

Governance News

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Boards and Directors

Getting a seat at the table: how general counsel can win trust and influence people

MinterEllison has released an insight piece presenting the views of the nation's top inhouse lawyers on how general counsel go about building their credibility and influence.

The full text of the article is available on the MinterEllison website here: https://www.minterellison.com/articles/general-counsel-getting-a-seat-at-the-table?sc_trk=%7B4A868A94-F99D-4089-873F-8F4749E159BA%7D&sc_camp=2FC08F27AF62474396019EDDB7F905D4

Remuneration

Top Story | APRA consults on new and more prescriptive remuneration requirements

Overview | ARPA discussion paper and draft new Prudential Standard CPS 511

Key Takeouts

- APRA has released a discussion paper and new draft Prudential Standard (CPS 511) proposing stronger and more prescriptive prudential requirements for remuneration across all APRA-regulated entities in the banking, insurance and superannuation sectors
- Draft Prudential Standard CPS 511 Remuneration proposes to introduce heightened requirements on entities' remuneration arrangements in response to issues identified over the course of the Financial Services Royal Commission (and other reviews), that existing arrangements have been a factor driving poor consumer outcomes
- The proposed new standard will apply to the remuneration arrangements of all employees in all APRA regulated entities but will be applied proportionately according to the size/complexity of the entity
- Among other things the new standard proposes to: a) elevate the importance of managing non-financial risks (it's proposed that financial performance measures must not exceed 50% of performance criteria for variable remuneration outcomes); b) impose minimum deferral periods for variable remuneration of up to 7 years for senior executives in larger, more complex entities and increase scope for boards to recover remuneration for up to 4 years after it has vested; c) increase board oversight and engagement by requiring boards to approve and actively oversee remuneration policies for all employees, and regularly confirm they are being applied in practice to ensure individual and collective accountability
- Timeline: Submissions close on 23 October 2019. APRA intends to release the final prudential standard (CPS 511) before the end of 2019, with a view to it taking effect in 2021 following transitional arrangements

The Australian Prudential Regulation Authority (APRA) is consulting on plans to strengthen prudential requirements for remuneration across all APRA-regulated entities in the banking, insurance and superannuation industries by issuing a proposed new prudential standard on remuneration (CPS 511).

The deadline for submissions is 23 October 2019.

A high level overview of APRA's proposed changes is below.

[Note: A table setting out APRA's key proposals is included in the discussion paper accompanying the draft standard at page 18 and can be accessed [here](#).]

Context

APRA states that the proposed approach in draft CPS 511 is based on consideration of better practice both domestically and internationally, and is reflective of what APRA considers to be reasonable in the current industry environment.



The proposed new standard aims to address the remuneration-related recommendations made by the Financial Services Royal Commission (Recommendations 5.1, 5.2 and 5.3) as well as insights gained from the Prudential Inquiry into the Commonwealth Bank of Australia (CBA), APRA's Review of Remuneration Practices at Large Financial Institutions and its summary of industry self-assessments of governance, accountability and culture.

In addition, standards and guidance produced by the Financial Stability Board (FSB) have also been incorporated to align APRA's requirements with evolving international practice.

Proposed changes

Draft prudential standard CPS 511 Remuneration introduces heightened requirements on entities' remuneration and accountability arrangements in response to evidence that existing arrangements have been a factor driving poor consumer outcomes APRA states. The package of proposed measures is 'materially more prescriptive than APRA's existing remuneration requirements and will place Australia in line with better international remuneration practice'.

Application

The proposed new standard will apply to the remuneration arrangements of all employees in all APRA regulated entities

APRA proposes to shift the remuneration requirements from the governance standards in CPS 510 and SPS 510 (CPS/SPS 510) into a stand-alone prudential standard covering all APRA regulated entities: ie authorised deposit taking institutions (ADIs), general insurers, life insurers, private health insurers and RSE licensees.

APRA proposes that the standard will apply to the remuneration arrangements of all employees.

APRA seeks feedback on whether a separate standard for superannuation may be appropriate: With the proposed removal of remuneration requirements from SPS 510, APRA proposes that superannuation-specific issues of scope and terminology will be addressed within the new standard. APRA notes that there may be a need to adjust aspects of the proposed requirements for particular structures, such as fiduciary structures, primarily outsourced business models or entities with mutual ownership structures in order to avoid unintended consequences.

APRA invites comments on these issues and whether a separate remuneration standard for superannuation may be more appropriate.

Increased board oversight and engagement

Under the current standard, the board must approve the remuneration policy and has responsibility for reviewing and approving remuneration recommendations for senior executives and limited other staff.

APRA is proposing to strengthen board oversight with respect to accountability and oversight of remuneration across entities, by mandating:

- board responsibility for the overall remuneration framework
- board involvement in remuneration arrangements for persons in special role categories ie the new standard will require boards to approve the remuneration outcomes of all persons in special role categories on an individual and collective basis
- boards will be required to establish a clear link between remuneration arrangements and prudent risk management of the entity to ensure risk outcomes are reflected in remuneration outcomes for persons in special role categories

APRA considers that by requiring the board to approve key remuneration decisions, they will need to be more actively involved in dealing with misconduct or compliance issues when variable remuneration outcomes are being determined.

Practical difficulties for boards? The AFR suggests that the expansion of the board's oversight role may present practical difficulties. For example, it's suggested that investors may be sceptical of boards' ability to correctly assess the balance between rewarding the right cultural behaviour and driving shareholder returns,



given the 'metronomic regularity' with which boards have paid bonuses in the past (despite the various issues identified over the course of the Financial Services Royal Commission for example). In addition, it's suggested that boards may also have misgivings about the scope of their expanded oversight role ie how they will deal with the practical difficulties of exercising discretion on pay across an entire organisation.

Proportionate approach: Additional new and more prescriptive requirements for larger and more complex entities (Significant Financial Institutions)

APRA considers it appropriate to be more prescriptive in certain areas for larger and more complex entities, where 'the payment of significant variable remuneration is more prevalent and where complex operations may lead to more opaque accountability'.

Accordingly, APRA is proposing a proportional implementation of the new requirements, with certain heightened expectations applied only to what APRA terms, Significant Financial Institutions (SFI), ie large, complex entities and to certain senior executives and other special roles.

APRA proposes to define the group of large, complex entities for these purposes (SFIs) based on asset size: more than \$15 billion in total assets for authorised deposit-taking institutions (ADIs); more than \$10 billion in total assets for general and life insurers; and more than \$30 billion in funds under management for registrable superannuation entities (RSE) licensees.

PHIs not included in the SFI categorisation: APRA is proposing not to include private health insurers (PHI) in the SFI categorisation at this time. APRA is in the process of modernising the PHI prudential framework more broadly, and will reassess the need to include PHIs as SFIs at a later date.

Remuneration Design

APRA is proposing to limit the use of financial performance measures, and promote a broader suite of measures of performance, including non-financial and risk-based measures.

APRA states that a key feature of its proposed new standard is to promote the use of non-financial performance criteria in designing variable remuneration incentives. In 'APRA's view financial targets have had too prominent a place in executive remuneration in some sectors of the financial industry' the regulator writes.

Accordingly, the proposed new standard proposes to: a) impose minimum design requirements for all employees (to promote prudent risk management and support remuneration objectives); b) cap the use of financial measures of performance at 50% and individually at 25% and c) impose constraints on deferral and vesting set for significant financial institutions (SFIs) (ie minimum deferral periods for variable remuneration of up to 7 years for senior executives, boards to have scope to recover remuneration for up to 4 years after it has vested).

Commenting on the changes, APRA Deputy Chair John Lonsdale said it was clear that existing remuneration arrangements in many entities were not incentivising the right behaviours 'Limiting the influence of financial performance metrics in determining variable remuneration will encourage executives to put greater focus on non-financial risks, such as culture and governance. As our recent response to the industry self-assessments made clear, this remains a weak spot in many financial institutions. Introducing the minimum holding periods for variable remuneration ensures executives have "skin in the game" for longer, and allows boards to adjust remuneration downwards if problems emerge over an extended horizon'.

In proposing the changes APRA makes clear it is not seeking to 'impose a cap on variable remuneration', or 'prescribe the proportion of variable and fixed remuneration'. Rather, it is proposing to introduce minimum standards with respect to the measures used to assess performance, as well as the time period over which variable remuneration must be deferred.

What is a financial metric? APRA proposes that financial measures that are not risk-adjusted and relate to financial performance, such as share price, total shareholder return, profit, revenue, sales and other volume measures are included in the 50% limit. However, financial measures that are risk adjusted and relate to financial soundness eg risk-adjusted capital adequacy, risk-adjusted cost of funding and RSE licensee investment return measures would not be included.

