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Contents

Diversity

Same profile (just better educated)? The AFR reports that leadership at Australia's top 100 companies looks much as it did five years ago

The AFR reports that analysis by BOSS magazine has found that the profile of a typical ASX 100 CEO has changed little over the past five years, except that he tends to be better educated.

Some Key Points

- **The proportion of CEOs with an undergraduate degree has increased**: The proportion of ASX 100 CEOs with at least an undergraduate degree has grown from 84% to 93% over the past five years. The most widely held undergraduate degrees are economics, commerce or business, with 41% of ASX 100 CEOs having completed one of those degrees, up from 32% in 2014. The proportion of CEOs holding an engineering degree increased from 16% in 2014 to 21% in 2019.
- **Post graduate study?** Approximately 25% of ASX 100 CEOs have an MBA (slightly down from the proportion in 2014), while a further 12% have completed an advanced management program
- **Trend towards working for multiple companies:** According to the report, there is a trend towards CEOs having worked for multiple companies over a career, rather than just one or two.
- **Average age has increased:** The average age of an ASX 100 CEO has increased slightly to 55 (from 54 since 2014)
- **CEO tenure:** 11% have been in the role for 10+ years and less than 40% of ASX 100 CEOs have been in their roles for more than 5 years
- **Being female is a disadvantage?** Only 7% of ASX 100 CEOs are women, barely changed over the past five years, despite years of companies running diversity programs and introducing flexible work arrangements.
- **Asian Australians continue to be underrepresented:** Of the 98 CEOs in the role permanently, 55 were born in Australia and 43 were born offshore. Of those who were born overseas, the majority were from Anglo-Saxon countries, such as the United Kingdom, the United States, Ireland and New Zealand. Only two were born in India, one in Vietnam and one in Malaysia. The AFR comments that this fails to reflect the backgrounds of the general population, 12.2% of whom identify as Asian Australian. The AFR also suggests that given seven of Australia's top10 export partners are in Asia, and given that by 2030 China, India, Japan and Indonesia are predicted to be among the largest economies in the world, it may also 'dampen' Australia's growth prospects.

[Sources: [registration required] The AFR 10/06/2019; 11/06/2019]

An alternative to imposing board gender quotas? Writing in Harvard Law School Forum, US academics suggest that imposing board term limits could provide a 'more organic route' to improving board diversity on US boards than gender quotas

Based on analysis of quantitative data on director turnover in the S&P 1500 and qualitative data on S&P 500 firms with term limits, US academics have found that firms with higher board turnover have more gender diverse boards. Based on this, they suggest that promoting board term limits may offer an alternative to other more controversial mechanisms (such as the imposition of board gender quotas) to improve board diversity.

Context

- **Female board representation on US boards remains low:** Citing various recent studies in support, the writers state that gender diversity on US boards remains low.
- **Director turnover in the US remains very low**, with boards of US firms seemingly hesitant to force out incumbents.
- **Pressure to improve diversity is increasing:** The article notes that pressure on US boards

to diversify is increasing. For example, pressure is growing from large investors (eg State Street, Vanguard and BlackRock) for boards to diversify. From a regulatory perspective, California has recently passed legislation mandating gender quotas (and other states, the writers suggest may follow). However, the writers argue that despite these pressures progress remains slow and the imposition of quotas remains controversial. In this context, they argue that director term limits could provide an alternative.

Term limits could achieve increased gender diversity?

The researchers found that firms experiencing higher board turnover were more gender diverse, and those with lower turnover were less gender diverse.

