2018, March 2019; [registration required] The AFR 01/04/2019]

ASIC to conduct research into a 'more appropriate' label for 'general advice' following the release of research indicating the term is not well understood by consumers, and calling into question the efficacy of the 'general advice' warning

Overview: ASIC report 614 Financial Advice — Mind the Gap (REP 614)

The Australian Securities and Investments Commission (ASIC) has released a report: *ASIC report 614 Financial Advice — Mind the Gap* (REP 614) summarising the findings of research into consumer awareness and understanding of general and personal advice.

Ultimately, the research found that many consumers are unable to distinguish between personal advice and general advice and are unaware of the significance of the distinction between the two. The research also calls into question the efficacy of giving a general advice warning.

About the research: Under the existing regulatory framework, general and personal advice are separate types of financial advice that are subject to different regulatory obligations and offer very different levels of protections for retail clients. The research used hypothetical advice scenarios to test consumer recognition of when general and personal advice was being provided, and awareness of adviser responsibilities when being given each type of advice.

Some Key Findings

- **General and personal advice are not familiar concepts for consumers** and are not used as a frame of reference when consumers consider getting advice.
- **The research suggests that consumers do not necessarily see personal and general advice as separate types of advice**. Rather, the findings suggests that some participants in the qualitative research thought that, depending on the amount of information shared, advice could straddle both general and personal advice.
- **General and personal advice are not clearly distinguishable concepts** for consumers:
  - 53% of participants correctly identified the general advice scenario, even though the general advice warning was given in the scenario
  - 19% of participants correctly identified the personal advice scenario. Most either thought that the personal advice scenario was general advice or a mix of both types of advice advisers' responsibilities when providing general and personal advice are unclear to consumers
- **Participants were more likely to view an advice scenario as general** if the advice was delivered: over the phone (rather than in person), delivered by customer service staff, from mass media (TV/radio), is a sales or marketing recommendations, has no fees and is about 'less personal' topics (eg advice about term deposits as opposed to advice about 'personal' topics such as superannuation)
- **Participants were more likely to view an advice scenario as personal advice** where it is delivered by more qualified staff, is delivered face to face (rather than over the phone), required to the consumer to provide personal information, has upfront fees and is about more personal topics (eg superannuation)

- **The general advice warning is not necessarily effective.** Participants views about the responsibilities of advisers providing general advice varied. Even when consumers were given the general advice warning, some did not understand the limitations of general advice. In fact, despite the warning, some consumers are likely to think that the adviser has taken their personal circumstances into account. Despite the general advice warning:
  - 38% of participants incorrectly thought that the adviser had a responsibility to consider the consumer's financial circumstances
  - 31% of participants incorrectly thought that the adviser had a responsibility to consider the consumer's financial goals
- **Most consumers are unaware of the obligations that apply when advisers provide personal advice:**
  - 45% of participants recognised that the adviser in the personal advice scenario had an obligation to act in the best interests of the consumer when providing the advice
  - 28% of participants were aware that the adviser was obliged to provide a Statement of Advice.

The findings reinforce the findings of earlier inquiries

Commenting on the findings, ASIC Deputy Chair Karen Chester said 'this disturbing gap in understanding whether the advice they [consumers] are getting is personal or not means many consumers are under the false premise their interests are being prioritised, when no such protection exists' [the Future of Financial Advice (FOFA) protections only apply when personal advice is provided].

Ms Chester added that the findings 'reinforce' those of the Murray Financial System Inquiry and the Productivity Commission reports on the financial and superannuation systems which made recommendations about the use of the term 'general advice'.

Given the regulator is seeing increased sales of complex financial products under general advice models, consumer confusion about 'general' and 'personal' advice and the protections that apply in each case, 'needs to be addressed'.

ASIC's planned next steps — research to identify a new label for 'general advice': ASIC writes that the report is the first stage in ASIC's broader research project into consumer experiences with and perceptions of the financial advice sector. ASIC plans to conduct additional research in 2019 to identify a 'more appropriate label for general advice and consumer-test the effectiveness of different versions of the general advice warning'.