Non-financial metrics? Table 7 in the consultation paper (at p32) includes examples of non financial metrics used in variable remuneration in large international banks over the past year. APRA's expectation is that



entities select non-financial metrics most appropriate to their business. As such, APRA does not intend to identify which types of non-financial metrics are more appropriate/favourable.

Proposed new requirements and the BEAR: APRA says that it considered the operation of the Banking Executive Accountability Regime (BEAR) provisions in developing the proposals relating to deferral of variable remuneration. APRA Deputy Chair John Lonsdale said that the draft standard is intended to 'complement' the BEAR.

APRA recognises that requirements proposed in draft Prudential Standard CPS 511 Remuneration (draft CPS 511) could apply to ADIs only to the extent they are not inconsistent with the BEAR and welcomes any feedback on the application of the proposed draft CPS 511 in the context of the existing BEAR requirements and potential future extension of BEAR (to the insurance and superannuation sectors).

Consequence management

Presently, APRA requires that remuneration policies allow the board to adjust variable remuneration downwards to zero if appropriate for employees in special categories.

APRA is proposing to strengthen this requirement by:

- **introducing new specific requirements for the application and oversight of adjustments to variable remuneration outcomes.** Under draft CPS 511, entities will be required to: a) ensure that adjustments to variable remuneration to reflect performance and risk outcomes are being made; and b) set minimum criteria for adjusting any deferred variable remuneration through application of malus, including in response to risk management failures, misconduct or significant adverse outcomes for beneficiaries, among other things.
- **requiring clawback to apply to senior roles in SFIs.** The aim is to strengthen the entity's ability to adjust remuneration outcomes to reflect performance outcomes, both pre and post-vesting. APRA is proposing that clawback provisions be determined in advance for variable remuneration (short term incentives (STIs) and long term incentives (LTIs)). More particularly, APRA proposes that SFIs must allow for variable remuneration to be recoverable for at least two years after the end of the deferral period, and a further two years where an individual's circumstances are under investigation.

APRA's intention in proposing the change is to ensure that remuneration 'pay-outs remain sensitive to risk outcomes into the future, once the impact of the current events [for example: the Financial Services Royal Commission] dissipates'.

APRA suggests that alignment of remuneration and risk outcomes may require 'significant investment in capability and cultural change' as well as review of employment contracts to ensure clawback provisions can be enacted.

Practical difficulties with the use of clawback: APRA acknowledges that use of clawback may present practical difficulties. However, in APRA's view, the fact that clawback 'may be an imperfect tool to effect ex post remuneration adjustments in all circumstances is not a sufficient argument to omit this tool from senior executive remuneration arrangements'. APRA goes on to suggest that, 'longer deferral periods could potentially be used as a substitute where clawback is seen as impractical'.

APRA seeks feedback on the possibility of including prudential requirements that support entities extending deferral periods as a substitute for the use of clawback.

Regular Reviews of the remuneration framework

Similar to requirements for risk management framework reviews under CPS 220, entities would be required to conduct a triennial effectiveness review, with a prescribed scope.

APRA proposes that the reviews would be undertaken by 'operationally independent, appropriately experienced and competent persons', and cover a number of specified components in their scope. The Board Remuneration Committee would then be required to take action to ensure review findings were adequately addressed and implemented in a timely manner.

Transparency



APRA observes that presently there are no requirements (other than for ADIs) under the current standard.

APRA plans to propose additional requirements for reporting and public disclosure of executive remuneration and invites feedback on whether it should impose additional disclosure requirements on all regulated entities. This could include, APRA suggests, requirements for: publication of each entity's remuneration policy and publication of the specific performance metrics used to set variable remuneration for senior executives and their current and historical values.

APRA plans to consult on such requirements, as well as prudential guidance that would support implementation of the proposed CPS 511, following consultation on draft CPS 511.

Timeline and next steps

- Following the consultation, APRA intends to publish a Response to Submissions and final prudential standard in late 2019 or early 2020.
- APRA expects that the new CPS 511 will come into effect on 1 July 2021 but will determine the effective date based on feedback regarding aspects of the implementation.
- APRA also intends to consult on an updated prudential practice guide in 2020, to support implementation of the new prudential standard, as well as reporting standards and disclosure requirements.
- APRA states that given the significance of the proposals and potential industry impact, it plans to conduct a review of the effectiveness of the prudential standard three years from its initial effective date.

[Sources: APRA media release 23/07/2019; Discussion paper: Strengthening prudential requirements for remuneration July 2019; Draft Prudential Standard CPS 511 Remuneration; [registration required] The AFR 23/07/2019]

New NAB CEO appointed, details of remuneration package released

National Australia Bank (NAB) announced the appointment of Ross McEwan as Group Chief Executive Officer and Managing Director.

NAB Chairman-elect Philip Chronican said NAB had secured a senior, global financial services executive with deep experience in international markets and long-standing knowledge of the Australian banking environment. Mr Chronican said that Mr McEwan had previously been CEO of the Royal Bank of Scotland and had led that organisation through significant change and recovery.

Mr McEwan announced his resignation from RBS in April 2019 and will start with NAB once his obligations to his current employer have been discharged, no later than April 2020. He will be invited to join the NAB Board at this time. The appointment is subject to regulatory approvals.

The appointment means that Mr Chronican will transition from interim CEO to the Chairman position in mid-November 2019, replacing Dr Ken Henry. The Board will then put other interim management arrangements suitable to APRA in place if required. Mr Chronican has been interim CEO since March 2019, following the resignation of Andrew Thorburn after four and a half years as CEO.

Dr Henry indicated his intention in February to resign from the Board once the permanent CEO was appointed. He joined the Board as a Director in 2011 and became Chairman in 2015.

Remuneration arrangements

There are three key components of Mr McEwan's remuneration package:

1. Fixed remuneration of \$2.5 million per annum (inclusive of superannuation and any salary sacrifice arrangements), reviewed annually in accordance with NAB's remuneration policy.
2. Variable remuneration: Potential to earn between 0% and 150% of fixed remuneration. 50% of any variable reward earned will be paid in cash and 50% will be provided in performance rights vesting evenly over four years. A dividend equivalent payment will be made only on vested rights.
3. Long term variable rewards: An annual grant of up to 130% of fixed remuneration provided in performance rights which are not dividend eligible. Vesting subject to performance testing at the end of a four-year

performance period against customer measures (relative Net Promoter Score) and financial measures (relative Total Shareholder Return).

In addition, the statement provides that vesting of all variable rewards remain subject to ongoing board review in accordance with the applicable terms and that all grants of performance rights remain subject to shareholder approval. 'It is not expected that Mr McEwan will be provided with any commencement benefits, subject to final approvals affirming retention of existing rights'.

Commenting on the remuneration package Mr Chronican said that NAB had 'reached agreement on an appropriate remuneration package when compared with domestic and international peers and other sectors'.

A sign that pay is on the rise again? The Age comments that Mr McEwan will be earning more than his predecessor, making him the first among the CEOs of the big four banks to do so following the conclusion of the Financial Services Royal Commission. The Age suggests that this sets an 'important new trend' ie that CEO pay packets are rising again.

[Sources: NAB media release 19/07/2019; [registration required] The AFR 19/07/2019; [Source: [registration required] The Age 20/07/2019]

Shareholder Activism

Lazard's latest review of activist activity has identified (among other things) that Japan is the busiest non-US jurisdiction

Report Overview | Lazard report, Review of Shareholder Activism — H1 2019

Lazard has released its review of activist activity levels and engagement trends for the first half of 2019.

