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Boards and Directors

Is a move to annual elections inevitable? The head of Morrow Sodali has reportedly suggested that the increasing push for 'regular accountability' from investors will see Australia follow the US and the UK in instituting annual director elections

The Australian reports that head of shareholder advisers Morrow Sodali, Maria Leftakis, predicts that a move to annual director elections in Australia is inevitable, given the increasing calls for 'regular accountability' from superannuation funds and activist investors.

'For me that is not an if, it's a when… It is happening in the US, UK and it eradicates the need to an extend for the "two strikes" rule…There is a lot of push for that more regular accountability' Ms Leftakis reportedly said.

The Australian, quotes Ms Leftakis as saying that the willingness of industry superannuation funds and activist investors to lodge protest votes against remuneration reports, and against individual directors has also changed the AGM landscape and has necessarily impacted companies' approach to engagement. 'The chairman or CEO used to pick up the phone and talk to five or 10 fund managers and have the vote in the bag…The rise of the super funds means they have taken their voting mandate away from fund managers to make their own decisions. It's become a very diverse ecosystem of investors' Ms Leftakis is quoted as saying.

In this changed environment, 'The biggest mistake a company can make is only speaking to their shareholders when the company is in trouble' Ms Leftakis reportedly said.

Related News: Recent Governance Institute survey

Citing a 'push' by investors and regulators globally towards annual director elections for listed entities, The Governance Institute recently undertook a survey of members and broader stakeholders, seeking their views on the issue of annual director elections and more particularly their thoughts on whether annual elections would improve governance in listed entities or undermine board effectiveness. The survey closed on 6 December.

[Source: [registration required] The Australian 09/12/2019]

Disclosure and Reporting

ASIC financial reporting focus areas for 31 December 2019

Key Takeouts

- **New accounting standards** will have the greatest impact for many companies since the adoption of International Financial Reporting Standards (IFRS) in 2005, ASIC states
- **ASIC will review more than 80 full year financial reports at 31 December 2019** to promote quality financial reporting, and useful and meaningful information for investors.
- **Governance review to be completed by 30 June 2020:** ASIC will also review the governance processes over financial reporting of several companies (generally where reported net assets and profits were materially changed following ASIC's inquiries on financial reports for recent reporting periods). ASIC says it will consider whether the results of the review indicate a need to improve governance at the company and/or audit firm. The planned completion date for this work is 30 June 2020.

The Australian Securities and Investments Commission (ASIC) has outlined its focus areas for 30 June 2019 financial reports. The regulator has called on companies to focus on new requirements that can materially affect reported assets, liabilities and profits. In particular, ASIC highlights that new accounting standards 'will have the greatest impact' for many companies.

New accounting standards

The new accounting standards will have the greatest impact for many companies since the adoption of International Financial Reporting Standards (IFRS) in 2005, ASIC states.

The new standards include the following.

- AASB 16 Leases (applies from years commencing 1 January 2019);
- AASB 17 Insurance Contracts (applies from years commencing 1 January 2021); and
- Amendments to standards to apply the new definition and recognition criteria in the Conceptual Framework for Financial Reporting (applies from years commencing 1 January 2020).

[Note: The International Accounting Standards Board will consider whether to defer the application date for the standard on which AASB 17 is based to years commencing 1 January 2022.]

New lease accounting and other requirements

ASIC says that full-year reports at 31 December 2019 must comply with the new accounting standard on lease accounting that requires lessees to recognise lease liabilities and a right-of-use asset for all leases (not just leases formerly classified as finance leases).

Commenting on the likely impact of the new standard, ASIC Commissioner John Price said that 'The new lease accounting standard can significantly affect reported assets, liabilities and results reported to the market by companies that are lessees, require changes to systems and processes, and affect businesses.'

In addition, ASIC notes that this is the second full year that new accounting standards on revenue recognition and financial instrument values (including hedge accounting and loan loss provisioning) — AASB 9 Financial Instruments and AASB 15 Revenue from contracts with customers — have applied. ASIC cautions that these new standards may have 'real business impacts' eg compliance with debt covenants or regulatory financial condition requirements, tax liabilities, dividend paying capacity, and remuneration schemes) as well as the need to implement new systems and processes.

ASIC also calls on directors and auditors to report any breaches of financial condition requirements to ASIC as required by the Corporations Act 2001. 'Because the financial condition requirements are on an "at all time" basis, compliance needs to be considered from the commencement of the financial year to which the standard first applied. This is the case even if ASIC were to subsequently change a licensee's conditions to allow right-of-use assets to be counted. Similar issues may arise with contract assets recognised in accordance with the revenue standard' ASIC states.

More extensive disclosure

Noting that required disclosure on the effect of the new standards is more extensive than that made by many companies for the 30 June 2019 half year, ASIC says that it is important that directors and management ensure that companies inform investors and other financial report users of the impact on reported results.

ASIC considers that public disclosure on the impact of the standards and timely implementation is important for investors and market confidence and adds that information that there will be no material impact may also be important for the market.

ASIC review

ASIC says it will be reviewing more than 80 full year financial reports at 31 December 2019 to promote quality financial reporting, and useful and meaningful information for investors.

Governance review to be completed by 30 June 2020

ASIC will review the governance processes over financial reporting of several companies, generally where reported net assets and profits were materially changed following ASIC's inquiries on financial reports for recent reporting periods.

The work will cover both how audit committees and directors fulfilled their role in ensuring the quality of the financial reporting and supporting the audit and the identification and effectiveness of actions by firms to address root causes from an audit perspective.

ASIC says it will consider whether the results of the review indicate a need to improve governance at the company and/or audit firm. The planned completion date for this work is 30 June 2020.

The role of directors

ASIC states that directors are primarily responsible for the quality of the financial report including ensuring that management produces quality financial information on a timely basis. ASIC expects companies to have appropriate processes in place, records and analysis to support information in the financial report.

In addition, ASIC says that companies should apply appropriate experience and expertise, particularly in more difficult and complex areas such as accounting estimates (including impairment of non-financial assets), accounting policies (such as revenue recognition) and taxation.

Further details

In addition, ASIC draws attention to a number of specific issues in relation to the following areas: 1) accounting estimates; 2) accounting treatments (revenue recognition, expense deferral, off-balance sheet disclosures); and 3) key disclosures. Among other things, ASIC flags the following issues.

Impairment testing and asset values: ASIC identifies the recoverability of the carrying amounts of assets such as goodwill, other intangibles and property, plant and equipment an 'important area of focus'. Other areas of focus on asset values include: companies affected by climate change, market changes, digital disruption, technological change or Brexit; and the valuation of financial instruments, particularly where values are not based on quoted prices or observable market data. Fair values should be based on appropriate models, assumptions and inputs.

Accounting treatments (revenue recognition, expense deferral, off-balance sheet arrangements, tax accounting)

- **Revenue recognition:** ASIC notes that the new revenue standard is considerably more detailed than the previous standard with a focus on performance obligations. ASIC says that in applying the new revenue accounting standard directors and auditors should review an entity's revenue recognition policies to ensure that revenue is recognised in accordance with the substance of the underlying transactions when applying the new revenue recognition accounting standard.

- **Expense deferral:** ASIC says directors and auditors should ensure that expenses are only deferred where: is an asset as defined in the accounting standards; it is probable that future economic benefits will arise; and the requirements of the intangibles accounting standard are met.

- **Off-balance sheet arrangements:** ASIC calls on directors and auditors to carefully review the treatment of off-balance sheet arrangements, whether other entities are controlled and should be consolidated, the accounting for joint arrangements and disclosures relating to structured entities

- **Tax accounting:** Preparers of financial reports should ensure that: a) there is a proper understanding of both the tax and accounting treatments, and how differences between the two affect tax assets, liabilities and expenses; b) the impact of any recent changes in legislation are considered; and c) the recoverability of any deferred tax asset is appropriately reviewed.

Key Disclosures

- **Operating and financial review (OFR):** Referencing ASIC Regulatory Guide 247 Effective disclosure in an operating and financial review, ASIC reminds companies that listed entities should disclose information that may have a material impact on the future position/performance of the entity and cites a number of examples of the sort of information this may include: Brexit, cybersecurity; new technology or climate.

ASIC also suggests that directors could consider 'whether it would be worthwhile to disclose additional information that would be relevant under integrated reporting, sustainability reporting or the recommendations of the Task Force on Climate-related Financial Disclosures where that information is not already required for the Operating and Financial Review'.

- **Non IFRS financial information:** Referencing Regulatory Guide RG 230 Disclosing non-IFRS financial information ASIC states that directors should consider whether any non-IFRS financial information in the OFR or other documents outside the financial report is 'potentially misleading'.

- **Estimates and accounting policy judgements:** ASIC states that disclosures regarding sources of estimation uncertainty and significant judgements in applying accounting policies are important to allow users of the financial report to assess the reported financial position and performance of an entity and that as such 'directors and auditors should ensure disclosures are made and are specific to the assets, liabilities, income and expenses of the entity'. In addition, the regulator states that key assumptions and sensitivity analysis are important as they enable users of the financial report to 'make their own assessments about the carrying values of the entity's assets and risk of impairment given the estimation uncertainty associated with many asset valuations'.