Immediate action required? Commenting on the report CEO of consumer advocacy group Choice has reportedly called on the government to act quickly to address the issue. 'We need to stop calling sales by bank tellers and telemarketers "advice" when it is clearly not. David Murray's Financial System Inquiry recommended this problem be fixed over four years ago. The Productivity Commission has made clear and simple recommendations to fix this in two major reports but there has been no action by government' Mr Kirkland said.

[Sources: ASIC media release 28/03/2019; ASIC Report 614 Financial Advice: Mind the Gap 28/03/2019; [registration required] The Australian 29/03/2019]

Replace the term 'general advice' with 'general information'? The Financial Planning Association (FPA) has called for the separation of financial advice from financial product marketing and product information, arguing that 'Financial advice should ONLY mean financial advice'.

The FPA favours replacing the term 'general advice' with 'general information', and has suggested that the terms 'financial advice' and 'financial product advice' should only apply to personal advice as defined by the Corporations Act 2001 (Cth).

Dante De Gori CFP CEO of the FPA said 'General advice poses a significant risk to consumers when they do not know how to distinguish if they are receiving a financial advice service, or are receiving financial product information. Following the findings of the Royal Commission, Australians should not have to contend with this uncertainty and we urge the Government to implement our recommendations in full'.

[Sources: FPA media release 03/04/2019; Independent Financial Adviser 04/04/2019]

In Brief | Legislation enabling mutual entities (registered under the Corporations Act to issue equity capital without risking their mutual structure or status — Treasury Laws Amendment (Mutual Reforms) Bill 2019 — passed both Houses on 4 April without amendment

[Note: *Treasury Laws Amendment (Mutual Reforms) Bill 2019* was introduced into the senate on 13 February. For an overview see: Governance News 20/02/2019]

[Source: Treasury Laws Amendment (Mutual Reforms) Bill 2019]

In Brief | Legislation to establish a $2 billion Australian Business Securitisation Fund to help smaller banks and non-bank lenders to lend to small to medium businesses — Australian Business Securitisation Fund Bill 2019 — passed both houses on 3 April

[Source: Australian Business Securitisation Fund Bill 2019]

Accounting and Audit

In Brief | No evidence of cartel conduct: The Australian reports that the Australian Competition and Consumer Commission (ACCC) will not proceed with an inquiry into the big four accounting firms — Deloitte, EY, KPMG and PwC — over alleged cartel conduct in the sale of audit and consulting services for lack of 'evidence that provides a basis for taking further investigative action'

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

In Brief | Structural reform on the cards? A UK Parliamentary report has recommended various audit rector reforms including that the 'CMA aims for a structural split or at the very least implements its proposed operational split between audit and non-audit. If operational separation does not end cross-subsidies and fails to produce improvements in culture, independence and transparency, we recommend that the CMA implements a full structural break-up of the Big Four into audit and non-audit businesses'

[Source: Future of Audit 02/04/2019]

Risk Management

Climate Risk

Top Story | Updated Hutley opinion released: Directors' exposure to the risk of climate change litigation has only increased since 2016

Context: On 7 October 2016, Noel Hutley SC and Sebastian Hartford-Davis provided an opinion considering the extent to which the duty of care and diligence imposed upon company directors by s 180(1) of the *Corporations Act 2001 (Cth)* permitted or required Australian company directors to respond to climate change risks (2016 Opinion) (see: Governance News 07/11/2016). The Centre for Policy Development (CPD) has now released a supplementary opinion, responding to developments since the 2016 Memorandum was finalised.

Key Takeouts

1. **The risk for directors has only increased since the original opinion was issued in 2016, and will 'probably' continue to do so:** Given the impacts climate change will have on the economy, it will become 'increasingly difficult' for directors to 'pretend that climate change will not intersect with the interests of their firms'. In light of this, 'the exposure of individual directors to “climate change litigation” is increasing, probably exponentially, with time'.

2. **Investors and regulators expect companies to act (and to invest):** Regulators and investors' now expect much more from companies and firms will be expected to invest seriously in 'capabilities to monitor, manage and respond to climate change risks'.

3. **There are, 'significant and well-publicised risks associated with climate change and global warming that would be regarded by a Court as foreseeable'.** These risks 'require engagement from company directors', especially directors in the banking, insurance, asset ownership/management, energy, transport, material/buildings, agriculture, food and forest product industries.