Some Key Points

Activist Activity levels

- Activist activity was down 25% relative to H1 2018's record pace, but is still in line with activist levels in recent years
- The top 10 activists increased their cumulative capital deployed in public activist positions (new and existing) from \$75.5bn at the end of Q1 2019 to \$82.2bn at the end of H1 2019
- Starboard Value was the most prolific activist in H1 2019. Elliott Management remains the leading activist in terms of capital deployed, with \$3.4bn of new capital deployed in H1 2019 and a total of \$17.4bn deployed in new and existing activist positions

M&A themes arising

- 46% of all activist campaigns in H1 2019 had an M&A related objective eg agitating for the sale of the company/encouraging industry consolidation; agitating for break-up or divestiture of a non-core business line; entering into a live M&A situation to improve deal terms/block a deal from proceeding. This marks a significant uptick. By comparison, from 2014-2018, M&A-related objectives arose in only one-third of all campaigns
- Activists won 81 Board seats in H1 2019, 91% (42 seats) of which came from settlements.
- Of the 19 campaigns that went to a final vote in H1 2019, 15 were against non-US targets and activists prevailed in only three situations
- There were 14 long slates nominated in 2019 with a total of 99 seats initially sought. Of these, 28 contested seats have been won (with two of the long slate campaigns still ongoing). Only one long slate campaign (EQT) actually resulted in a majority of directors being replaced in the final vote
- 19% of CEOs of companies targeted by activists left their role within one year of campaign launch, as compared to a baseline turnover rate of 12% for companies not targeted by activism

Activism outside the US is at record highs



- New campaigns against non-US targets accounted for 45% of global capital deployed in H1 2019, compared to 37% in H1 2018
- In the Asia Pacific region, activism accounted for 18% of H1 2019 global capital deployed,

with Japan being the single busiest non-US jurisdiction

- In Europe, activity declined as activists focus on existing positions. 20% of H1 2019 global capital deployed activists focused on smaller targets and M&A theses for new targets

Active managers are increasingly vocal

- Traditional active managers are no longer waiting until a shareholder vote to make themselves heard on important corporate matters, but are increasingly publicly voicing their opinions on corporate strategy and M&A

- In the absence of an activist campaign, active managers are choosing to act as the activist, even nominating board slates

Top passive managers are driving culture, purpose and ESG issues

- H1 2019 saw numerous companies face contested shareholder votes on issues surrounding environmental, social and governance and executive compensation

- With increasing shareholder concentration, passive manager statements and policy updates continue to be closely monitored eg State Street's updated climate change disclosure policy and Vanguard's change in fund voting

[Source: Lazard report: Review of Shareholder Activism — H1 2019]

Institutional Investors

In Brief | ISS has launched its annual policy survey looking at potential policy changes including in relation to: board composition/accountability, board/capital structure, compensation, risk oversight on climate change globally for 2020. The survey will close on August 9, 2019

[Sources: ISS media release 22/07/2019; ISS Policy survey 2019]

Regulators

Engaging with regulators in a post-Hayne environment: The Governance Institute and LexisNexis have jointly released a green paper outlining the results of a survey of members, and an expert panel discussion on the issue

LexisNexis and the Governance Institute have released the results of a survey into strategies for dealing with regulators in a post-Hayne world and a subsequent roundtable discussion of the survey results. The Governance Institute has called also called for submissions on specific questions (set out at the end of this post) to further discussion.

Survey of Governance Institute members: some key points

- **Most organisations believe their regulatory strategy is fit for purpose post-Hayne:** 60% of respondents have a strategy for dealing with regulators and of these respondents, 82% believe that their strategy is fit for purpose post-Hayne
- **Defensive/reactive approach?** Almost 50% of respondents currently have a defensive or reactive approach to engaging with regulators and there appears to be little appetite for change
 - Of the 36 respondents for whom compliance has the responsibility for regulator engagement, 22 describe their approach as proactive, 8 describe it as reactive and 6 as defensive
 - Of the 19 respondents for whom the legal department has responsibility for engaging with regulators, 10 described their approach as reactive, 8 as proactive and 1 as defensive. These



responses suggest that where the responsibility for engaging with regulators sits with Legal, the organisation's approach is more likely to be reactive

- Of the 25 respondents to the survey for whom the risk management function has responsibility for regulatory engagement, 10 described their approach as reactive, 1 as defensive and 14 as proactive

- **The custodian of regulatory engagement within firms is most likely to be the compliance function (and this looks unlikely to change):** 43% of respondents reported that the compliance function within their organisation is the custodian of regulatory engagement, 34% reported that the custodian was risk management and 23% said it was the legal department. 90% of respondents reported no change of custodian was anticipated
- **Nearly 40% of respondents believe that the recent whistleblowing amendments do not go far enough**
- **No impact on remuneration?** Almost 70% of respondents said that the findings of the Hayne Commission will not impact their organisation's approach to remuneration
- **There are a diverse range of views** on the impact of regulators' more intense supervisory and enforcement approach on management decision making around the consequences of compliance breaches and funding allocations for enhanced risk and compliance measures
- **Survey respondents were of the view that there is little likelihood of the blurring of roles between management and the board**

Roundtable discussion — some key points to emerge

- **Roundtable participants agreed it was now time to 'reset the dial' on what is acceptable corporate behaviour to restore trust and confidence** following the significant breaches of trust and failures of leadership uncovered in the Hayne Royal Commission
- **Culture** — There was agreement among participants that:
 - ultimately, responsibility for the misconduct identified over the course of the Hayne Royal Commission, lay with boards and senior management and in light of this, that close attention needs to be paid to culture, governance and remuneration practices
 - culture starts and stops with the CEO and boards must hold him or her accountable. Non-executive directors (NEDs) must also play their part. 'However, NEDs can't do as much as you expect. They are part time and independent,' commented one participant
 - organisations must reflect broader societal expectations
 - ASIC is increasingly focused on culture in its supervision which is seen as the key driver for good governance
 - large entities are often dealing with a complex web of legacy systems and 'bolt-ons' which are difficult to unpick where there is a systemic issue. Regulators are very aware of these issues and the impact it can have eg in the context of breach reporting (where it has led to significant delays in reporting breaches to regulators/remediating consumers)

In light of this, participants felt that there has been a shift, towards viewing culture as a whole of business concern — 'everyone in the company must do the right thing. Everyone in the company has to be a risk/compliance person'.

- **Issues for boards post-Hayne?**
 - **Transparency:**
 1. Directors will be increasingly apprehensive about what gets documented due to the potential risks of regulatory and shareholder class actions.



2. Concerns were also expressed about the effect the new supervisory and enforcement approaches requiring open, transparent and constructive engagement will have on the legal protections against self-incrimination.

- **Engagement with regulators is top of mind?** Despite the survey finding that 60% of respondents have a strategy for dealing with regulators, and of those, 82% believing that their strategy is fit for purpose, roundtable participants feel strongly that engagement with regulators is top of mind for directors, and not just those on the boards of large listed financial services entities.
- **Increased focus on compliance issues:** Participants were of the view that boards may become so focused on compliance issues, they will have insufficient time to deal with strategy.

▪ **Issues for management:**

- Focus on boards receiving the correct information: Building systems and processes to support board decision-making and to ensure that information for the board is consistent and integrates recommendations of the entire management team was seen as an important priority for management
- Complexity of dealing with multiple regulators: Another issue discussed by the roundtable participants was the importance of ensuring governance and risk management professionals manage the risks of getting the regulatory strategy wrong. There was also a recognition that every regulator is different and may require a different approach and that, for some organisations, dealing with multiple regulators is an increasingly complex task

▪ **More structured approach to dealing with regulators post-Hayne:** Participants identified that post-Hayne, engagement strategies for dealing with regulators had changed in two respects: 1) participants identified that their organisation was now designating different people within the organisation to deal with different regulators and in some cases different people within the regulator; 2) some participants said that they were using a stakeholder engagement approach with clear rules about who deals with each regulator

▪ **Remuneration:** Reflecting on the 2018 AGM season in which saw a sharp uptick in the incidence of 'strikes' against companies, participants felt that there is a disconnect between the expectation of regulators and investors as regards remuneration. 'Boards are caught between meeting the market...government requirements and proxy advisors.' They also raised concerns about the capacity of regulators, particularly APRA, to regulate remuneration as part of its broader remit. Participants also flagged the importance of focusing on behaviours and rewards lower down the organisation

▪ **ASIC's 'why not litigate' approach to enforcement:** Roundtable participants agreed that post-Hayne, regulators are under pressure to adopt a more aggressive approach. They expressed concern that while organisations are now statutorily required to be open, constructive and transparent with regulators, this could impact on legal protections against self-incrimination

Call for submissions: The Governance Institute has called on key stakeholders and other interested parties to participate in a broader discussion of these issues, and more particularly seeks feedback on 6 questions.

1. What specific processes do stakeholders/interested parties have in place to engage with regulators
2. Whether the process differs depending on the regulator and/or the magnitude of the issues
3. What stakeholders/interested parties see as the key challenges of engaging with regulators
4. Whether, in light of ASIC's continuing focus on culture, the current culture in organisations meets ASIC's expectations
5. Whether in the post Hayne environment, boards and senior management will be challenged to meet the expectations of both shareholders and regulators and why
6. whether increased scrutiny from regulators will impact what is and what is not recorded in minutes

The deadline for submissions is 28 August 2019.

[Source: Strategy for Engaging with Regulators]



Capability review finds APRA's culture and regulatory approach need a reset

Report Overview | APRA Capability Review 2019

Governance News subscribers received an alert on 19 July with a link to the full text of this article.