[Source: ASIC Media release 6/12/2019]

Related News: Over 50% of organisations falling short on lease accounting standards?

Accountants Daily reports that according to a poll released by software provider LeaseAccelerator and RGP, that more than 50% of the 163 executives surveyed said that their organisations were still working towards full compliance with the new standards set by the IFRS which began to take effect at the beginning of 2019.

[Source: Accountants Daily 09/12/2019]

Meetings and Proxy Advisers

What about sell-side research? Writing in the AFR, Ownership matters argues against imposing additional regulation on proxy advisers

Writing in The AFR, director of proxy adviser Ownership Matters Dean Paatsch argues against the need to impose additional regulation on proxy advisers.

There is no need for additional regulation Mr Paatsch argues for the following reasons.

- **Regulation is already in place and there is no case for treating proxy advisers differently to other researchers:** Mr Paatsch observes that Ownership Matters has an Australian Financial Services Licence (AFSL) and is required to abide by the same guidelines that govern research quality and conflicts of interest for all sell-side researchers, independent experts and investment banks. An 'AFSL could be cancelled if error-ridden reports are published that mislead investors; quality falls below the minimum standard as a result of failing to meet issuers; or conflicts of interest unduly affect research recommendations' he argues. Mr Paatsch observes that 'It's strange that organisations that routinely advocate for the removal of red tape are demanding a censorious and unwarranted intrusion into the rights of sophisticated private citizens to contract with each other. It is notable that the critics of proxy advisers express no concern over shoddy but favourable sell-side research and the retinue of analysts with undisclosed holdings that affect their recommendations.'

- **ASIC review did not identify a need for further regulation:** Citing ASIC's 2017 review of proxy advisers, (see: Governance News 02/07//2018 at p5) Mr Paatsch said 'ASIC found no evidence of systemic errors and no instance where investors had been misled, deceived or dictated to by advisers. It found no case for changes to the existing system of regulation'.

- **Research quality is kept high by client expectations (without the need for additional regulation):** Any provider of 'poor-quality analysis ought not to expect their work to have much influence or commercial success' Mr Paatsch argues. As such, research quality is 'kept high by the expectations of sophisticated clients, not by regulatory oversight'. Mr Paatsch goes on to say that provided that there is a free and competitive market for proxy advice, he considers that 'good research will prevail over bad. Wholesale investors are capable of identifying quality research, regulators do not need to do it for them'.

- **'We don't think the state has a role in regulating voting behaviour' writes** Mr Paatsch. 'In a free market, each actor bears the consequences of their decisions: sophisticated investors should be free to make their own mistakes'. As such, where there is 'badly prepared proxy research', he says, Ownership Matters is 'untroubled' by it, because there is 'no compulsion to follow it.'

No case for the imposition of a Code of Conduct for proxy advisers

Mr Paatsch argues there is no case for the establishment of a code of conduct for proxy advisers in Australia. 'We will consider the idea the day after ASIC imposes a policy that prevents investment banks from providing hospitality to company directors. Until then we will stick to our view that behavioural codes generally favour incumbents and provide additional barriers to entry to new market players' he argues.

No case for the imposition of US-style reforms?

Mr Paatsch says that proxy advisers are 'perplexed' by renewed calls by CEOs and media commentators for the imposition of additional regulation on proxy advisers. He adds that 'it's even more perplexing that the Australian Institute of Company Directors is suggesting ASIC import a draft US Securities and Exchange Commission ruling in order to regulate the industry' Mr Paatsch said. 'This measure, dreamt up by the extreme right-wing US corporate lobby, is aimed at curtailing the US proxy advisory industry by preventing investors contracting with them except under certain circumstances' he writes.

[Note: The Australian Institute of Company Directors (AICD) has reportedly suggested that consideration should be given to changing the way in which proxy recommendations are prepared, and more particularly that consideration should be given to following the proposals being considered by the US Securities and Exchange Commission, including a proposal to give companies more opportunity to review/respond to draft proxy advice before it is distributed to shareholders (see: Governance News 20/11/2019 at p7; 06/11/2019 at p8).]

Mr Paatsch goes on to draw a distinction between Australia and the US, again noting that: the AFSL system is adequate; there is a more competitive market for domestic proxy advice than offshore; 'most sophisticated investors apply a commercial filter to their voting decisions rather than a "back office" approach that follows advisory recommendations' and there is no compulsion in Australia for any wholesale investor to vote their securities.

'Shameless demands'

Mr Paatsch concludes by saying that 'the demands for immediate government action are febrile and shameless: it's as if proxy advice alone was responsible for the misconduct examined by Hayne…Most complaints made by corporates are not about quality of advice but the embarrassment caused by advice that rejects the company line'.

[Source: [registration required] The AFR 06/12/2019]

United Kingdom | How the FCA will discipline and investigate proxy advisers: The FCA has released a policy statement summarising feedback on changes to the Decision Procedure and Penalties manual and the enforcement guide

Context: The Proxy Advisors (Shareholders' Rights) Regulations 2019, which implement the parts of the Shareholder Rights Directive (SRD II) that apply to proxy advisers, came into force on 10 June 2019. The Regulations establish a new regulatory framework for proxy advisors and require them to provide a range of information to their clients and the public, with the aim of promoting greater transparency. They also give the Financial Conduct Authority powers to investigate and sanction proxy advisors.

The Financial Conduct Authority (FCA) released a consultation paper in June, outlining proposed changes to its Decision Procedure and Penalties manual (DEPP) and Enforcement Guide (EG) to reflect the changes introduced by the regulations and seeking feedback on the changes.

Policy paper released: On 25 November, the FCA released a policy paper — PS19/28: Proxy Advisors (Shareholders' Rights) Regulations Implementation (DEPP and EG) – Feedback and final rules for CP19/21 — summarising the feedback received in response to the consultation and confirming the changes being made to the guidance.

- **Changes to the Decision making procedure:** Changes to the Decision Procedure and Penalties manual include amendments setting out the decision making procedures for: a) deciding when to publish a statement about a proxy advisor who has breached a relevant requirement; b) deciding when to impose a financial penalty on a proxy advisor; and deciding when to impose a restitution requirement.

- **Penalty policy:** The FCA confirms it will apply its existing penalty policy ie it will consider all the relevant circumstances of the case including the factors set out in the Regulations.

- **Changes to the enforcement guide:** A new section has been added to the enforcement guide (Chapter 19 of EG (non-FSMA powers) explaining how the FCA will use its powers under the regulations. The FCA says that its approach will 'broadly mirror our approach to conducting investigations, sanctioning and using our regulatory powers under FSMA [Financial Services and Markets Act 2000]'.

- **Feedback received?** Three responses to the consultation were received. Overall, the respondents either agreed with, or did not comment on, FCA's proposed decision-making procedure, approach to sanctions or investigations.

[Sources: FCA media release 25/11/2019; PS19/28: Proxy Advisors (Shareholders' Rights) Regulations Implementation (DEPP and EG) – Feedback and final rules for CP19/21]

Corporate Social Responsibility and Sustainability

Top Story | Stakeholder (not shareholder) capitalism is the only way?

The World Economic Forum has issued a new manifesto ahead of the January annual meeting advocating a shift to stakeholder not shareholder capitalism and calling for a realignment of business metrics, including executive remuneration, to solidify the necessary changes.

Key Takeouts

- Ahead of the January annual meeting, the World Economic Forum (WEF) has released a new Davos manifesto which states that: companies should pay their fair share of taxes, show zero tolerance for corruption, uphold human rights throughout their global supply chains, and advocate for a competitive level playing field.

- WEF founder and Executive Chair Klaus Schwab says that stakeholder capitalism, not shareholder capitalism, 'offers the best opportunity to tackle today's environmental and social challenges'.

- WEF says that living up to the principles in the manifesto (shifting to a stakeholder model) requires changes in/realignment of, current metrics including: a) the incorporation of a new measure of 'shared value creation'; and b) the realignment of executive performance metrics with long-term value creation (rather than stakeholder interests).

- WEF suggests that embracing the stakeholder model is an opportunity for leaders, 'if they really want to lead their mark on the world'.

- Commenting on the release of the manifesto, MinterEllison Partner Geraldine Johns-Putra says that the release of the manifesto is an indicator of the growing acceptance, in Australia and overseas, of the growing acceptance by companies of the need to take into account multiple stakeholder interests through a long term lens.

The World Economic Forum (WEF) has released a new manifesto — Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution — describing a firm's principal responsibilities towards its stakeholders, ahead of the January annual meeting.

Stakeholder capitalism is the best approach?

WEF Founder and Executive Chair Klaus Schwab argues that shareholder primacy/shareholder capitalism (as propounded by Milton Friedman) on the basis a single minded focus on maximising profits to shareholders, and delivery of those profits in the short term, 'is no longer sustainable' both from a financial and from an environmental perspective.