Introduction

The opinion (which was provided by Noel Hutley SC and Sebastian Hartford-Davis on instruction from MinterEllison's Sarah Barker for the Centre for Policy Development) finds that there has been a shift, since the 2016 memorandum was finalised, in the way in which Australian regulators, firms and the public perceive climate risk which 'elevate the standard of care that will be expected of a reasonable director'. The opinion goes on to say 'company directors who consider climate change risks actively, disclose them properly and respond appropriately will reduce exposure to liability. But as time passes, the benchmark is rising.'

Significant Developments since 2016

The opinion highlights a number of developments since the original opinion was finalised with potential impact for directors. These include the following.

1. **The regulatory environment has changed since 2016 — Australian regulators are largely aligned on the economic/financial significance of climate risk:** The opinion states that the regulatory environment has 'profoundly changed' since 2016, even if legislative and policy responses have not. 'Climate risk and disclosure have become a shared focus of Australian financial regulatory bodies. There is now a striking degree of alignment between the Reserve Bank of Australia (RBA), the Australian Securities and Investment Commission (ASIC) and the Australia Prudential Regulation Authority (APRA) as to the financial and economic significance of climate risks'.

2. **New reporting/disclosure frameworks:** There have been a number of developments with respect to disclosure/reporting of climate risk since the original opinion was released, which mean, the Opinion suggests, that 'directors should expect that the content of climate disclosures, particularly as part of the statutory financial reporting framework, will attract increasing scrutiny'. These developments include:

   - the release of the Taskforce for Climate-related Financial Disclosures Recommendations (TCFD recommendations) which have been 'endorsed' by Australian regulators (APRA, RBA) and also supported by ASIC

   - the release of joint guidance on the relevant of climate related risks for financial statement accounting estimates released by the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AUASB). Though voluntary, the authors suggest that it is likely to be adopted by accountants and audits as a benchmark for materiality assessments relating to climate risk

   - updated guidance for listed companies in the ASX Corporate Governance Council which highlights that 'environmental or social risk' (including climate change) should be disclosed pursuant to recommendation 7.4 of its Principles and Recommendations. The guidance to the 4th edition of the Principles and Recommendations states that 'many listed entities will be exposed' to transitional and physical risks associated with climate change and encourages entities to review and disclose exposures, where relevant, as recommended by the TCFD.

3. **'Investor pressure represents a subcategory of risk to which directors should be alert':** The opinion gives a number of examples illustrating that investor and community pressures concerning climate risk 'are becoming more acute'. For example, since 2016 there have been a number of prominent climate-related shareholder resolutions being moved at company meetings (eg at QBE Insurance Group, Origin Energy and Whitehaven Coal). More recently, there has been public scrutiny of an announcement by the Swiss mining company Glencore (which has accepted the TCFD Recommendations) that it will move to limit the amount of coal that it will extract from the earth to current levels following discussions with the Climate 100+ initiative (see: Governance News 27/02/2019). Looking further afield, the Governor of the Bank of England has recently expressed the view that, in

future, climate, environmental, social and governance considerations 'will likely be at the heart of mainstream investing'.

4. **There have been developments in the state of scientific knowledge, and more particularly greater insight into the timeframes** which 'inevitably bear upon the gravity and probability of climate risks which directors need to consider' eg modelling in the Intergovernmental Panel on Climate Change (IPCC) report which indicates, among other things, a consensus that global warming is likely to reach 1.5ºC with various adverse consequences, between 2030 and 2052 if it continues to increase at the current rate. Given that adverse outcomes may occur within 10 years unless 'unprecedented' change occurs before then, the authors advise that 'diligent' company directors ought now to be assessing:
   - the impact on their business if concerted decarbonisation efforts (of the kind envisaged by the IPCC Report) do not occur. That is, what steps are necessary or appropriate to adapt to global warming of 1.5ºC (possibly within 5 years)
   - the impact on their business if concerted decarbonisation efforts do occur. That is, what steps are necessary or appropriate to seek to predict, influence and respond in the short to medium-term to the "unprecedented" transitions which will be required in order to avoid global warming of 1.5ºC, most particularly in the resource, energy, transport and industrial sectors
   - the impact on their business as a result of the escalating physical changes, which appear to be likely under either scenario
5. **Developments relevant to litigation risks:** The authors highlight two developments: 1) scientific/technological advances that enable the causality of weather events to be identified with more certainty (as flagged above); and 2) a recent decision in the NSW Land and Environment Court in Gloucester Resources Limited v Minister for Planning [2019] NSWLEC 7 (which is under appeal). The decision rejected the 'market substitution assumption' ie the assumption that the in this case, the greenhouse gas emissions relating to the mining project would occur regardless of whether it was approved or not because of market substitution and carbon leakage.