Key Takeouts

- The Review makes 24 recommendations (19 directed at APRA and 5 directed to the government) to better position the regulator to deal effectively with post-Hayne environment as well as emerging risks
- The main conclusion in the review is that APRA's regulatory approach and culture need to change. In addition, the review is critical of APRA's leadership and flags the need for the regulator to build internal capacity/capability including in the areas of culture, accountability and governance risk (GCA risk) and cyber risk.
- Among the key recommendations are: a) a proposed veto power for APRA over the appointment/reappointment of directors and senior executives; b) a new requirement for regulated entities to undertake biennial self-assessments; c) for APRA to embed CBA-style prudential inquiries into its toolkit; d) for APRA to adopt a more forceful and transparent approach to enforcement (including an end to APRA's preferred 'behind closed doors' approach); e) consideration of introducing stronger penalties; e) a stronger focus on superannuation (and on member outcomes in superannuation); and f) the restructure of the regulator along industry lines and the creation of a separate superannuation division within APRA.
- All recommendations have been publicly supported by both APRA and the government and both have said that they will action them. APRA has flagged it will require additional resourcing in order to be able to execute its expanded remit.

The full text of the article can be accessed on the MinterEllison website here: <https://www.minterellison.com/articles/summary-apra-capability-review-2019>

Summary of the government, APRA and ASIC's response to the recommendations: As flagged in last week's news, a table summarising every recommendation, with APRA and the government's response is included as an appendix to this issue of Governance News.

Response to APRA's capability review

- **Kenneth Hayne** (Commissioner of the Financial Services Royal Commission) has reportedly said that he fully supports the review recommendations including the recommendations with respect to regular capability reviews of the financial regulators. 'In particular, as the CBA review showed, periodical reviews of that kind are important and valuable...What appears in the APRA Capability Review is, I think, entirely consistent with what I wrote in my final report' Commissioner Hayne reportedly said.

[Source: [registration required] The AFR 22/07/2019]

- **Customer Owned Banking Association (COBA):** In a statement, COBA welcomed APRA's agreement to more actively champion the consideration of competition in its decision making processes. 'COBA accepts that APRA's role is not to actively promote competition but the regulator needs to more effectively and systematically consider the impact on competition of its decisions...Australia's customer owned banking institutions are ready and willing to take on the "Big Four" banks but we need a regulatory framework that delivers our sector a fair go. Stronger competition leads to better customer outcomes. The cure to misconduct is to create a more competitive market where customers can put banks on notice if they fail to meet expectations' COBA CEO Michael Lawrence said.

[Source: COBA media release 17/07/2019]

- **Industry Super Australia (ISA):** In a statement, ISA called on the federal government to act quickly to implement the Review recommendations or risk leaving consumers 'further exposed to the exploitation and misconduct seen during the Royal Commission'. In particular, ISA welcomed the recommendations

relating to APRA's supervision of superannuation including the recommendations that APRA to 'embed, publish, performance benchmarks for super funds and take action on underperforming funds that consistently fail on member outcomes and make APRA's mandate explicit; develop a superannuation performance tool; update its superannuation reporting standards and collect product level data that facilitates accurate assessments of outcomes and comparability across funds and to crack down on non-reporting'. The statement adds that though supportive of the recommendations, it was important that 'APRA applies its powers fairly and prioritises decisions and regulatory action in the areas where member harm is the highest'.

[Source: ISA media release 17/07/2019]

- **The Association of Superannuation Funds of Australia (ASFA):** In a statement, ASFA cautioned that 'while delivering the best retirement outcomes for fund members is the top priority, care should be taken in implementing the recommendations made by the APRA Capability Review panel, to avoid long term risks, costs and poorer outcomes for superannuation members'. The statement goes on to say that 'simplistic approaches to assessing member outcomes, such as reliance on league tables of short-term fund performance, reduce the efficacy of the superannuation system and go against the interests of fund members.' In addition the statement emphasises the need for APRA to be appropriately funded and for APRA to be appropriately transparent.

[Sources: ASFA media release 17/07/2019; Investor Daily 18/07/2019]

- **Shadow Treasurer Jim Chalmers** said that the Federal Labor party welcomes the release of the Australian Prudential Regulation Authority Capability Review and supports the broad directions of the recommendations as a 'step in the right direction' towards rebuilding trust. 'Clearly APRA needs to lift its game, and the recommendations outlined are likely to be a step in the right direction. When it comes to superannuation, workers need to know their retirement nest egg is in a fund that is performing well, and is well regulate' Mr Chalmers said. Mr Chalmers added that 'much more needs to be done to implement Commissioner Kenneth Hayne's recommendations right across the financial system, beyond these proposed reforms to APRA'.

[Source: [registration required — accessed via LexisNexis Capital Monitor] Treasurer Jim Chalmers media release 17/07/2019]

Financial Services

ASIC is consulting on its proposal to ban unsolicited phone sales of direct life insurance and consumer credit insurance

Overview | ASIC consultation paper: CP 317 Unsolicited telephone sales of direct life insurance and consumer credit insurance

Key Takeouts

- ASIC is seeking feedback on plans to ban unsolicited telephone sales of life insurance (including funeral insurance) and CCI when sold with general advice or no advice. ASIC proposes to do this by using the modification power in s992B(1)(c) of the Corporations Act so that the prohibition on hawking in s992A(3) would apply (with no exemptions) to these sales
- The aim of the proposed ban is to prevent the sale of complex products which 'consumers do not need, want or understand'
- The proposed ban follows the release of [REP 622 Consumer credit insurance: Poor value products and harmful sales practices](#) which identified unfair sales practices that were consistently failing consumers, and recommended a ban on unsolicited telephone sales of CCI (see: [Governance News 17/07/2019](#))
- ASIC points out that the proposed ban is consistent with the Financial Services Royal Commission anti-hawking recommendations, which recommended that the law should be changed to clearly prohibit unsolicited sales of superannuation ([recommendation 3.4](#)) and insurance products ([recommendation](#)

4.1). ASIC considers that the proposed ban will provide interim protection for consumers ahead of broader law reform by the government.

- ASIC also intends to review its guidance in [Regulatory Guide 38 The Hawking Provisions \(RG 38\)](#) later this year
- The consultation is open for a period of six weeks, with submissions due by 29 August 2019

The Australian Securities and Investments Commission (ASIC) intends to ban unsolicited telephone sales of direct life insurance and consumer credit insurance (CCI) to provide interim protections to consumers ahead of broader law reform by the government.

More particularly, ASIC's consultation paper (CP 317) details its proposal to ban unsolicited telephone sales of life insurance (including funeral insurance) and CCI when sold with general advice or no advice. ASIC proposes to do this by using its modification power in s 992B(1)(c) of the Corporations Act 2001.

The need for reform: In ASIC's view, the consumer harms identified in various reviews are **not** adequately addressed by either existing protections under the Corporations Act or by industry initiatives.

1. **In ASIC's view, the hawking provisions are insufficient to prevent the potential consumer harms** of buying unnecessary, unwanted, or unsuitable life insurance and CCI products. ASIC considers that the disclosure requirements for unsolicited telephone contact do not by themselves ensure that the consumer has had the opportunity to reflect on their personal circumstances, consider alternative products and make an informed decision. ASIC notes that the Financial Services Royal Commission also found that the prohibition on hawking in s992A does not effectively protect consumers from harm.
2. **Neither the Banking Code of Conduct or the Life Insurance Code are sufficient:** The Life Insurance Code of Practice developed by industry to establish minimum standards for the sale of life insurance came into effect on 1 July 2017. The Code commits life insurers that are members of the Financial Services Council to minimum standards on sales practices and advertising, including not engaging in pressure selling, and appropriate consequences for inappropriate sales conduct. However, in ASIC's view, the Code does not go far enough to eliminate the risks associated with unsolicited telephone sales of direct life insurance as the products are too complex to be sold by unsolicited telephone contact without personal advice. Likewise the ASIC considers that recent changes (the deferred sales model standards) in the Australian Banking Association Code of Conduct, though a positive step, are not sufficient to address the risk.

Proposed ban: ASIC intends to ban unsolicited telephone sales of life insurance (including funeral insurance) and CCI when sold with general advice or no advice. ASIC proposes to do this by using the modification power in s992B(1)(c) of the Corporations Act so that the prohibition on hawking in s992A(3) would apply (with no exemptions) to these sales.

Rationale for the proposed ban: ASIC's intention is to prevent the sale of complex insurance products which consumers do not need, want or understand.