There is increasing recognition Mr Schwab writes that 'adherence to the current economic system represents a betrayal of future generations, owing to its environmental unsustainability.' In addition, he argues that pressure/influence of younger generations who do not want to work for/invest in/buy from companies that 'lack values beyond maximizing shareholder value' is having an impact, as is the increasing acceptance by executives and investors of the link between their own long-term success and that of their customers, employees, and suppliers.

Given this, and given that the third alternative model state capitalism — which entrusts the government with setting the direction of the economy — is also in his view flawed, Mr Schwab argues that stakeholder primacy in which companies are positioned as 'trustees of society', with responsibility not only to shareholders but to the community more broadly 'offers the best opportunity to tackle today's environmental and social challenges' and as such is the better approach.

The new Davos manifesto

The manifesto includes the following principles.

- **The purpose of a company is to engage all its stakeholders in shared and sustained value creation.** Further, in so doing, a company serves not only its shareholder but all its stakeholders including: employees, customers, suppliers, local communities and society at large. 'The best way to understand and harmonize the divergent interests of all stakeholders is through a shared commitment to policies and decisions that strengthen the long-term prosperity of a company'.

- **A company serves its customers by providing a value proposition that best meets their needs.** The manifesto gives a number of examples of this including that a company: a) accepts and supports fair competition and a level playing field; b) 'has zero tolerance for corruption'; c) makes customers fully aware of the functionality of its products and services (including adverse implications); d) treats its people with dignity and respect (eg fosters diversity', 'fosters continued employability through ongoing upskilling and reskilling'); e) considers its suppliers as 'true partners in value creation' and integrates respect for human rights into the entire supply chain; f) serves society through its activities, supports communities in which it works; and g) pays its fair share of taxes.

- **A company provides its shareholders with a return on investment that takes into account the incurred entrepreneurial risks and the need for continuous innovation and sustained investments.** It responsibly manages near-term, medium-term and long-term value creation in pursuit of sustainable shareholder returns that do not sacrifice the future for the present.

- **A company is more than an economic unit generating wealth.** It fulfils human and societal aspirations as part of the broader social system. Performance must be measured not only on the return to shareholders, but also on how it achieves its environmental, social and good governance objectives. Executive remuneration should reflect stakeholder responsibility.

- **A company that has a multinational scope of activities not only serves all those stakeholders who are directly engaged, but acts itself as a stakeholder – together with governments and civil society – of our global future.** Corporate global citizenship requires a company to harness its core competencies, its entrepreneurship, skills and relevant resources in collaborative efforts with other companies and stakeholders to improve the state of the world.

Concrete action is required

Mr Schwab comments that living up to the principles in the manifesto requires concrete actions from companies including the use of new metrics to measure performance differently.

For example, he suggests that companies need a new measure of 'shared value creation' and that this should include environmental, social and governance goals in addition to financial metrics. In addition, he suggests that executive performance metrics need to be realigned with delivery of long-term shared value creation, rather than purely with shareholder returns.

Why issue a new manifesto now?

Mr Schwab said that a new manifesto has been released now to capitalise on the shift on the part of investors, and by the community, towards acceptance of stakeholder capitalism (as opposed to shareholder capitalism) as the better approach.

For example, the release of the manifesto follows the release by the US Business Roundtable of a statement redefining the purpose of a corporation to include delivery of benefits to all stakeholders (see: Governance News 21/08/2019) and the rise of impact investing.

In light of this, he argues that 'We should seize this moment to ensure that stakeholder capitalism remains the new dominant model. To that end, the World Economic Forum is releasing a new "Davos Manifesto," which states that companies should pay their fair share of taxes, show zero tolerance for corruption, uphold human rights throughout their global supply chains, and advocate for a competitive level playing field – particularly in the "platform economy."'

Indicative of a shift in approach here, and overseas

Commenting on the release of the manifesto, MinterEllison Partner Geraldine Johns-Putra said that 'The WEF's new manifesto and refutation of shareholder primacy as the chief purpose of the corporation reflects increasing recognition from so many quarters that a corporation's purpose is to consider multiple stakeholder interests through a long-term not short-term lens. In Australia, the focus is increasingly on how directors can best reflect this principle in their decision-making and how companies can embed this ethos throughout the organisation'.

[Sources: World Economic Forum Manifesto; WEF Blog 01/12/2019; [registration required] The FT 04/12/2019]

Tackling greenwashing: EU to establish a sustainable investment rulebook specifying what can be marketed as 'green' and what cannot

The FT reports that EU negotiators have agreed to establish a common categorisation system (rule book) determining which financial products can be marketed as 'green'. The aim is reportedly to address the issue of 'greenwashing' ie where countries/companies seek to make their environmental credentials appear stronger than they are.

The rule book – the taxonomy for sustainable activities – will reportedly cover all types of energy sources including nuclear energy and will inform how investors treat a range of assets from green bonds to bank loans and investment products. It will reportedly create three categories of sustainable investment to help markets and investors judge the green credentials of financial products.

The highest label will be 'green' (covering renewable activities), followed by 'enabling' and 'transition' technologies (eg steel/cement production used for wind farms) that will capture investments that are not fully renewable but help reduce emissions.

Reportedly coal investments will be excluded from any definitions of sustainability under the rules.

Pascal Canfin, Chair of the European Parliament's environment committee that co-led the negotiations, is quoted as saying that the rules will 'create a new grammar for financial markets to know what is green or not…This is the basic layer for Europe's financial markets so we speak the same language and can reallocate more capital to activities that are aligned with the Paris climate agreement."

Next steps? According to the FT, the framework is expected to be formally adopted before the end of the year and will probably come into force in 2021.

[Source: [registration required] The FT 06/12/0219]

RIAA study finds that superannuation funds that build responsible investment considerations into their broader investment beliefs and processes financially outperform their peers over one, three and five year timeframes

Report Overview | RIAA report, Responsible Investment Super Study 2019

The Responsible Investment Association Australasia's (RIAA's) third annual survey of Australia's 57 largest superannuation funds compares the MySuper performance of super funds employing responsible investment (RI) strategies with the MySuper options of those super funds that are not.

The report identifies that funds that 'comprehensively engage' in RI strategies — that is, build responsible investment considerations into their broader investment beliefs and processes — financially outperform their peers over one, three and five year timeframes.

The funds included in the survey manage 91% of all APRA-regulated super fund assets and, excluding the NZ Super Fund, represent 60% of total Australian superannuation assets of $2.87 trillion as at 30 June 2019.

Some Key Findings

Funds that employ RI strategies deliver 'better member outcomes'

RIAA found that funds that employ RI strategies across their entire fund financially outperformed their non-RI peers over five, three and one year periods. RI funds delivered an average return of 7.33% over one year, 9.06% over 3 years and 8.14% over 5 years. By comparison, non-RI funds delivered an average return of 7.31% over one year, 8.65% over 3 years and 7.70% over 5 years.

Commenting on the findings, RIAA CEO Simon O'Connor said that 'the outperformance of responsible investment super funds is even more stark when we considered the performance of our Super Study leaders against the performance of the non-leaders, with outperformance of about 100 basis points over each of the three time periods…This reinforces how important the consideration of environmental, social and corporate governance factors is to delivering the best possible outcomes for super fund members'.

The report suggests that funds should take note, given the Australian Prudential Regulation Authority's (APRA's) increased focus on superannuation, and more particularly on fund performance/delivery of better member outcomes.

Responsible investing is increasingly 'par for the course'

Consideration of climate risk by fund boards continues to grow, in light of, RIAA suggests,1) 'rising public concern'; 2) the increasing acceptance of the financial materiality of environmental, social and governance (ESG) issues including climate change; and 3) an increasing focus on management and disclosure of material 'non-financial risk' (including climate change) by finance sector regulators.

- **46 out of 57 funds (81%) have some form of responsible investment (RI) commitment in place.** This is in line with 2018, but up by 11% from 2016. 44 funds (77%) explicitly state their RI commitments either in a standalone policy or in the investment beliefs (up from 74% in 2018 and 70% in 2016).

- **45 of 57 funds (79%) state that the full board or board committees are accountable/responsible** for oversight of ESG risks/opportunities (up from 9% in 2018 and 23% in 2016)

- **72% report annually on RI activity** (up from 44% in 2016). The RIAA says that this highlights that RI is increasingly being embedded within Australian investment markets.

- **51% of funds are employing one or more full-time employees with significant responsibility for RI.**

Areas for improvement?

Though the results show that the consideration of climate risk by fund boards continues to grow there remains room for improvement.

- **Climate related financial disclosure:** Though climate changes is 'systematically considered' by more boards than previously, nearly doubling to 18% and though boards are starting to adopt the Task Force on Climate-related Financial Disclosures (TCFD) in their reporting, only two funds have reported against the TCFD at November 2019.