[Sources: Supplementary Memorandum of Opinion: Climate Change and Directors' Duties, Mr Noel Hutley SC and Mr Sebastian Hartford Davis 26/03/2019; [registration required] The AFR 29/03/2019]

Australian Sustainable Finance Initiative: The big four banks have joined with super funds, insurance companies and financial sector peak bodies to form a climate investment initiative aimed at realigning the finance sector to support greater social environmental and economic outcomes for the country

The leaders and senior executives of Australia's major banks, superannuation funds, insurance companies, financial sector peak bodies, civil society and academia have joined together in an initiative — The Australian Sustainable Finance Initiative — to realign the finance sector to support 'greater social, environmental and economic outcomes for the country'.

The group's steering committee (which includes MinterEllison's Sarah Barker) has been tasked with developing a set of recommendations (a 'roadmap') to:

1. mobilise capital to deliver on national and global sustainable development and climate goals
2. enhance the sustainability, resilience and stability of the financial system by embedding sustainability, climate and human rights considerations into financial markets and products;
3. ensure better informed financial decision making by enhancing disclosures and transparency on environmental, social and governance risks and opportunities; and
4. deliver a financial system that meets community expectations around sustainability.

The timeline for delivery of the roadmap is 2020.

[Sources: Australian Sustainable Finance Initiative media release 27/03/20190; [registration required] The AFR 27/03/2019; Financial Standard 27/03/2019]

Shell Industry Associations Climate Review released: Shell has announced it will not renew its membership of the American Fuel and Petrochemical Manufacturers (AFPM) in 2020 due to material misalignment with the association's climate policy position

In response to requests from institutional investors, Royal Dutch Shell (Shell) has released its review of its memberships of 19 industry associations in Australia, Europe and North America.

The aim of the review was to identify differences in climate policy positions between Shell and the industry associations over the past five years.

Shell assessed the stated positions of the associations in relation to four of Shell’s key climate-related policy positions: supporting the goal of the Paris Agreement on climate change; government-led carbon pricing mechanisms; policy frameworks for low-carbon technologies; and the role of natural gas in the energy system.

The review found that:

- **Shell is aligned with nine of the 19 industry associations** including the Australian Industry Greenhouse Network (AIGN); the Australian Petroleum Production & Exploration Association (APPEA) and Business Council of Australia (BCA)
- **'Some misalignment' with nine associations**: American Chemistry Council (ACC); American Petroleum Institute (API); BusinessEurope; Canadian Association of Petroleum Producers (CAPP); European Chemical Industry Council (Cefic), FuelsEurope; National Association of Manufacturers (NAM); US Chamber of Commerce (USC) and Western States Petroleum Association (WSPA))
- **There was material misalignment with one industry association**, American Fuel & Petrochemical Manufacturers (AFPM) including with respect to support for the goals of the Paris Agreement. As a result, Shell announced that it will not renew its membership of AFPM in 2020

Shell states that the review is the 'first step towards greater transparency around our activities with industry associations on the topic of climate change'.

New governance principles to improve the management of industry association memberships going forward: Shell also released a set of governance principles, which it will implement this year, to improve the way in which it manages industry association memberships on climate related topics in future which will be implemented this year. The principles provide increased transparency about Shell's own climate related policy positions and also set out the actions Shell will take when it identifies differences between its own climate policy position and those of associations.

Misalignment will not automatically mean withdrawal from membership: Where Shell identifies 'misalignment in climate-related policy positions', it will not automatically result in withdrawal from the association. Rather, the company may elect to take a variety of actions depending on its own 'assessment of the importance of the topic, the extent of the misalignment, and the broader value of our membership'. These actions include (among others): remaining the association and increasing engagement on the areas of difference; pursuing advocacy independently or through other coalitions; and reassessing membership including ending activities such as board and committee participation, or ending overall membership.