ASIC is of the view that the proposed ban appropriately: a) ensure that consumers have an opportunity to consider their needs and the products available before taking out an insurance policy; and b) reduce the likelihood that consumers will be sold insurance products that are not necessary or suitable.

ASIC's proposal addresses, in part, the Royal Commission's recommendation that the hawking of insurance products should be prohibited. ASIC considers that the proposed ban addresses areas of consumer harm identified by ASIC and will provide interim protections to consumers ahead of broader law reform by the government.

[Note: The Financial Services Royal Commission's final report recommendations go further than ASIC's proposed action. The Commission recommended that the hawking of superannuation ([Recommendation 3.4](#)) and insurance products ([Recommendation 4.1](#)) should be prohibited. See: Financial Services Royal Commission Final Report volume 1. The law reform referred to appears to be a reference to the government's



statement in response to the Financial Services Royal Commission's final report recommendations in which the government expressed support for both recommendations. With respect to recommendation 3.4 (no hawking of superannuation) the government said that it 'agrees that hawking of superannuation products should be prohibited, and the definition of hawking should be clarified to include selling of a financial product during a meeting, call or other contact initiated to discuss an unrelated financial product'.]

Commenting on the proposed ban, ASIC Commissioner Sean Hughes stated that, 'ASIC will step in to stop practices that lead to poor consumer outcomes and destroy trust in the system. It is only fair that consumers have a proper opportunity to consider which insurance product best meets their needs and then compare alternative products, without feeling pressured to make a purchase.' Mr Hughes said that 'such a ban is consistent with the Financial Services Royal Commission recommendations, and will provide consumers with further protections from mis-selling practices now, ahead of wider law reform by Government. Without such a ban, we are concerned that consumers will continue to be preyed upon by peddlers of inappropriate insurance products, using pressure sales tactics'.

ASIC said that once the ban is implemented, it will monitor compliance and take enforcement action as necessary if insurers or distributors do not comply.

Timeline

- Consultation on the proposed changes closes on 29 August
- ASIC plans to consult on a possible draft instrument and consider changes to existing regulatory guidance (RG 38) in December 2019
- ASIC plans to finalise the instrument by March 2020

[Sources: ASIC media release 18/07/2019; Consultation Paper: CP 317 Unsolicited telephone sales of direct life insurance and consumer credit insurance]

Financial Services Council response: a deferred sales model may be sufficient?

In a statement, the Financial Services Council (FSC) agreed there is no place for 'cold calling random people and pressuring them into purchasing life insurance or consumer credit insurance' and that if these practices are still occurring ASIC is correct to step in. However, the statement goes on to say that 'businesses do need to be able to contact existing customers to discuss products and services, a business reasonably believes are relevant and appropriate for the customer, provided there are safeguards' and suggests that a deferred sales model would ensure there is no pressure selling.

The FSC said that it intends to lodge a submission to the ASIC after consulting with members.

[Source: [registration required — accessed via LexisNexis Capital Monitor] FSC media release 18/07/2019]

The Senate Standing Committee has recommended a delay in implementing opt-in insurance changes

Treasury Laws Amendment (Putting Members' Interests First) Bill 2019 proposes to amend the Superannuation Industry (Supervision) Act 1993 to prevent trustees from providing insurance on an opt out basis to members who are under 25 years old and begin to hold a new product on or after 1 October 2019, and to members who hold products with balances below \$6000.

The Bill was referred to the Senate Standing Committee on Economics on 4 July, and submissions to the committee closed on 15 July. The Committee reported on 23 July.

The report makes two recommendations:

1. The committee recommends that the government changes the date of commencement to 1 December 2019
2. Subject to the deferral of the commencement date, the committee recommends that the Bill be passed.

Submissions



- **Calls to delay the proposed implementation date:** The Committee states that the most frequently raised concern related to the 1 October 2019 implementation date with a number of submissions stating the date was 'unworkable or unachievable, given the information system changes required and the need to contact their membership'. The Committee further noted that this was consistent with concerns raised during the prior inquiry where participants proposed deferring or staging the Bill's implementation. A number of funds proposed later alternate commencement dates on this basis. In response to this, the Committee said that 'while mindful of this concern, the committee considers that renegotiating insurance contracts is not an unfamiliar process to superannuation funds. Further, the policy implemented by the Bill forms part of the Protecting Your Super Package that was announced over a year ago in the 2018-19 Budget and originally included for consideration in the prior Bill. Notwithstanding this, the committee encourages the government to consider changing the date of commencement to 1 December 2019 to allow for trustees to effectively engage with their members'.
- **A large number of submitters argued that members in high-risk occupations should be exempted from the opt-in arrangements.** In response, the Committee 'reminds stakeholders that the Bill does not bar members impacted by the measures in the Bill from electing to opt-in to insurance, particularly in cases where employment is more casual. Furthermore, the committee reiterates that there are other support mechanisms available to assist people affected by illness or injury and who are unable to work' eg sick leave; social security payments; workers' compensation schemes; the National Disability Insurance Scheme; and various other arrangements, including compulsory third party motor vehicle accident insurance.
- **Impact of the Bill on insurance premiums:** The committee notes that the impact of the Bill on insurance premiums was a common matter of concern raised by stakeholders. In response, the Committee said that it 'recognises that there may be changes in the overall risk profile of insured members due to these changes; however, as stated previously, the committee stresses that any increases in insurance premiums that result from the proposed measures only demonstrate the substantial cross-subsidies that are inherent in the current system'.

[Sources: Treasury Laws Amendment (Putting Members' Interests First) Bill 2019 [Provisions]; InvestorDaily 23/07/2019]

Rural Finance Bill re-introduced: Banking Amendment (Rural Finance Reform) Bill 2019

Centre Alliance MP Rebekha Sharkie reintroduced a private Member's Bill, The *Banking Amendment (Rural Finance Reform) Bill 2019*, into the House of Representatives on 22 July 2019.

The Bill proposes to enact additional protections for small primary production businesses in light of the challenges they face in managing their credit. In her second reading speech, Ms Sharkie said that the Bill 'seeks to address the power imbalance between family farmers and banks, relating to loans under \$5 million. It seeks to do this prudently and even-handedly and without undermining the incentives for rural lenders to supply credit to agricultural communities. But it also seeks to restore trust and integrity to the financial relationships between lender and farmer'.

Noting that the Bill had previously been referred to the Standing Committee on Economics and that the inquiry lapsed with the dissolution of the last parliament, Ms Sharkie said that she will seek to re refer the Bill to the Committee.

Some Key Points

The Bill proposes to:

- Require authorised deposit taking institutions (ADIs) to provide a simple one-page summary (Key Facts Sheet) of the clauses that may trigger a non-monetary default by the borrower
- Prohibit ADIs from including catch-all material adverse change clauses in their loan documents, except where it relates to fraud or criminal activity
- Prohibit ADIs from being able to unilaterally perform a valuation of any security given in respect of the loan
- Require ADIs to provide a 30 business day notice period where it intends to exercise a power under a general restriction covenant, except where it relates to fraud or criminal activity



- Require ADIs that conduct valuations of any security to a loan, to provide a copy of valuation instructions and final valuation reports to the borrower, and provide that ADIs not require the borrower to meet any part of the cost the valuation
 - Require ADIs that conduct audits (ie investigative accounting) of the business, to provide a copy of the report to the borrower. ADIs must not require the borrower to meet any part of the cost the audit
 - Require ADIs to notify and request to meet with the borrower at least 6 months prior to the expiry of a term loan
 - Prohibit ADIs from unilaterally varying a term or condition of the loan unless: the ADI has given the borrower at least 6 months' written notice; or the borrower has failed to comply with a term or condition of the loan (and the non-compliance is not of a minor or technical nature); or the change reduces the obligations of the borrower or extends time for payment; or is a change in a rate payable under the loan that is determined by referring to a reference rate.
 - Require ADIs to provide a minimum 90 business day notice period where a decision is made not to renew or extend the loan
 - Require ADIs to provide notice about borrower rights to external dispute resolution (EDR) when: a borrower receives a default notice from the ADI; or a borrower requests assistance relating to financial hardship and that request is declined; or the ADI refuses to renew or extend the borrower's loan.
- Failure to adhere to these protections will result in civil penalties for the ADI.

The proposed commencement date is the first 1 July after the Royal Assent.