- **Disclosure of stewardship activity and/or company engagement:** RIAA found that though 49% of funds have formal engagement policies and processes in place, and that most of these (44%) have been involved in direct company engagement, less than half (18 funds of the 38 involved in direct and/or collaborative engagements) publish engagement reports. Likewise, though 39% of funds are signatories to either the Australian Council of Superannuation Investors' stewardship code or the Financial Services Council stewardship code, disclosure of stewardship activity remains low.

Simon O'Connor, CEO of RIAA commented 'If the superannuation industry is to realise its potential for delivering long-term retirement outcomes, super funds need to be demonstrating how they are fuelling a productive, prosperous and healthy future for their members. This report shows us that this responsible investment is not just something Australians want, but is a critical part of delivering stronger member outcomes'.

[Sources: RIAA media release 06/12/2019; RIAA report: Responsible Investment Super Study 2019]

The next twelve months will be 'critical to mainstreaming sustainable finance' says BoE Governor Mark Carney

In a speech at the US Climate Action Centre, Bank of England Governor Mark Carney spoke about the changes needed to meet the goals of the Paris Agreement, the benefits (for companies) in taking immediate action and the risks (for companies), in failing to act. 'Firms that align their business models with the transition to net zero will be rewarded handsomely. Those that fail to adapt will cease to exist. Now is the time to ensure that every financial decision takes climate change into account' he said.

Mr Carney went on to say that meeting the goals of the Paris Agreement requires a shift in approach to: 1) reporting; 2) risk management; and 3) the measurement of returns.

- **Reporting**: Mr Carney said that the 'demand for TCFD disclosure is now enormous' and there is increasing uptake. Four fifths of the top 1100 global companies are now reporting in line with the TCFD recommendations and three quarters of major investors are now using TCFD disclosures when investing. To build on this 'foundation' over the next year, the focus will be on 'enhancing both the quality and quality of disclosures to make TCFD standards as comparable, efficient and as decision-useful as possible' and on exploring pathways to make TCFD disclosure mandatory (by COP26).

- **Risk management**: Mr Carney said that in order for the market to understand where climate risks/opportunities lie, it's necessary for disclosures to 'go beyond the static to the strategic'. This requires that firms assess the resilience of their strategies to transition risks. However, Mr Carney observed, 'this is hard. Only half of TCFD supporters systematically conduct scenario analysis and, of those that do, three fifths don't disclose it.' He then outlined a number of initiatives to 'build best practice' including (among others) stress testing of the major banks/insurers by the Bank of England, against different climate scenarios. The stress test he said, 'will reveal the banks – and by extension companies – that are preparing for the transition to net zero as well as those who have not yet developed strategies consistent with America's Pledge or the UK's legislated commitment to net zero'. The results of the stress test will be shared with 50 other central banks and supervisors in the Network for Greening the Financial System to enable them to stress test their own financial systems.

- **Measuring returns**: Achieving the goals of the Paris Agreement, requires sustainable investment 'to go mainstream'. This requires, he said, that sustainable investment 'do more than exclude incorrigibly brown industries and finance new deep green technologies'. Rather, it requires that sustainable investing 'catalyse and support all companies that are working to transition'. Further, it requires a more sophisticated and forward-looking approach to measuring and managing the financial implications of climate change for investments. Mr Carney suggests that 'one of the most promising options' is to assess the "warming potential" of investment portfolios. To this end, for COP26, the TCFD is establishing a subcommittee to consider how to standardise the methodology for measuring the warming potential of assets and expanding its use.

Mr Carney concluded by observing that the next year will be 'critical to mainstreaming sustainable finance'.

[Source: Speech by Governor of the Bank of England, Mark Carney at the US Climate Action Centre Madrid 10/12/2019]

Financial Services

Top Story | Updated responsible lending guidance released: ASIC aims to clarify expectations

Following consultation, the Australian Securities and Investments Commission (ASIC) has released updated responsible lending guidance for lenders and brokers: RG 209: Credit licensing: Responsible Lending Conduct on the responsible lending obligations that apply to consumer credit.

Separately, ASIC also released a report — Report 643 Response to Submissions — outlining the key issues raised in the 74 submissions to the consultation, and ASIC's response to these issues.

A high level overview of the changes to the guidance, and the response to the changes is below.

Scope of the guidance

The guidance sets out ASIC's views on what is required in order to comply with the responsible lending obligations in in Ch 3 of the National Consumer Credit Protection Act 2009 (NCCP Act), and the steps lenders and brokers can take to minimise the risk of non-compliance.

ASIC Commissioner Sean Hughes said that the updated guidance is intended to provide clarification for industry and to 'assist industry to more confidently make responsible lending decisions and to facilitate good lending outcomes for consumers'.

Technological developments

The guidance has also been updated to reflect technological developments including open banking and digital data capture services.

What is not covered

In response to feedback received and 'recent public commentary' that has expressed 'mistaken views and concerns about the effect of applying the responsible lending obligations to business lending' ASIC has also included a section identifying the areas that are not subject to responsible lending obligations – such as small business lending irrespective of the nature of the security used for the loan.

'This guidance will make it clear that lending that is predominantly for business purposes, including to individuals who operate a small business, is not regulated (even if the loan is secured over personal assets, such as residential property)' ASIC states.

What has/hasn't changed?

ASIC's 'general approach' to the guidance remains 'principles based' (but is more detailed)

The consultation queried whether the guidance should identify examples of what ASIC would consider to be 'reasonable steps' to determine unsuitability ie identify the particular inquiries and verification steps that ASIC would consider to be reasonable.

ASIC says that it received 'strongly divergent' responses to this query, and in light of this, that the regulator has decided to continue the 'existing principles-based approach'. However, ASIC has also made changes to 'more clearly articulate the principles that it considers licensees should apply when determining how to comply with their obligations and provided more illustrative examples of how the principles should be applied in individual circumstances'.

This is intended, ASIC says, to maintain/support 'flexibility for licensees' in their approach.

'Non-prescriptive', more detailed guidance

- **increased emphasis on the purpose of the responsible lending obligations**

- **expanded guidance to illustrate where a licensee might undertake more, or less, detailed inquiries** and verification steps based on different consumer circumstances and the type of credit that is being sought.

- **more 'direct' guidance around the treatment of living expenses,** and the different types of living expenses on the basis that the regulator considers it 'is important for licensees to understand that consumers will give more priority to some expenses and expenditure than others' and that 'an understanding of current expenditure, and the consumer's views about what is important and likely to be maintained, provides a starting point for assessing whether the credit product is unsuitable for that consumer'. In taking this approach, ASIC concedes that 'licensees find it frustrating being asked to obtain information to verify expenses when they consider those expenses to have little relevance for the assessment of unsuitability'.

- **more detailed guidance about the use of benchmarks** as a way to check the plausibility of expenses, as well as additional guidance about the household expenditure measure (HEM) benchmark itself.

  - **Use of any benchmark is not required**: ASIC says that it considers the guidance 'should make it clear that comparison to a benchmark figure (with or without a buffer) as a floor is not required'.

  - **Where lenders do use the HEM, banks are expected to also take individual circumstances into account.** 'We consider that if a consumer provides estimates that are lower than the HEM benchmark, there is a higher likelihood that they have underestimated (as the methodology is based on the majority of households having a higher expenditure). This should therefore trigger additional information-gathering steps. However, if the lower estimate is confirmed by that additional information, we do not consider it is necessary to then raise the verified amount to a higher floor'.

  - **RG 209 includes guidance about circumstances where comparison to a benchmark, but not verification, may be a reasonable step to take**

  - **Use of benchmark figures generally:** RG 209 notes the importance of only using benchmark figures in a way that is consistent with their design, and in accordance with any instructions for use from the designer and scheduled updates by the designer.

- **expanded guidance on how spending reductions may be considered** as part of the licensee's consideration of the consumer's financial situation, requirements and objectives. ASIC says it considers that this will 'be useful to help licensees put in place processes that are appropriate for their business that will enable them to understand the consumer's objectives and requirements, and assess whether the offered credit product will meet those objectives and requirements'. ASIC adds that it considers it appropriate that licensees determine how they achieve these outcomes. 'We do not consider that it is necessary or appropriate to specify particular processes that should be implemented' ASIC states.

- **clarity about more complex situations for some consumers** eg the different situations of consumers such as income from small business, casual employees, new employees, the gig economy, as well as joint and split liabilities and expenses.

[Note: ASIC has published a table comparing the 2014 and 2019 versions of RG 209. This can be accessed on the ASIC website here.]

Pending appeal?

The Response to Submissions document, makes a brief reference to ASIC's appeal against the Federal Court's decision in Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial) [2019] FCA 1244. It states that 'the decision will be reflected in the revised guidance, along with earlier decisions of the Federal Court'.