Shell states that the implementation of the principles 'will ensure that our participation in industry associations contributes to our support for the Paris Agreement' Shell states.

[Note: In 2018, a shareholder resolution filed by the Australian Centre for Corporate Responsibility (ACCR) seeking Origin Energy Ltd conduct a similar review secured the 'largest vote for any shareholder proposal in Australian corporate history' receiving 46% proxy support ahead of the meeting despite the fact that it was not supported by the board (and was not ultimately successful (see: Governance News 22/10/2019).

Criticism for retaining membership of Australian Industry Associations? The AFR reports that Shell has been criticised by the Australian Centre for Corporate Responsibility (ACCR) for remaining a member of certain industry associations on the basis that, contrary to Shell's assessment, the associations 'steadfastly obstructed sensible climate policy in this country for the last 25 years'.

Noting that last year Shell agreed (under investor pressure) to link executive pay to carbon emissions targets, The AFR suggests that the move by Shell is the latest indication that investor pressure on oil companies, particularly in Europe, is impacting company decisions on climate risk.

[Note: The updated 'Hutley Opinion' (covered in a separate post in this issue of Governance News) notes that investor pressure on climate issues has intensified since 2016, and is likely to continue to do so.]

[Sources: Shell media release 02/04/2019; Shell Industry Association Climate Review; [registration required] The AFR 03/04/2019]

Acting on climate risk: QBE has said it will stop insuring/underwriting coal projects due to global warming

QBE has said that it will stop insuring new thermal coal mines, power plants and transport networks from July 1 this year, and will shut down its thermal coal underwriting business by 2030.

In a statement, climate lobby group Market Forces welcomed the announcement, but said that the company's decision to continue its investment in, and underwriting of, oil and gas companies/projects means that it remains out of line with the Paris Agreement goal of limiting global warming to 1.5 degrees. Market Forces called on shareholders to write to QBE asking that it extend its position on coal to oil and gas.

Shareholder climate resolution? QBE advised shareholders to vote against both shareholder resolutions (constitutional amendment and a contingent climate resolution) prompted by Market Forces at the upcoming AGM, on the basis that amendment to the constitution would create uncertainty, and on the basis that the climate resolution is unnecessary given the actions the company is already taking on climate risk.

The QBE AGM will be held on 9 May.

[Note: Market Forces has previously announced it is mounting a campaign at a number of companies urging them to align their businesses with the goal of the Paris Agreement. See: Governance News 27/03/2019.]

[Sources: QBE ASX Announcement: Notice of AGM 02/04/2019; Market Forces media release 02/04/2019; [registration required] The AFR 30/03/2019]

United Kingdom | Updated environmental reporting guidelines released: The BEIS has released updated guidance to assist companies and limited liability partnerships to comply with the Streamlined Energy and Carbon Reporting regulations, including greenhouse gas (GHG) reporting

The UK Department for Business, Energy and Industrial Strategy (BEIS) has published updated environmental reporting guidelines, to reflect new reporting obligations which came into effect on 1 April. The new requirements include (among other things) a requirement for (certain) companies to report information on greenhouse gas (GHG) emissions in their Directors' Reports.

Application: The guidelines are intended principally for those companies and limited liability partnerships subject to the *Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013* and the *Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018* but BEIS encourages other organisations voluntarily, report in line with the guidelines.

Updates? The guidance has been updated to include:

- The steps to take when considering environmental impacts and which KPIs to report.
- Guidance on Streamlined Energy and Carbon Reporting (SECR) to assist organisations to comply with legal obligations that come into force on 1 April 2019. It also outlines additional voluntary information that is likely to be useful to qualifying organisations and a wide range of stakeholders.