[Sources: Banking Amendment (Rural Finance Reform) Bill 2019; Explanatory memorandum; second reading speech]

Open Banking update | Current State of play for the Consumer Data Right

MinterEllison has prepared a detailed update on the status of the Consumer Data Right (CDR) regime. The full text can be accessed on the MinterEllison website here: <https://www.minterellison.com/articles/current-state-of-play-consumer-data-right>

In Brief | Following the Treasurer's announcement earlier in the week, Treasury Laws Amendment (Consumer Data Right) Bill 2019 (which will enact open banking) was introduced into the House of Representatives on 24 July

[Sources: Treasury Laws Amendment (Consumer Data Right) Bill 2019; Treasurer Josh Frydenberg media release 22/07/2019; ABA media release 22/07/2019]

In Brief | Implementing Financial Services Royal Commission recommendation 3.5 (superannuation accounts should be 'stapled' to the person): A report from KPMG (commissioned by ISA) has found that stapling superannuation accounts to members could deliver higher returns for workers. The report found that the best way to do it would be to automatically combine a person's super when changing jobs into a single quality checked fund. The findings have been backed by the ACTU

[Sources: ISA media release 18/07/2019; ACTU media release 18/07/2019; [registration required — accessed via LexisNexis Capital Monitor] KPMG report: Stapling of superannuation Accounts: Industry Super Australia 03/07/2019]

In Brief | The SMH reports that Health Minister Greg Hunt has launched a review of private health insurance with the aim of reducing premiums and reversing declining membership which is putting increased pressure on the public system

[Sources: The SMH 23/07/2019]

In Brief | Regulatory framework for financial services under review: The UK government has launched the first phase of the Financial Services Future Regulatory Framework Review. The review is starting with a three-month consultation looking at how co-ordination between regulatory authorities could be improved/may need to adapt in the future, particularly in relation to when UK leaves the EU

[Sources: HM Treasury consultation: Financial Services Future Regulatory Framework Review 19/07/2019; Future Regulatory Framework Review Call for Evidence; Accountancy Daily 22/07/2019]

Accounting and Audit

The AUASB has issued a bulletin reminding auditors of their responsibilities when auditing a financial report and alerting them to proposed additional disclosure requirements for financial reports prepared using a special purpose framework

As part of its recent outreach and research activities the Auditing and Assurance Standards Board (AUASB) Technical Group have observed a number of instances where:

1. preparers of financial reports have not adequately referred to or described the financial reporting framework (FRF) (including whether a general purpose or a special purpose framework was applied); and
2. auditor's reports of financial reports prepared using a special purpose framework (SPF) did not include an Emphasis of Matter paragraph

On this basis, the AUASB has issued a bulletin reminding auditors of their responsibilities in relation to considering the FRF when auditing a financial report.

- ASA 2101 requires the auditor, as a precondition to accepting the engagement, to determine whether the FRF that is to be applied in the preparation of the financial report is acceptable, and obtain acknowledgement from management that they understand their responsibility to prepare the financial report in accordance with this FRF
- ASA 7002 requires auditors to evaluate whether the financial report adequately refers to or describes the applicable FRF
- ASA 8003 has additional reporting for inclusion in auditor reports of financial reports prepared in accordance with a SPF, namely: a) a description of the purpose for which the financial report is prepared, and if necessary, the intended users, or refer to a note in the financial report that contains this information; b) if management have a choice of FRF in the preparation of the financial report, the explanation of management's responsibility for the financial report shall also make reference to its responsibility for determining that the applicable FRF is acceptable in the circumstances; and c) an Emphasis of Matter paragraph alerting users that the financial report is prepared in accordance with a special purpose framework and that, as a result, the financial report may not be suitable for another purpose.

(Proposed) additional disclosure requirements: In addition the Bulletin alerts auditors to additional disclosure requirements being proposed for financial reports prepared using a SPF.

- **Context:** The AASB is currently undertaking a project which proposes to remove the ability for certain entities to prepare financial reports using a SPF when they are required to comply with Australian Accounting Standards (AAS). Given the project will take time, as an interim measure the AASB has recently issued ED 2934 that proposes certain entities preparing financial reports using a SPF to disclose additional information.
- **Additional (proposed) disclosure requirements include:** a) the basis on which the decision to use a special purpose framework was made; and b) an explicit statement as to whether or not the accounting policies applied in its preparation comply with all the recognition and measurement requirements in AAS and, if not, an indication of where they do not comply.
- **Impact for auditors:** If ED 293 is enacted as proposed by the AASB, auditors of financial reports using a SPF are reminded of the requirements in relation to the consideration of the FRF outlined above when auditing the financial report. In particular auditors will be required to consider whether the preparer has appropriately included the additional disclosures required by ED 293, and assess whether the additional disclosures are materially misstated in accordance with ASA 3205.

AASB has said that feedback and queries are welcome. No timeline is provided.

[Source: [registration required — accessed via LexisNexis Capital Monitor] Auditing and Assurance Standards Board AUASB Bulletin 18/07/2019]

Risk Management



Culture Reviews | Matters for inclusion in self-assessments going forward: The APRA Capability Review suggests self-assessments should be more prescriptive and include coverage of certain key questions

Among the recommendations in the review of Australian Prudential Regulation Authority's (APRA's) Capability Review (outlined here) was Recommendation 4.1 which recommended (among other things) that as part of its work to revise and enhance its supervisory and policy frameworks, APRA should embed the recent entity self-assessment process into its more intense supervision of governance corporate and accountability risks and that the self assessments should be more prescriptive than APRA's recent program.

[Note: Following the release of its prudential inquiry into the CBA in May 2018, the Australian Prudential Regulation Authority (APRA) requested 36 financial institutions (9 Authorised Deposit Taking Institutions (ADIs), 9 General insurers, 4 Life insurers, 3 Private Health insurers and 11 superannuation funds) to undertake self-assessments against the findings in the CBA report. APRA released an information paper on 22 May outlining some of the key themes to emerge from the self-assessments, and weaknesses identified in some assessments. Among other things, APRA questioned whether boards/leadership teams were sufficiently critical of their own performance. See: Governance News 28/05/2019]

Appendix 2 of the report sets out the questions that the reviewers consider the self-assessments should cover (see: p143-144). They specify that a modified version of these matters should be considered for superannuation funds.

Matters for inclusion in self-assessments

Boards should consider what APRA would like to achieve from the self-assessment process: In designing its self-assessment, the board must consider the outcomes that APRA would like to achieve from the process. Boards should consider the following.

- APRA is clearly informed about the governance, culture and accountability (GCA) frameworks in the institution
- APRA can assess from the information and data provided that: a) the GCA arrangements are robust; b) that the board has the capability to oversee them; c) that senior management have invested appropriately in them; and d) that senior management has the capability to implement them
- The self-assessments complement and reinforce the requirements of the banking executive accountability regime (BEAR regime), APRA's prudential standards on governance, risk management and fit and proper, and APRA's more intense supervisory focus on these issues
- The self-assessments strengthen APRA's capability to identify before the event, potential risks to the financial safety of the institution stemming from the organisation's oversight of its GCA frameworks

Quality of board oversight

- Self-assessments should include a description of the GCA frameworks within the institution including the role of the board, CEO and senior management in setting the tone from the top
- An assessment of whether the board has requested and received adequate and timely information on GCA risks to enable it to set risk appetite and hold management to account, including any action taken by the board for the provision of inadequate information by management: a) evidence that key quality assurance roles — including the CRO, internal and external auditors and actuaries as relevant — have regular, confidential access to the board, including an assessment of material provided by them to the board; and b) case studies of key areas of GCA risk, including investigations of breaches and consequences where relevant
- The actions taken by the board to hold executives to account for good and poor performance against the institution's GCA framework, including: a) the board's guidance to management on its expectations in determining appropriate consequences for good and poor GCA risk behaviours and outcomes, including, but not limited to, adjustments to remuneration ; and b) any action taken by the board to adjust the remuneration of the CEO and senior management or impose other consequences for breaches of GCA arrangements by them or their staff



- An assessment of whether the board has requested and received comprehensive analysis of the links between achieving GCA guidelines and remuneration outcomes

[Note: Separately, APRA is consulting on a proposed prudential standard setting more prescriptive requirements around remuneration for all APRA regulated entities and for all employees within APRA regulated entities. This is covered in a separate post in this week's issue of Governance News.]