[Note: In Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial) [2019] FCA 1244 (Wagyu and Shiraz case), Justice Perram found that a lender 'may do what it wants in the assessment process' and is not obliged under the NCCP Act to take into account a prospective borrower's actual/declared expenses when assessing whether a loan will be unsuitable to consumers. On 10 September, the Australian Securities and Investments Commission announced that it has filed an appeal. See: Governance News 11/09/2019.

ASIC Commissioner Sean Hughes has since said that ASIC considers the decision 'creates uncertainty' about what is required in order to comply with responsible lending laws. 'If the judgment is to be understood as standing for the proposition that a lender may do what it wants in the assessment process (as His Honour found), then we consider that to be inconsistent with the legislative intention of the responsible lending regime… Put simply, we believe that the judgment left it too unclear what steps are required of a lender. We are seeking clarity by appealing. Notwithstanding our appeal in the Westpac case, we consider that ASIC should still provide updated guidance mindful that the appeal has not yet been heard. ' Mr Hughes said. See: Governance News 20/11/2019 at p21]

[Sources: ASIC media release 10/12/2019; Regulatory Guide 209; Report 643 Response to submissions]

Response to the release of the guidance

- **The Australian Financial Complaints Authority (AFCA) issued a statement confirming that its approach to responsible lending will be 'fully aligned to ASIC's guidance'.** AFCA CEO and Chief Ombudsman David Locke said AFCA believes the guidance will provide greater clarity to financial firms in meeting their obligations and will result in fairer outcomes for consumers. He added that AFCA also welcomes ASIC's clarification that its responsible lending guidance does not apply to providers of credit to small businesses. 'The guidance makes it explicitly clear that the National Consumer Credit Protection Act does not apply to small business lending' Mr Locke said.

[Source: AFCA media release 10/12/2019]

- **The Australian Banking Association (ABA) has welcomed the release of the updated guidance** as 'an important milestone in clarifying responsible lending obligations for banks'. Australian Banking Association Anna Bligh CEO said that the updated RG 209 would provide clarity to banks on ASIC's views on what responsible lending obligations require before offering credit to customers. 'This is an important document for the industry to guide each bank's approach to responsible lending which we will now study closely to assess any impacts it may have on borrowing for customers' Ms Bligh said. Ms Bligh added that the industry 'is pleased to see ASIC has maintained a principles based approach to lending, which as an industry we have called for, and to ensure banks are able to fulfil their obligations without the process becoming too restrictive for customers. The industry also welcomes ASIC providing greater clarity in some areas, such as where it is difficult to determine income from certain customers, such as small business owners and gig economy workers'

[Source: ABA media release 09/12/2019]

- **The Consumer Action Law Centre (CALC) also welcomed the release of the guidance**, with CALC CEO Gerard Brody saying that it 'underscored the importance of lenders following the guidance as intended, rather than trying to get away with doing the bare minimum'.

- **Financial Rights Legal Centre CEO**, Karen Cox added that the guidance 'is a welcome update to ASIC's approach to responsible lending oversight, with more individualised guidance and use of specific examples that flesh out real life scenarios – many of which we see every day with our clients on the National Debt Helpline…While ASIC have not gone as far as we would have liked on some points, they have made it clear that a lot of current lending practices are not up to scratch, nor do they meet the community or regulator expectations. The days of using the HEM benchmark as a substitute for genuine inquiry and communication with a potential borrower are over.'

[Source: CALC media release 09/12/2019]

- **The revised guidance will accelerate 'switching'?** The AFR reports that Lendi has welcomed the guidance on the basis that it 'will remove a big barrier to switching'. The guidance clarifies that where a lender is able to verify that a customer has a history of paying on time, full verification may not be necessary. As such, under the change, Lendi Founder and Managing Director of home loan platform Lendi, David Hyman said that 'the concept of 'mortgage prisoners' –where borrowers are unable to leave a lender because they don't meet altered eligibility requirements – may be eliminated'. He described this as a 'huge win' for customers.

[Source: [registration required] The AFR 10/12/2019]

Uncertainty remains? The Australian comments that given the outcome of ASIC's appeal in the 'wagyu and shiraz case' is yet to be determined, ultimately 'a cloud of uncertainty' remains.

[Note: The 'Wagyu and Shiraz' case is a reference to the decision in Australian Securities and Investments Commission v Westpac Banking Corporation (Liability Trial) [2019] FCA 1244 in which the Federal Court dismissed ASIC's responsible lending test case against Westpac. On 10 September, the Australian Securities and Investments Commission announced that it has filed an appeal. See: Governance News 11/09/2019.]

[Source: [registration required] The Australian 11/12/2019]

ASIC says its report into timeshare schemes 'has reiterated long-held concerns and provided a deeper understanding of the issues', Consumer group CHOICE has welcomed ASIC's confirmation it will launch a formal investigation

Report Overview | ASIC report ASIC Report 642 Timeshare: Consumers' experiences (REP 642)

Key Takeouts

- The report confirms 'long held' concerns by the regulator about the way in which products are designed and sold and the potential risks for consumers
- ASIC has called on product offerers to ensure that the way in which they: a) design and sell their products; b) provide services; and c) respond to complaints, leads to good outcomes for their members
- ASIC Commissioner Danielle Press reminded financial advisers, involved in the sale of timeshare products are required to 'comply with the law' and to put their clients' interests first when providing personal advice.
- In light of the findings, ASIC plans to launch a formal investigation which will consider enforcement action
- ASIC's actions have been welcomed by consumer group CHOICE which has raised concerns about timeshare products previously with the regulator.

An Australian Securities and Investments Commission (ASIC) has released a report – ASIC Report 642 Timeshare: Consumers' experiences (REP 642) – presenting the findings from qualitative research into consumers' experiences with timeshare from the initial approach and sale through to membership use and the exit process.

The research involved in-depth interviews with 50 consumers who had all received personal advice to purchase timeshare membership from one of the five main points-based timeshare operators in Australia.

Some Key Findings

- While some research participants were satisfied with their timeshare membership, there was a high level of discontent overall.

- Many consumers felt that they were not getting the expected value from their membership and that they had experienced financial stress because of unexpected changes to membership fees, or in some cases, to their personal circumstances.

- Timeshare memberships generally range from 20 to 99 years. While most research participants were generally aware of the long-term contract period, they had not considered their options if they could no longer afford their membership or if the financial liability was to be transferred to a family member in the future.

Citing data 2018-19 data sourced from the Australian Timeshare Holiday Owners Council (ATHOC), ASIC says that consumers pay $23,000 on average for their timeshare membership and about $800 in ongoing annual membership costs. The loan interest rate is 13.5% on average, and 48% of consumers who bought or upgraded their membership took a loan to do so.

ASIC is concerned about sales tactics used

ASIC Commissioner Danielle Press said that 'ASIC is concerned about the sales tactics used by timeshare operators that harness a range of well-known behavioural techniques to propel consumers toward a purchase decision such as the use of time-bound 'exclusive' offers. We saw consumers spend large sums of money on a purchase they did not expect to make and then enter into ongoing financial commitments under time pressure'.

ASIC's expectations

- **Timeshare operators:** Commissioner Press said, 'This consumer research has reiterated long-held concerns and provided a deeper understanding of the issues. Timeshare is a 'sticky' product – it is easy for consumers to get into but harder to get out of. Timeshare operators need to ensure the way they design and sell their products, provide services and respond to complaints, leads to good outcomes for their members'.

- **Financial advisers:** Commissioner Press said that 'Financial advisers involved in the sale of timeshare products must comply with the law and put their clients' interests first when providing personal advice. We will take action to address mis-selling, poor advice or lending practices that result in significant financial loss to consumers'.

Next steps?

ASIC says that the release of the report is the first step in a broader program of work.

- **Formal investigation:** ASIC says it plans to undertake a targeted review of personal advice given by timeshare operators; release of updated policy settings in Regulatory Guide 160 Time-sharing schemes in the first half of 2020; and undertake a formal investigation, which will consider enforcement action.

- **Consult on changes next year:** ASIC will also issue a consultation paper also in the first half of 2020 seeking feedback on proposals to address known risks of consumer harm occurring at different stages of timeshare membership. As part of this, ASIC will consult on an enhanced cooling-off regime or whether a deferred sales model is necessary to replace the current cooling-off 'opt-out' model.

- **Upcoming design and distribution obligations:** ASIC notes that from April 2021, timeshare operators will need to comply with the design and distribution obligations in Pt 7.8A of the Corporations Act, which seeks to ensure that issuers and distributors take a consumer-centric approach to financial product design and distribution.

Commenting on the report Commissioner Danielle Press said that ASIC is 'focusing on issues such as the ability for consumers to have their timeshare application voided where it is subject to obtaining finance but finance is not approved or the consumer decides not to proceed with the finance application, exit arrangements for consumers facing hardship and other measures to address consumer harms in this sector'.