[Source: Environmental Reporting Guidelines: Including streamlined energy and carbon reporting guidance March 2019 (updated introduction and chapters 1 and 2)]

In Brief | Smog cost? Reportedly, 92% of people in the Asia-Pacific region are exposed to levels of air pollution that pose a significant risk to health. This is reportedly impacting firms' ability to attract executives to work in polluted cities. Though companies are offering 'pollution premiums' (eg insulated apartments, home air purifiers, breathing masks, medical checkups, 'smog break' holidays

and cash executives (up to 20% of base salary)) executives, especially those with families, are reportedly increasingly unpersuaded

[Source: YahooNews 31/03/2019]

Cybersecurity and Privacy

Commitment to change the decryption law? (If elected) Federal Labor reportedly plans to amend the controversial Telecommunications Assistance and Access Act 2018 (decryption law)

The AFR reports that shadow minister for the digital economy Ed Husic has said that (if elected) a Federal Labor government will amend Australia's controversial *Telecommunications Assistance and Access Act 2018* (which passed in December 2018).

Mr Husic reportedly said Labor intends to make three changes to the encryption regime: a) to prohibit the injection of 'systemic weakness' into companies' systems; b) strengthen judicial warrant requirements, and c) commission an inquiry into the economic effects of the laws.

[Note: For a summary of the legislation and its possible implications, see MinterEllison's article: Decryption laws update - what's the latest? 25/01/2019]

[Source: [registration required] The AFR 27/03/2019]

New legislation to ensure that online platforms 'cannot be exploited and weaponised by perpetrators of violence' in the wake of the Christchurch terrorist attach — Criminal Code Amendment (Sharing of Abhorrent Violent Material) Bill 2019 — passed both Houses on 4 April

[Sources: Criminal Code Amendment (Sharing of Abhorrent Violent Material) Bill 2019; Explanatory memorandum]

Culture

Top Story | Little measurable improvement? Assessment of UK Bank Culture released

Overview: UK Banking Standards Board Annual review of bank culture 2018/2019

The UK Banking Standards Board has released its third annual review of bank culture. The review is the 'largest assessment of behaviour, competence and culture in banking not only in the UK, but globally'.

The assessment examines the extent to which characteristics associated with 'good organisational culture' — that is, 'cultures that produce good outcomes for a firm’s customers, clients or members, employees, the economy and society as a whole' — are demonstrated by and within firms'. Though the assessment is designed with the banking sector in mind, the BSB suggests that as the issues explored are not sector or jurisdiction specific they may have broader significance.

Below is a high level overview of the report findings and a brief description of the indicators the BSB used, the outcomes based approach it took to assess progress.

Some Key Findings

Findings overall — little improvement in 2018?

- **Little overall change (in aggregate) in 2018?** Overall, despite continued investment (time/resources) in managing culture, there was little improvement across firms as a whole, in 2018. Having said this, 2017 improvements were maintained. The BSB also notes that the aggregate picture is not necessarily representative of each individual firm progress.
- **Perseverance required?** Commenting on the results, BSB CEO Alison Cottrell writes that 'We cannot infer from these results that firms "tried harder" in 2017 or took culture less seriously in 2018'. Rather, the report suggests the lack of progress could be due to a number of causes including: that 'easy wins' have been exhausted; some initiatives in managing culture may have been less effective than others; and/or more time may be needed for initiatives to come to fruition. The report urges banks and society to 'persevere in determining what does and does not work'.

- **Evidence of continuing commitment to raising standards:** The report states that the scale of participation, as well as firms' engagement with the BSB's work more broadly, is evidence of a 'strong commitment on the part of member firms to continuous improvement and to raising standards across the sector'.

Rebuilding trust takes time?

Commenting on the findings, BSB Chair Dame Colette Bowe said that the findings demonstrate the scale and the nature of the task. 'From the many discussions we have had with firms, we would say: these results are telling us that, making continuing significant changes to the method of operation of large and/or long-established businesses is a hard slog, and that many firms are in the hard yards of achieving progress in improving their culture. Rebuilding trust, and making themselves worthy of being trusted, is a long job.'