Senior leadership performance:

- Whether the CEO and senior management accepts and embeds these frameworks in the institution, including: a) taking action to reduce these risks and mitigate their impact; b) promoting the voice of audit, risk and compliance functions as an effective counterbalance to the business units; and c) engaging in constructive challenge and debate
- How the CEO and senior management embed the GCA framework in the institution, including committee structures around GCA risks and the cascading of information through the firm
- An assessment of the quality of analytics and reporting used by the CEO and senior management to identify and monitor GCA risks. This could include breach reporting, systemic client complaints, incidents reported by staff and counterparties
- Information on investments undertaken by the CEO and senior management to ensure that GCA risks can be effectively monitored and dealt with promptly in the institution and that staff have the appropriate skills and resources. This should include information of the use of new technological approaches — 'regtech' — to monitor and pre-empt GCA risks
- The timeliness and effectiveness of any response to problems resulting from poor GCA frameworks
- An assessment of the CEO and senior management's engagement with regulators, including the nature and speed of response to regulatory requests

[Source: Appendix 2: APRA Capability Review]

Appendix 1: APRA Capability Response: Table of recommendations, APRA response and government response

The table below outlines each of the recommendations as well as APRA's response and the government's response. Both APRA and the government have expressed support for all of the review recommendations.

Government Response: The government has said it will take action on all 5 of the recommendations directed to it, and it has agreed to:

1. ensure that APRA has sufficient powers and flexibility to prevent inappropriate directors and senior executives from being appointed or re-appointed to regulated entities (Recommendation 4.3)
2. consider changes to APRA's regulatory framework including a review of penalties, amending its private health insurance licensing powers and providing APRA with the power to appoint a person to undertake a review of a regulatory entity (Recommendation 6.2)
3. establish the Financial Regulator Oversight Authority, and streamline and improve the effectiveness of both APRA and ASIC's accountability arrangements (Recommendation 6.5)
4. outline its expectations for APRA on superannuation in its next Statement of Expectations (Recommendation 5.3)
5. work with APRA and the Australian Public Service Commission to ensure APRA can attract and retain high skilled staff (Recommendation 2.5)

[Sources: Treasurer Josh Frydenberg media release 17/07/2019; Government Response to the APRA Capability Review Report 2019]

APRA Response



In a statement, APRA expressed support for all 19 recommendations directed toward it and said that work is already underway on to implement many as part of APRA's current corporate plan. APRA went on to say that it will continue to focus on its core mandate of safeguarding financial system stability as it expands capability in other areas, in line with the recommendations.

APRA Chair Wayne Byres said that the report is comprehensive and ambitious in its views of APRA's future remit and required capabilities, and that it 'highlights the need to accelerate the necessary changes if APRA is to remain a successful prudential supervisor into the future'.

APRA's statement also notes the regulator's expanded remit and proposed 'ambitious further extension' highlights the additional resourcing and government support required.

[Source: APRA media release 17/07/2019]

Summary: APRA Capability Review Recommendations, APRA response, government response

Recommendation	APRA's response	Government Response
Recommendation 2.1: APRA Members should address variation in leadership capability for all management levels. This should include a priority focus on leading change, effective execution and accountability. In addition, APRA should develop a cultural change program that fosters internal debate and contestability.	APRA has said it will build on its existing leadership, people and culture strategic initiatives to address these areas as part of its review of the Corporate Plan, which will be published in August 2019.	No specific response provided beyond supporting the recommendations.
Recommendation 2.2: APRA should set transparent standards to hold staff and itself accountable for the timeliness of approvals and other commercially-important decisions for regulated institutions. APRA should publicly disclose adherence rates to these performance standards in its external accountability assessment (see recommendation 6.4).	APRA will review its decision-making processes and current Service Charter to address this recommendation. APRA will include information on its performance in key areas as part of its enhanced communication approach (refer to Recommendation 6.6).	No specific response provided beyond supporting the recommendations.
Recommendation 2.3: APRA should revise its organisational structure to reinforce the impact of the leadership and cultural changes recommended by the Review and APRA's own strategic plans. APRA should: a) restructure supervision divisions along industry lines — banking, insurance and superannuation; b) revise management structures and levels, with a view to widening spans of control and enhancing efficiency, speed of decision-making and empowerment; c) shift internal configuration to better support industry-focussed strategic activities and more agile ways of working; and d) create distinct people-leader and technical-specialist career pathways.	APRA states that it is now progressing implementation of changes to its organisational structure that support flexible and effective modes of operating and address the areas highlighted by the Capability Review. This will include review of the current roles and responsibilities of the APRA Members (refer to recommendation 2.4) and restructuring the supervisory divisions along industry lines. APRA notes that some changes to management structures and levels are contingent on the Government accepting Recommendation 2.5 (removing APRA from the APS Workplace Bargaining Policy) and/or changes to APRA's Employment Agreement.	No specific response provided beyond supporting the recommendations.
Recommendation 2.4: APRA's Chair should relinquish his ADI-specific oversight role and adopt a broader organisation-wide role. The remaining Members should split their roles to include a mix of industry, policy and functional responsibilities.	APRA supports this recommendation. See response to Recommendation 2.3.	No specific response provided beyond supporting the recommendations.



<p>Recommendation 2.5: To help facilitate a number of recommendations in the Review, the Government should remove APRA from the application of the APS Workplace Bargaining Policy. APRA should engage with the Government to consider ways to enable greater variation in remuneration levels.</p>	<p>APRA supports this recommendation and welcomes the Government's commitment to understand and address restrictions to ensure APRA can attract and retain the staff it needs to deliver its mandate.</p>	<p>The Government agrees APRA should have the flexibility to attract and retain the staff it needs to deliver its mandate.</p> <p>The Government will work with APRA and the Australian Public Service Commission (APSC) to better understand and address any restrictions within the current APS Bargaining Framework in order to ensure that APRA can attract and retain high skilled staff, particularly in niche areas subject to high market demand.</p>
<p>Recommendation 3.1: APRA should retain its long-standing and core capability of fostering financial safety and financial stability</p>	<p>APRA supports this recommendation, but notes that to maintain APRA's core capabilities in financial safety and stability, while also expanding its organisational capability across all the important areas identified by the Capability Review, will require additional resources</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 3.2: APRA should build credit risk capacity to simultaneously maintain high supervisory intensity in both non-retail and retail credit risk.</p>	<p>APRA supports this recommendation but notes that to simultaneously maintain high supervisory intensity across both non-retail and retail credit risk will require additional resourcing.</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 3.3: APRA should take a more transparent and assertive role in articulating the objectives of its macro-prudential policies, the design of the instruments chosen and assessment of its impacts, including on the broader areas of its mandate. APRA should continue to develop its public communication around the extent of systemic risks, conditions required for macro-prudential actions and assessments of any actions taken.</p>	<p>APRA supports this recommendation. Work is underway to strengthen external engagement and communication under one of the strategic initiatives in APRA's 2018- 2022 Corporate Plan. This existing initiative will be broadened to ensure it addresses the areas highlighted by the Capability Review. APRA will publish its 2019- 2023 Corporate Plan in August 2019.</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 3.4: APRA should advise the Government of the current state of its resolution capability and crisis preparedness as a basis for assessing whether additional resources are required to advance this work more quickly. This should be completed by the end of 2019.</p>	<p>APRA supports this recommendation. APRA is strengthening its resolution capability and crisis preparedness under the strategic initiatives of the 2018-2022 Corporate Plan. APRA will provide advice to the Government by the end of 2019 on the status of this work and the additional resources needed to enable it to be advanced more quickly.</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 3.5: APRA should seek to build strong allegiances with public and private sector experts, other regulators and financial firms to augment its internal capacity and to collaborate on ways to strengthen the cyber resilience of APRA's regulated sectors</p>	<p>APRA supports this recommendation. APRA has identified cyber and technology as priority areas for focus across all APRA-regulated industries, and is developing a cyber and technology strategy that includes building strong allegiances with public and private sector experts.</p>	<p>No specific response provided beyond supporting the recommendations.</p>