[Source: ASIC media release 6/12/2019; Report 642 Timeshare: Consumers' experiences]

Consumer group welcomes the announcement of a formal investigation

In a statement welcoming the ASIC's action on timeshare, CHOICE CEO Alan Kirkland said that

'CHOICE supports strong action on timeshare companies by ASIC. For decades, we've seen repeated examples of families locked into unethical, manipulative and costly contracts that are almost impossible to exit. CHOICE has made a number of complaints to ASIC about the timeshare industry and we welcome the regulator commencing a formal investigation'.

Mr Kirkland went on to say that CHOICE 'experts' had reviewed timeshare products were unable to recommend a single product. 'Timeshare preys on people through high-pressure sales tactics, bullying them into purchasing contracts that last up to 99 years, with ongoing fees. These are not holiday packages - they are complex managed investment schemes - and this ASIC report shows how the timeshare industry is failing to comply with financial advice and responsible lending laws'.

Mr Kirkland said that CHOICE advises consumers to 'avoid timeshare completely' and for those 'currently stuck in a timeshare contract and finding it difficult to exit' to lodge a complaint with the Australian Financial Complaints Authority.

[Source: CHOICE Media release 6/12/2019]

APRA has released its first MySuper heatmap identifying areas for improvement across MySuper products

Following the release of an information paper and sample heatmap in November (see: Governance News 20/11/2019) the Australian Prudential Regulation Authority (APRA) has released its first MySuper heatmap identifying areas for improvement across investment performance and fees for MySuper products.

MySuper Product heatmap

APRA says that the 'additional transparency' around fund performance the heatmap provides is designed to lift industry practices and enhance member outcomes by publicly identifying which MySuper products are underperforming and the areas they need to improve.

The heatmap uses a graduating colour scheme to rank MySuper product performance in three areas: 1) investment performance; 2) fees and costs; and 3) sustainability of member outcomes.

Some insights from the data

In addition APRA has released an information paper, and 'data insights' paper. Insights include the following.

- member outcomes vary widely across the industry, and underperformance is evident across all industry sectors and investment risk profiles
- although there are exceptions, higher fees are generally correlated with lower net returns

- low balance accounts are most impacted by administration fees, while high balance accounts are most impacted by percentage-based fees
- more single strategy products outperform the investment benchmarks than lifecycle product stages

The heatmap is intended to lift industry standards

Consistent with her previous comments, APRA Deputy Chair Helen Rowell said the heatmap represents a major step forward for industry transparency and accountability. The primary aim, Ms Rowell said is to lift industry performance. No fund should be 'complacent', 'we expect all trustees to use the heatmap to reflect on the drivers of their current performance, and identify where they can do better' Ms Rowell said.

Ms Rowell added that since the release of the information paper and sample heatmap in November, APRA has directly contacted the trustees of the 'worst performing products' and requested they provide/update action plans outlining how they will address the weaknesses identified.

Ms Rowell added that 'if they are unable to make substantial improvements in good time, we will consider other options, including pressuring them to consider a merger or exit the industry'.

The heatmap will be updated H1 2019: APRA plans to 'refresh' the heatmap at least annually, but will update the heatmap in the first half of next year to assist trustees and other stakeholders assess any early improvements being made.

[Sources: APRA media release 11/12/2019; Data Insights MySuper Product Heatmap 10/12/2019; APRA MySuper heatmap; Information paper — Heatmap — MySuper products; [registration required] The Australian 10/12/2019; [registration required] The AFR 10/12/2019]

Response

- **Super Consumers Australia (CHOICE) welcomed the release of the data** as a 'welcome step towards removing serial underperforming superannuation funds from the retirement income system'. Director of Super Consumers Australia Xavier O'Halloran said that the data 'must be taken seriously by the trustees of underperforming funds. Trustees must answer why they should continue to exist, as those in the heatmap red zone have been serving up chronic underperformance for long enough. The only difference here is that we now have some transparency over who has consistently been at the bottom of the barrel for the last five years. It's time for poor performing funds to look for mergers and stop inflicting any further harm on the retirement savings of Australians'.

[Source: Super Consumers Australia media release 10/12/2019]

- **Industry Super Funds** (ISF) also welcomed the release of the heatmaps as a 'welcome new tool to help identify underperforming funds' but with some reservations. ISF said that it has 'concerns' about the methodology used to generate the heatmap which could 'cast some products in a poorer light than warranted' and others in a better one. To address this, the ISF considers that 'further work needs to be done to get the methodology right'. Industry Super Australia Deputy CEO Matthew Linden said 'APRA's heatmaps are a vital tool to shine a light on this underperformance and get trustees to lift their game, but more work is needed to get the detail right… With any new measuring tool there are always kinks to iron out and we look forward to working with APRA as they refine the first cut of analysis and update the results in the new year'.

[Source: ISF media release 10/12/2019]

- **Caution needed?** In a statement, **The Association of Superannuation Funds of Australia** (ASFA) cautioned against a 'knee jerk' reaction to the heatmap data. ASFA CEO, Dr Martin Fahy warned of the potential for unintended consequences from APRA's methodology, particularly its decision to focus on the short term three- and five-year performance of individual products. 'Achieving sound investment performance and broader member outcomes is a long-term journey, it's not measured in terms of years, it's measured in terms of decades…Australia's superannuation system is ranked as the third best globally and according to the OECD, has about the best investment returns and lowest costs charged to fund members anywhere in the world' he said. Dr Fahy also noted that APRA's recent efforts to engage with funds to improve performance in accordance with the member outcomes legislation is the appropriate way forward.'

[Source: ASFA media release 10/12/2019]

ABA has called for public views about financial institutions allowing credit cards to be used for gambling and the role of banks in addressing these problems

The Australian Banking Association (ABA) has released a consultation paper seeking public views about financial institutions allowing credit cards to be used for gambling.

Issue

The ABA writes that access to credit for gambling 'can create a unique harm whereby large amounts of debt can be accumulated in a limited period' and that for those with a gambling addiction, a credit card can lead to severe financial stress for the individual and their family.

The consultation paper says that ABA members are concerned about, and have introduced a range of initiatives to help address/mitigate the harms of problem gambling. In addition, governments have introduced various restrictions on use of credit cards for gambling. For example: the introduction of a National Online Gambling Self-Exclusion Register and the banning access to credit in casino/gambling areas of licensed venues (which means that gamblers cannot use a credit card to gamble/withdraw cash at licensed venues).

However, credit cards can still be used when gambling online.

Consultation questions: The ABA is seeking feedback on: 1) the risks/concerns associated with gambling with credit cards; 2) whether the use of credit cards for gambling should be restricted/banned; 3) whether the restriction or prohibition (were it implemented) should apply to all forms of gambling; 4) the potential consequences of banning/restricting the use of credit cards in gambling; and whether there should be a transition period if banks elect to implement changes.

Announcing the consultation, ABA CEO Anna Bligh said, 'For many Australians, gambling is a form of entertainment and recreation, however for some it can become a problem that potentially has devastating consequences for the individual and their family. As an industry, we are currently assessing a number of options to help tackle problem gambling. We are seeking feedback across the community on a number of important questions, which will then help banks as they each consider further reform on this issue'.

Timing: The deadline for submissions is 4 March 2020.

[Sources: ABA media release 05/12/2019; Consultation paper]

[Note: Two Bills — Interactive Gambling Amendment (National Self-exclusion Register) Bill 2019 and National Self-exclusion Register (Cost Recovery Levy) Bill 2019 — passed both houses on 5 December, the same day the ABA consultation opened.]

Mandatory Credit Reporting Bill introduced (incorporating financial hardship reporting changes)

Key Takeouts

- The National Consumer Credit Protection Amendment (Mandatory Credit Reporting and Other Measures) Bill 2019 was introduced into the House of Representatives on 5 December 2019.
- The Bill has been updated to include changes to the reporting of hardship arrangements previously announced by the government. More particularly, the Bill introduces a new category of credit reporting information, enabling hardship information to be reported alongside repayment history.

The National Consumer Credit Protection Amendment (Mandatory Credit Reporting and Other Measures) Bill 2019 was introduced into the House of Representatives on the last sitting day for the year, 5 December 2019.

Some Key Points

Mandatory comprehensive credit reporting regime

- **Establish a mandatory comprehensive credit reporting regime:** Schedule 1 proposes to amend the Credit Act to mandate a comprehensive credit reporting regime (the mandatory regime).

- **Application:** The mandatory regime will apply to 'eligible licensees' which initially are large Authorised Deposit Taking Institutions (ADIs) that hold an Australian Credit Licence (ACL). An ADI is considered large when its total resident assets are greater than $100 billion. Other credit providers will be subject to the regime if they are prescribed in regulations.

- **ASIC to monitor compliance:** Schedule 1 proposes to expand the Australian Securities and Investments Commission's (ASIC's) powers to enable ASIC to monitor compliance with the mandatory regime

- **Data storage requirements:** Schedule 1 imposes additional requirements on where data held by a credit reporting body must be stored.

- **Financial Hardship information:** Schedule 2 to the Bill proposes to amend the Privacy Act 1988 to permit reporting of financial hardship information within the credit reporting framework. Schedule 2 to the Bill also makes other minor changes intended to improve the overall administration of credit reporting.