More detailed findings 2018/2019

- **Improvement in perceptions of leaders — leaders perceived to be taking responsibility and as more credible:** The largest 'sustained improvement' relates to increased perception that senior leaders taking responsibility (especially where things go wrong). In 2016, 58% of employees said that senior leaders took responsibility. This increased to 65% in 2017 and to 66% in 2018. There was also improvement in relation to a question on believing that leaders mean what they say. This is consistent with and reflective of the 'considerable regulatory focus on responsibility and leadership in recent years' BSB Chair Dame Colette Bowe writes. For example, the introduction of the Senior Managers and Certification Regime.
- **Progress towards creating a speak up culture is 'much less positive':**
  - **Over 60% of employees would speak up:** Of those employees who said in 2018 that they had wanted over the past year to raise a concern about something at work, 63% said that they had done so.
  - **Firms aren't listening?** 40% of those who spoke up said, indicated that they had not felt listened to or taken seriously, and a further 19% were unsure. The BSB observes that 'the experience of those who do speak out about something may affect the willingness of others to do likewise (whether that experience is relayed directly or observed at a distance). A firm that wishes to encourage people to say when something is going wrong or could be improved, needs to demonstrate beyond doubt — and keep on demonstrating — that it welcomes feedback and is prepared to listen to it'.
  - **Less likely to speak up about harassment, bullying or discrimination than other issues?** The BSB also observes that individuals are more likely to challenge behaviour or practices that might damage the firm, its customers or markets than they are to speak up about bullying, discrimination or harassment. The BSB suggests that 'firms need to consider how to encourage speaking up on both organisational issues and personal concerns, recognising in particular the importance of how the firm itself listens and responds, and is seen to listen and respond'.
  - **Why not speak up?** According to the BSB, there is a 'mismatch' within individual firms between the extent to which those who choose not to speak up, think that they would be listened to and the experience of those who do speak up. According to the BSB's analysis, these 'mismatches' can run in either direction — that is, the reality may be better, or worse, than the expectation.
- **'Perceptions of equality of opportunity between men and women are strongly influenced by the leadership, or failure to exercise leadership, in this area by senior people in the firm':** Perceptions of equality of opportunity between men and women are more positive in business areas where leaders are seen to take responsibility for the need to improve. On average, 83% of men and 80% of women said that opportunities at their firm were equal irrespective of gender. Employees in most focus groups noted the limited representation of women in senior positions at their firm. Other common observations were that: a) taking maternity or paternity leave hindered career progression; b) policies to promote gender equality were applied inconsistently across the firm; and c) their firm's culture was itself a barrier to gender equality.
- **25% of banking employees say that working at their firm has a negative impact on their health and wellbeing,** a proportion that has barely changed over three years, notwithstanding the attention that

firms have been giving this issue. The most common reasons given for this were: excessive workload, the pressure of expectations and a lack of resources. Issues relating to line management, working relationships and the physical working environment were also frequently mentioned. The BSB writes that issues 'around wellbeing and stress matter if we want and expect people to be able to exercise judgement, manage risk, take decisions and demonstrate high standards of behaviour and competence at work'.

- **Excessive complexity is a barrier to being able to serve customers well:** Customer-facing employees identified the complexity of internal systems and processes as the main barrier to being able to serve customers well with 55% of employees said that their firm’s internal processes and practices were a barrier to continuous improvement. This proportion has shown little change over the three years of the survey.

Next steps? Three key focus areas for the coming year

The BSB identified the following three key themes as areas of focus for the coming year:

1. **decision making —** the BSB will use the survey and other approaches to better understand the connection between decision making and a firm's social purpose and outcomes
2. **technology and culture —** 'digging down into the perspectives of the people who design and manage technology for our member firms and their customers or members'
3. **speaking up and listening —** 'collaborative work to understand best practice and to share it'

In addition, the BSB will continue to focus on topics such as wellbeing, the question of what ‘good’ looks like for consumers of banking services, and the effective implementation of the Certification Regime.

Broader Relevance?

Though the assessment is designed with the banking sector in mind, the BSB suggests that the issues explored are not sector or jurisdiction specific and therefore may have broader significance. This view appears to be shared by Professor Emeritus of Philosophy at Cambridge University Baroness Onora O’Neill who writes: 'The standard that matters most in banking and financial services is not trust, but trustworthiness. Being trustworthy has three elements; honesty, reliability and competence. Regulation alone cannot produce trustworthiness. That responsibility sits with firms themselves in the organisational cultures they create, manage or tolerate. The work of the Banking Standards Board – providing independent support and challenge and identifying and sharing good practice – should be part of the toolkit of any firm that takes its culture seriously.'

Implications and relevance for Australian firms? Media reports suggest that the report may have relevance in the Australian context, especially in the in the wake of the Financial Services Royal Commission and the need to 'rebuild trust' in the sector. 'It's worth reflecting on what banks in the UK are doing. And questioning whether local financial institutions fully appreciate the mammoth task ahead' The AFR suggests.