<p>Recommendation 3.6: To better prepare for and respond to the consequences of digital innovation and disruption, APRA should increase its IT risk capacity and capability, including through increased collaboration and partnerships. In doing so, APRA should consider the implications of new business models, management and transformation of legacy IT landscapes, greater reliance on third-party providers (for example, cloud providers), and technology-enabled competition.</p>	<p>APRA supports this recommendation, but notes that increasing IT risk capacity and capability will require additional resourcing.</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 3.7: To support its consideration of competition, APRA should: a) create a competition champion within APRA, preferably at Member level. Their role should be to ensure that issues of competition are embedded effectively across all areas of APRA; b) ensure that there is sufficient tension in the internal debate and analysis of competition. It should test how policies are developed and applied by supervisors. This could be done in the Quality Assurance function and reported to the competition champion; and c) report regularly on competition developments in its external accountability assessment (see recommendation 6.4).</p>	<p>APRA supports the objective of this recommendation. All APRA Members have overarching responsibility for achieving APRA's mandate, including consideration of competition, efficiency, contestability and competitive neutrality. APRA will review and enhance its decision-making processes to more actively champion the consideration of all elements of APRA's mandate. APRA will strengthen its engagement and collaboration with the ACCC, as part of its strategic initiative in the 2018-2022 Corporate Plan. APRA will include information on its performance in this regard as part of its enhanced communication approach (refer to recommendation 6.6).</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 4.1: APRA should: a) ensure the policy framework is focussed on assessing appropriate outcomes around governance, culture and accountability (GCA) risk in regulated entities, not just appropriate processes; b) further develop its toolkit for assessing GCA risks, including board and senior management performance, and ensure that it has an escalating suite of options for engaging with entities; c) embed the recent entity self-assessment process into its more intense supervision of GCA risks by making it a biennial requirement. The self-assessments should be more prescriptive than APRA's recent program, including coverage of questions set out in Appendix 2 to the Review. The self-assessments, APRA's assessment of each of them, APRA's thematic reviews, and any rectification requirements imposed by APRA in response to a self-assessment should be published; d) establish an external Panel of experts to assist it in undertaking more in-depth assessments of individual entities; and e) explore ways to collaborate with regtech specialists and other experts to develop more efficient and effective tools to identify GCA risks.</p>	<p>APRA supports this recommendation. Issues of governance, culture, remuneration and accountability are priority areas for APRA. APRA is reviewing its program of work to enhance its regulatory and supervisory approach in these areas, following the Government's announcement of additional funding as part of the 2019-20 Commonwealth Budget. The Capability Review will inform this.</p> <p>Developing an enhanced regulatory and supervisory framework is a multi-year program of work and APRA will publish its strategy by end 2019.</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 4.2: APRA should build on the CBA Prudential Inquiry and entity self-assessments by embedding CBA-style prudential inquiries as an ongoing part of its supervisory</p>	<p>APRA supports this recommendation. APRA will consider as part of its broader response to Recommendation 4.1 how similar reviews can be incorporated into its work plan. Given the</p>	<p>No specific response provided beyond supporting the recommendations.</p>



<p>toolkit. The Panel would expect to see several prudential inquiries in the first few years to reinforce the need for rigorous self-assessments (see recommendation 4.1). In time, the inquiries should involve retail and industry superannuation, insurance and ADI entities</p>	<p>significant cost of such reviews, the precise number of reviews will be dependent on overall resourcing.</p>	
<p>Recommendation 4.3: The Government should consider providing APRA with a non-objections power to veto the appointment or reappointment of directors and senior executives of regulated entities. This would bring it into line with international regulators and strengthen its capacity to pre-emptively regulate GCA risks. The power should be available to APRA only where the risks associated with the entity, including but not limited to member outcomes for superannuation funds, warrant it.</p>	<p>APRA supports the objective of a strong regime for the fitness and propriety of directors and senior executives, but notes that ultimately this is a matter for Government. APRA will engage with the Government on how the objectives identified by the Capability Review can best be achieved, noting the potential for moral hazard and administrative burden.</p>	<p>The Government will ensure that APRA has sufficient powers and flexibility to prevent inappropriate directors and senior executives from being appointed or re-appointed to regulated entities, as part of extending the Banking Executive Accountability Regime.</p>
<p>Recommendation 5.1: APRA should create a new Superannuation Division, headed by an Executive General Manager. A key focus of the Division should be the overall performance of the superannuation system for members.</p>	<p>APRA supports this recommendation. This will be implemented as part of APRA's response to Recommendation 2.3.</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 5.2: APRA should embed and reinforce its increasing focus on member outcomes, and continue to ensure that trustees prudently manage member funds. Consistent with this change of approach, APRA should: a) publish objective benchmarks on product performance and publicly take action to demonstrate its expectations for member outcomes; b) develop a superannuation performance tool that replaces PAIRS by the end of 2019. The tool should be focussed on member outcomes; c) update its superannuation reporting standards and collect product level data that facilitates accurate assessments of outcomes and comparability across funds; and d) increase the resourcing dedicated to the superannuation industry.</p>	<p>APRA supports this recommendation. APRA will build on its work in recent years which was provided further impetus with the passing of the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation) Act 2019.</p> <p>APRA's work on performance benchmarking and data collection will be a priority, and should be aligned with other initiatives that require legislation (such as choice product dashboards).</p> <p>APRA's program of work to review its supervisory model, initiated under APRA's 2018- 22 Corporate Plan, includes a revised PAIRS model by mid-2020.</p> <p>APRA will consult with Government on the additional resources needed.</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 5.3: In accordance with recommendation 23 of the Productivity Commission's Superannuation Inquiry, the Government should legislate to make APRA's member outcomes mandate more explicit. The Government should clearly outline its expectations for APRA on superannuation in its next Statement of Expectations.</p>	<p>APRA supports its member outcomes mandate being clear. This was recently achieved through the Treasury Laws Amendment (Improving Accountability and member Outcomes in Superannuation) Act 2019. APRA supports the Government further clarifying its expectations through the Statement of Expectations.</p>	<p>The Government agrees that it will outline its expectations for APRA on superannuation in its next Statement of Expectations. The financial regulator oversight authority will be tasked with monitoring APRA's performance against the Government's expectations.</p>



<p>Recommendation 6.1: The Panel supports the direction of the APRA Enforcement Strategy Review. To effectively embed the Enforcement Approach, APRA should change its existing internal norms that create a low appetite for transparent supervisory challenge and enforcement by: a) departing from its behind closed doors approach with regulated entities; b) adopting a stronger approach towards recalcitrant institutions; c) building organisational confidence and improving management support; and d) increasing its risk appetite and use of the escalation toolkit.</p>	<p>APRA supports this recommendation. APRA is implementing the revised Enforcement Approach that was released in April 2019. This program of work will be included in APRA's 2019-2023 Corporate Plan to be published in August 2019.</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 6.2: While APRA's regulatory tools are generally fit-for-purpose, the Government should consider: a. reviewing the adequacy of penalties across APRA's legislative framework; b. providing APRA with the power to appoint a skilled person to undertake a review of a regulated entity; and c. enhancing its private health insurance licensing powers.</p>	<p>APRA supports this recommendation, but ultimately it is a matter for Government. This recommendation builds on the matters identified in APRA's Enforcement Review and APRA welcomes the Government's commitment to consider review of these areas.</p>	<p>The Government agrees to consider a review of APRA's penalties, providing a power to appoint a person to undertake a review of an entity, and enhancing private health insurance licensing powers.</p>
<p>Recommendation 6.3: APRA should reinvigorate its approach to collaboration and information sharing with regulators and its international peers including clear protocols for staff.</p>	<p>APRA supports this recommendation. Strengthening collaboration and cooperation with peer regulators was identified as a priority in APRA's 2018-2022 Corporate Plan. APRA-ASIC engagement is a current priority, with new protocols established for senior executive coordination, and a revised MoU to be published by end 2019. From 1 August 2019, APRA is establishing a new Regulatory Affairs Unit to strengthen cross-agency cooperation.</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 6.4: APRA should use its existing external accountability framework more effectively, including a more assertive use of the Statement of Intent and it should publish a regular external accountability assessment.</p>	<p>APRA supports this recommendation. APRA will publish a review of its activities and performance at the end of 2019. This is part of the work underway in response to recommendation 6.6.</p>	<p>No specific response provided beyond supporting the recommendations.</p>
<p>Recommendation 6.5: The Government should consider streamlining and improving the effectiveness of existing accountability arrangements when establishing the financial regulator oversight authority.</p>	<p>APRA supports this recommendation and welcomes the Government's commitment to seek to streamline and improve the effectiveness of APRA's accountability arrangements.</p>	<p>The Government agrees that as part of establishing the financial regulator oversight authority, it will seek to streamline and improve the effectiveness of both APRA and ASIC's accountability arrangements.</p>
<p>Recommendation 6.6: APRA should take a more strategic, active and forceful approach in its public communications. In relation to specific areas, APRA should: a) publish an interpretation of its mandate; b) clearly articulate its role and approach to macro-prudential policy (see recommendation 3.3); c) advise the Government of the current state of its resolution capability and crisis preparedness (see recommendation 3.4). Taking account of the impact on the market, part of this advice could be published; and d) be more transparent in relation</p>	<p>APRA supports this recommendation. Work is underway to enhance communications as a strategic priority from APRA's 2018-2022 Corporate Plan. Existing initiatives will be strengthened in this year's plan to address this recommendation.</p> <p>APRA will publish its updated Corporate Plan by end August 2019, and publish other material relevant to this recommendation as</p>	<p>No specific response provided beyond supporting the recommendations.</p>



to superannuation, including by publishing objective benchmarks for superannuation performance on member outcomes and a strategy to promote long-term industry performance.

part of its enhanced strategic communication plan.