- **(Proposed) Timing:** 'Eligible Licensees' will be required to provide credit information on consumer credit accounts to credit reporting bodies from 1 April 2020. A credit provider that has supplied credit information under the mandatory regime will also be required to keep the information up to date, complete and accurate, including by supplying information on eligible accounts that are subsequently opened.

- **The initial bulk supply of data will be split across two years:**

    - If passed, by 29 June 2020, large ADIs will be required to supply credit information on 50% of the consumer credit accounts within the banking group to all credit reporting bodies the large ADI had a contract with on 2 November 2017.

    - By 29 June 2021, large ADIs will be required to supply credit information on the remaining accounts, including those that opened after 1 April 2020 and those held by subsidiaries of the large ADI to the same credit reporting bodies as the first bulk supply.

Objective? According to the Explanatory Memorandum the aim of these changes is both to enable credit providers to better meet their responsible lending obligations by enabling them to obtain a comprehensive view of a consumer's financial situation, and to benefit consumers in various ways including by giving 'more reliable individuals' a means of better showing their credit worthiness/secure a better deal.

Announcing the introduction of the Bill, Treasurer Josh Frydenberg said the legislation will: a) drive more competition in the market by encouraging new entrants and smaller lenders, including innovative FinTech firms, to compete for customers with positive credit histories; b) enable improved competition and data-driven innovation that will allow consumers to get a better deal; and c) enable improved competition and data-driven innovation that will allow consumers to get a better deal.'

[Sources: National Consumer Credit Protection Amendment (Mandatory Credit Reporting and Other Measures) Bill 2019; Explanatory Memorandum; Treasurer Josh Frydenberg media release 05/12/2019]

The ACCC has authorised the MFAA Code of Practice for two years

The Australian Competition and Consumer Commission (ACCC) is proposing to grant re-authorisation to the Mortgage and Finance Association of Australia (MFAA) to allow it to continue enforcing disciplinary rules among its members for a further two years. The disciplinary rules enforce the MFAA's Code of Practice, which establishes standards of conduct and behaviour for MFAA members, as well as mechanisms for suspending or expelling members.

The ACCC says that the disciplinary rules submitted by the MFAA include some limited changes from previous versions including: clarification of disciplinary and appeal processes for members and improvements to members' rights to appeal their suspension from the MFAA.

The ACCC says it has authorised versions of these disciplinary rules on three previous occasions, each time for five years, but in this case has granted authorisation for two years due to expected reforms to the mortgage and finance industry arising from the Financial Services Royal Commission recommendations.

The ACCC quotes the MFAA as saying that it will approach the ACCC as necessary to accommodate any relevant regulatory or legislative reforms into its disciplinary rules'.

[Note: A number of recommendations made by the Financial Services Royal Commission relate to mortgage brokers specifically. Legislation to implement the government's response to four Financial Services Royal Commission recommendations, including two relating to mortgage brokers — 1.2 (Mortgage broker best interests duty),1.3 (mortgage broker remuneration), 4.2 (removing the exemptions for funeral expenses policies) and 4.7 (application of unfair contract terms provisions to insurance contracts) — Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Bill 2019 — was introduced into the House of Representatives on 28 November. (See: Governance News 04/12/2019). The government's plan for implementing its legislative response to the Financial Services Royal Commission's recommendations indicates that legislation to implement recommendation 1.6 (reference checking and information sharing for mortgage brokers) will be introduced by 30 June 2020. Recommendation 1.5 (regulating mortgage brokers as financial advisers) is planned to be 'progressed' following the review of financial advice reforms (recommendation 2.3).]

[Source: ACCC media release 10/12/2019]

Bill to defer education and training standards for existing financial advisers introduced

The Treasury Laws Amendment (2019 Measures No 3) Bill 2019 was introduced into the House of Reps on 5 December.

Deferring education and training standards for existing financial advisers

Schedule 2 to the Bill would defer the transitional timeframes for existing providers to comply with the education and training standard requiring completion of an approved degree or equivalent qualification by two years (ie to January 2016) and the standard requiring the passing of an approved exam by one year (ie to 1 January 2022).

In his second reading speech, the Minister said that the extension 'will ensure financial advisers have sufficient time to meet the new requirements, balancing the professionalisation of the industry with the need to maintain the ongoing flexibility and affordability of advice. In particular, the extension assists rural and regional advisers and working parents, including parents taking parental leave during the transition period, maintaining a diverse adviser industry'.

[Sources: Treasury Laws Amendment (2019 Measures No 3) Bill 2019; Explanatory Memorandum; Minister's second reading speech]

New Zealand | Planned changes to improve insurance claims handling announced, including 'addressing unfair contract terms

New Zealand Minister for commerce and consumer affairs, Kris Faafoi has announced plans to address 'outdated' insurance contract laws.

Following extensive public feedback in response to a review of existing laws, the NZ government says its planned changes include:

- Strengthening protections for consumers against unfair terms in insurance contracts.

- Introducing various new requirements on insurers including: holding insurers responsible for asking consumers the right questions when processing new insurance policies (rather than leaving it to consumers to know what to tell their insurer); requiring insurance policies to be written and presented clearly/understandably; ensuring insurers respond proportionately when consumers don't disclose something they should have, or misrepresent themselves.

- Extending powers to the Financial Markets Authority (FMA) to monitor and enforce compliance with new requirements

Mr Faafoi said that 'These measures will complement decisions the Government made earlier this year requiring insurers and other financial service providers to treat their customers fairly. It's about ensuring financial products and services are appropriate for consumers to use and properly meet their needs'.

Next steps: The government plans to consult on draft legislation next year on the planned measures, before any changes come into effect.

[Note: In Australia, legislation to implement a four Financial Services Royal Commission recommendations, including recommendation 4.7 (application of unfair contract terms provisions to insurance contracts) — Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Bill 2019 — was introduced into the House of Representatives on 28 November. See: Governance News 04/12/2019. On 29 November, the government released a draft Bill and regulations for consultation proposing to implement recommendation 4.8 (removal of the insurance claims handling exemption). Consultation will close on 10 January (after Parliament rises for 2019 on 5 December). Both houses are scheduled to resume sitting on 4 February 2020. For a summary of the draft legislation see: Governance News 04/12/2019 at p14.]

[Source: NZ Minister for commerce and consumer affairs, Kris Faafoi media release 04/12/2019]

In Brief | The AFR reports that a report from the Attorney General's department has identified that Enterprise agreement restrictions are locking 13,974 workers into 'mostly underperforming' industry superannuation funds even if the workers already had a different fund

[Source: [registration required] The AFR 6/12/2019]

In Brief | Senator Jane Hume has announced the appointment of Will Hamilton as a part-time Director to the Financial Adviser Standards and Ethics Authority (FASEA) commencing 9 December 2019. Mr Hamilton is joined on the Board by the Chair, Catherine Walter, Mark Brimble, Simon Longstaff, Carolyn Bond, Elissa Freeman, Deborah Kent, Louise Lakomy, and Catriona Lowe

[Source: Assistant Minister for Superannuation, Financial Services and Financial technology Jane Hume media release 09/12/2019]

In Brief | The Australian Business Growth Fund Bill 2019 (Bill) was introduced into the House of Representatives on 5 December. The Bill proposes to implement the government's commitment to increase the availability of capital for small and medium enterprises by authorising the contribution of $100 million to invest in an Australian Business Growth Fund. Separately, APRA has written to ADIs outlining the regulatory capital treatment of ADI's equity investments in the government's Business Growth Fund

[Sources: Australian Business Growth Fund Bill 2019; Explanatory Memorandum; Treasurer Josh Frydenberg media release 05/12/2019; APRA Letter to ADIs 09/12/2019]

Risk Management

'Learned helplessness' and 'short-termism' are no excuse? It's clear that climate change posts a material and measurable risk, and directors and firms that fail to take this into account, do so at their own risk says Kenneth Hayne

Speaking at the Centre for Policy Development Business Roundtable on Climate and Sustainability, former Commissioner Kenneth Hayne cautioned boards, individual directors and companies that they have a legal duty to act on climate change risk.

Some Key Points

- **Obligation to act and report on the actions taken is clear:** Mr Hayne prefaced his remarks by observing that Australian law, international opinion and the position of the Australian regulators 'is clear': 'In Australia, a director acting in the best interests of the company must take account of, and the board must report publicly on, climate-related risks and issues relevant to the entity'. More particularly, Mr Hayne said that there is a need for boards to: a) recognise both the nature and extent of climate-related risks and the speed with which change will have to be made; b) develop strategic plans in response; and c) to report to shareholders and the wider market about what they have done, are doing and will do in response.

[Note: This view appears to reinforce the view put forward in the 2016 and 2019 Hutley opinions which state that directors have a legal obligation to consider climate risk. 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 since released a supplementary opinion, responding to developments since the original opinion was finalised (see: Governance News 05/04/2019.)]