BSB assessment framework

The survey assesses rather than 'ranks' culture: The BSB comments that the fact that 'culture does not lend itself to measurement…does not mean that it cannot or should not be assessed and appraised in order to manage it more effectively'. Having said this, the assessment does not, measure or 'rank' culture directly as every organisation will have its own individual culture(s)) and there is no one 'model culture' against which others can be measured/ranked. Rather, the assessment is intended to provide feedback

and guidance to assist in managing culture based on 'outcomes' – ' 'Culture is important, in other words, not for its own sake but because of what results from it'.

Measuring 'outcomes' — assessment against nine characteristics: The survey (underpinning the report) asks how far a firm demonstrates the following characteristics: 1) competence; reliability; responsiveness; personal/organisational resilience; accountability; openness; respect; and honesty. 'A firm that demonstrates these to a high degree would, we would argue, be better equipped and motivated to serve its customers, clients and members' better than one in which the characteristics were lacking.

Changes in 2018? The core survey questions are consistent over time and the responses comparable across firms and business areas, enabling progress to be assessed in both absolute and relative terms. 2018 is the first year the survey: was run outside the UK banking sector, both with the non-UK banking operations of some member firms, and with member firm non-banking operations in the UK. The survey also includes banks in Ireland, providing a first year of baseline data for these firms and for the newly established Irish Banking Culture Board. 2018 was also the first year the survey contained one-off questions relating to speaking up, wellbeing and equality of opportunity by gender as well as customer focus. These themes were explored in more detail through focus groups with 837 employees, asking questions of boards, and talking individually with 71 senior executives and non-executive board members.

[Sources: UK Banking Standards Board media release 01/04/2019; Banking Standards Board Annual Review 2018/2019; [registration required] The AFR 04/03/2019; 04/03/2019; 03/041/2019]

Supply Chain Risk

In Brief | Consultation on draft Modern Slavery Reporting Guidance: The Commonwealth Modern Slavery Act 2018 established Australia's national Modern Slavery Reporting Requirement. The government has now released draft guidance on how to comply with the reporting requirement (including how to prepare a statement) and the consequences for noncompliance. Comments are due by 19 May

[Note: For an overview of the legislation see: Governance News 03/12/2018]

[Sources: Department of Home Affairs media release 29/03/2019; Modern Slavery Act 2018: Draft Guidance for Reporting Entities 29/03/2019]

Whistleblowing

United States | The US SEC has awarded a total of $50m to two whistleblowers for information leading to successful enforcement action

The US Securities and Exchange Commission (SEC) has announced awards totalling $50 million to two whistleblowers for 'high-quality information' which assisted the regulator to bring successful enforcement action.

One whistleblower received an award of $37 million and the other received an award of $13 million.

The $37 million award is the SEC's third-highest award to date after the $50 million award made in March 2018 to joint whistleblowers and more than $39 million award announced in September 2018.

The SEC has now awarded approximately $376 million to 61 individuals since issuing its first award in 2012. All payments are made out of an investor protection fund established by Congress that is financed entirely through monetary sanctions paid to the SEC by securities law violators. SEC notes that no money has been taken or withheld from harmed investors to pay whistleblower awards.

[Note: If elected, the Federal Labor Party has said that it plans to introduce a whistleblower reward scheme in Australia. See: Labor Leader Bill Shorten media release 03/02/2019; Governance News 13/02/2019.]

[Source: SEC media release 26/03/2019]

Insolvency and Restructuring

In Brief | The Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018 — which strengthens enforcement and recovery options to deter and penalise company

directors and others from engaging in activity designed to reduce employer liability for employee entitlements in insolvency — passed both Houses on 4 April with amendments

[Source: Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018]

Other News

In Brief | The Federal Labor Party has promised a second budget? The Federal Labor Party has reportedly said that if elected, it plans to deliver another budget in August 'We need to reset the economic settings. We need to update the forecasts with the new government in place, and then, of course, we would return to the normal budget cycle of budgets in May from 2020 onwards' Shadow Treasurer Chris Bowen is quoted as stating

[Source: The Conversation 31/03/2019]