- **Urgent and immediate action is required by more companies**: Citing the 2019 TCFD Status Report, Mr Hayne said that the speed at which changes are required to limit the rise in global average temperature requires that more companies than are currently doing so, need to consider the potential impact of climate change and disclose their material findings. 'The entities, and their boards must ask at least two questions: What is the potential financial impact of climate-related issues? What is now, and what will be, our strategic response?' he said.

- **Why the inaction?** Mr Hayne suggested that, in the face of clear legal requirements to act, there are two reasons why entities/boards, globally, are failing to do so: 'learned helplessness [we can do nothing to help given Australia's relatively small contribution will not affect change in the absence of action by the big emitters] and entrenched short-termism [boards might think they can put off addressing the risk if it is not immediately realised in the next financial period]'.

- **Cost of ignoring so called 'non-financial risk'**: Mr Hayne observed that 'as recent events in the financial services industry should have shown, the notion of "non-financial" risks can be very misleading' in that failing manage non-financial risk (including climate change) in the short term, can lead to expensive consequences.

- **Framing climate change as a matter of 'belief of ideology' rather than scientific observation is no excuse for inaction:** Mr Hayne argued that 'both learned helplessness and short-termism yield a result that fits comfortably with those who still see climate-change as a matter of belief or ideology'. For example, framing the 'most recent debates provoked by the bushfire emergencies as part of the "culture wars" reinforces the notion that climate science is a matter of belief, not scientific observation and extrapolation. No less importantly, because the debate remains framed as a debate about belief, learned helplessness and short-termism can be translated into the nativist-populist terms that now have such currency in many political systems' Mr Hayne observed. Mr Hayne emphasised that though learned helplessness and short-termism may explain how political debates are being framed, neither 'helplessness (whether that is learned or real) nor short-termism provides any answer to the director's duty to act in the best interests of the company'.

- **Act, or lose the choice (and pay the potentially very expensive price of inaction):** Mr Hayne concluded by saying that boards have a choice to respond or of 'having a response thrust upon the company'. He added that 'boards simply cannot confine their attention to the short-term. As I have said, entities which did not look beyond short-term profit have recently suffered very large financial and non-financial losses'.

[Sources: Centre for Policy Development Business Roundtable on Climate and Sustainability, Remarks by Kenneth Hayne: Climate Change Round Table 21/11/2019]

Mr Hayne's comments are in line with mainstream legal opinion

Commenting on Mr Hayne's speech in The AFR, MinterEllison's Sarah Barker said Mr Hayne's views are in step with the mainstream of legal opinion. 'Mr Hayne's comments are wholly consistent with opinions expressed by ASIC, APRA and the RBA over the last 24 months. So it seems pretty clear that this is reflective of a mainstream interpretation of the law' Ms Barker said.

Ms Barker also commented that attitudes to managing climate risk have shifted, and that the assumption that acting on climate risk would necessarily harm profits is changing in light of evidence that failure to act presents the greater (and potentially more expensive) risk. 'In the modern economy that historical assumption [acting on climate risk will harm profits] just doesn't hold true' she said.

Ms Barker added that climate risk is not a narrow issue, but is increasingly relevant to a broad range of sectors. 'The unique characteristic of climate change is that the potential for material impacts are not confined to only one or two sectors of the economy. So it might be that companies involved in the plastics sector might have greater exposure to economic transition risk, whereas companies involved in infrastructure may be more concerned with physical risks. This is an issue that is of increasing concern, not only to activist shareholders, but for mainstream investors and market regulators. It would be ill-advised for any director to dismiss the potential for a claim in this area as being remote. The law is clear, and stakeholder expectations are only increasing' Ms Barker observed.

[Source: [registration required] The AFR 10/12/2019]

Related News: The AFR reports that Australian Defence Force Chief Angus Campbell has cautioned government departments/agencies that climate change will stretch the capabilities and resources of the military on several fronts going forward. For example, the increased need to respond to climate change disasters will require more troops; there are likely to be more disaster relief efforts and more peace keeping missions (given climate change has the 'potential to exacerbate conflict.')

[Source: [registration required] The AFR 10/12/2019]

Regulator raises concerns about Wells Fargo's management of non-financial risk?

The WSJ reports that the Office of the Comptroller of the Currency (OCC) has raised concerns about Wells Fargo & Co's management/approach to non-financial risk. More particularly the OCC has reportedly raised concerns about the 'backlog' of employee human-resources complaints and 'poor controls' around pay including an inadequate policy for clawing back compensation from executives suspected of wrongdoing.

The WSJ reports that Wells Fargo responded to requests for comment with the following: 'We do not comment on specific regulatory matters, however, Wells Fargo is making progress on our regulatory obligations but more work needs to be done'.

[Source: [registration required] The WSJ 04/12/2019]

In Brief | The Australian Securities and Investments Commission (ASIC) has released a report — ASIC Report 641 An inside look at mining and exploration initial public offers — outlining the findings of a review of the initial public offer (IPO) process for mining and exploration entities in the Australian market. The review of found that companies, directors and lead managers need to implement better practices that take account of the unique characteristics and vulnerabilities of the micro-cap sector

[Sources: ASIC media release 05/12/2019; ASIC Report 641 An inside look at mining and exploration initial public offers; ASIC media release; [registration required] The Australian 06/12/2019]

Insolvency and Restructuring

Legislative package to consolidate and modernise business registers and establish the DIN regime reintroduced

The new Commonwealth business registry regime and Director Identification Bills have been reintroduced (after they lapsed at the dissolution of parliament) on 4 December.

Five Bills

The five Bills comprising the package — Commonwealth Registers Bill ; Treasury Laws Amendment (registries modernisation and other measures) Bill 2019; Business Names Registration (Fees) Amendment (registries Modernisation) Bill 2019; Corporations (Fees) Amendment (Registries Modernisation) Bill 2019; National Consumer Credit Protection (Fees) Amendment (registries modernisation) Bill 2019 — together will create a new Act, the Commonwealth Registers Act 2019 and amend existing laws to create a new Commonwealth business registry regime and introduce Director Identification Numbers (DINs).

Director Identification Numbers

Schedule 2 to the Treasury Laws Amendment (Registries Modernisation and Other Measures) Bill 2019 will introduce a director identification number (DIN) requirement. The proposed commencement date for this measure is two years after Royal Assent (or on an earlier date proclaimed by the Governor General).

New Commonwealth business registry regime

- **New Commonwealth business registry regime:** The legislative package creates a new Act called the Commonwealth Registers Act 2019 (the new Act) and makes related amendments to a range of existing laws to create a new Commonwealth business registry regime. It sets out: a) what information is subject to the new regime; b) who may be appointed to administer the new regime as its registrar; c) the functions and powers of the registrar; d) how the registrar performs its functions and exercises its powers; e) the framework for protecting and disclosing information held by the registrar; and f) other matters that support the new regime.

- **The objective of the regime** is to facilitate a modern government registry regime that is flexible, technology neutral and governance neutral, and that facilitates timely and efficient access to information (including, where appropriate, on a real time basis) by regulators and other users of the information.

- **Information subject to the new regime**: Initially, information related to 35 existing business registers will be subject to the new registry regime. The existing business registers comprise 34 registers currently kept by the Australian Securities and Investments Commission (ASIC) and the Australian Business Register, which is currently kept by the Commissioner . Additional government registers may be brought into the regime by future legislative reforms.

- **(Proposed) Timing?** The proposed commencement date for the Commonwealth Registers Bill 2019 is the day after Royal Assent. The remainder of the new registry regime is planned to commence two years after Royal Assent (or on such earlier date as may be proclaimed by the Governor-General).

[Sources: Explanatory Memorandum; Commonwealth Registers Bill ; Treasury Laws Amendment (registries modernisation and other measures) Bill 2019; Business Names Registration (Fees) Amendment (registries Modernisation) Bill 2019; Corporations (Fees) Amendment (Registries Modernisation) Bill 2019; National Consumer Credit Protection (Fees) Amendment (registries modernisation) Bill 2019]

Response

- **Australian Small Business and Family Enterprise Ombudsman** Kate Carnell welcomed the introduction of the legislation to implement the DIN regime and modernise business registers. Commenting on the DIN regime, in particular, Ms Carnell said 'the legislation will help combat illegal phoenixing, a process where directors inappropriately take assets out of a business before liquidating, leaving staff, small businesses and suppliers in the lurch. 'Illegal phoenixing not only hurts small business, it costs the economy as much as $3 billion per year'.

[Source: ASBFEO media release 05/12/2019]

- **Master Builders Australia** also welcomed moves to implement a Director Identification Number (DIN) regime. CEO of Master Builders Australia Denita Wawn said that the introduction of the legislation 'means a DIN is finally one step closer…We have long supported a DIN as a way to help government agencies and regulators enforce existing laws far more effectively while avoiding the need for higher levels of red tape and regulation.'

[Source: [registration required — accessed via LexisNexis Capital Monitor] Master Builders Australia media release 05/12/2019]