- **Diversity tends to improve where multiple directors depart in the same year (regardless of the reason for their departure):** The researchers found that where there was a 'tenure shock' (a situation in which the board's aggregate average tenure dropped by more than one full year eg the departure of multiple directors in the same year) firms tended to experience improvement in their gender diversity ratio, regardless of the reason for the rapid board renewal.
- **Why should increased supply of board positions lead to more diverse boards?** The researchers attribute the correlation between board turnover (ie increased supply/availability of vacant board seats) and greater gender diversity to both 'external and internal shifts in the governance landscape'. External forces include the overall market pressure, as well as the rise in investor and advocate activism, for increased diversity. Internal shifts include the entry of a newer generation of directors, which both includes more women and men more familiar with diverse work environments. These combined pressures, the writers suggest, mean that newly appointed directors are more likely to recruit from a wider candidate pool.
- **Tenure limits as an alternative to quotas?** Based on their findings, the writers argue that 'effectively designed term limits, combined with external pressure to diversify, could provide a more organic route to improving board diversity without quotas' and 'sidestep the complex questions embedded with a more direct and aggressive approach'. 'In jurisdictions with seemingly intractable political divisions, consensus remedies for inclusion could point the way forward for public policy' the writers argue.

Mandating term limits? Regulating term limits is the most 'onerous' option (and also the likely to achieve the fastest rate of board refreshment/improved diversity)

The writers outline a number of policy alternatives to implement tenure limits including: encouraging boards to adopt voluntary tenure limits, 'self-regulation' by industry (individuals or industries could set norms as part of their corporate social responsibility policies to encourage firms to self-regulate). Ultimately, the writers conclude that regulatory intervention (imposition and disclosure of mandatory term limits) is most the likely to achieve rapid board refreshment (and increased diversity), though they note it would be more 'onerous' than other options (though it would have the advantage of side-stepping 'polarised' diversity debates associated with the imposition of board quotas).

[Sources: Harvard Law School Forum on Corporate Governance and Financial Regulation 10/06/2019; [registration required] Nili, Yaron and Rosenblum, Darren, Board Diversity by Term Limits? (March 15, 2019). 71 Alabama Law Review (2019, Forthcoming); Univ. of Wisconsin Legal Studies Research Paper No. 1467]

Remuneration

Details of remuneration package for new Bank of Queensland manager director and CEO released

The Bank of Queensland has announced it has appointed former Chief Executive of the Consumer Bank at Westpac, George Frazis as manager director and CEO, effective 5 September 2019.

Remuneration details

- **Fixed remuneration:** According to the announcement, Mr Frazis will receive total fixed remuneration of $1.3m per annum
- **Short Term Incentive:** Mr Frazis will be eligible to receive a short term incentive (from 0% to a maximum of 150% of fixed remuneration) for the financial year ending 31 August. 50% of any short term incentive

awarded will be deferred into equity over three years. Mr Frazis is eligible for an STI opportunity in future years, on terms set by the Board.

- **Long Term Incentive:** Subject to shareholder approval, the Executive will be eligible for an initial offer of Performance Award Rights (PARs) under the Bank's Award Rights Plan equivalent in value to 100% of Fixed Remuneration.

Possible merger with another lender? Noting that Mr Frazis' executive service agreement includes a 'fundamental change' clause which states that 'If Mr Frazis ceases to be the most senior executive in the Group, ceases to report directly to the Board or his role is substantially diminished, he may terminate his employment with immediate effect and BOQ must treat him the same way it would if BOQ had given 9 months' notice, The AFR comments that there is 'recurring talk' of Bank of Queensland merging with another regional lender such as Suncorp, Bendigo Bank or Adelaide Bank.

[Note: The Australian Prudential Regulation Authority (APRA) has indicated that it will soon consult on revisions to current prudential standards relating executive remuneration by the middle of the year. See: Governance News 05/04/2019; 28/05/2019]

[Source: BoQ ASX announcement 06/06/2019; [registration required] The AFR 06/06/2019]

In Brief | APRA has finalised its approach to apportionment of variable remuneration for medium and small ADIs under the BEAR. The final legislative instrument will be published before the BEAR comes into force for medium and small ADIs on 1 July 2019

[Sources: APRA media release 12/06/2019; Response Letter BEAR — Legislative Instrument; Final wording of the Schedule]

In Brief | No enforcement action? The AFR reports that having conducted a 'thorough investigation,' the Australian Securities and Investments Commission (ASIC) has determined that it will take no enforcement action against the CPA Australia board in relation to its decision to unanimously approve a large (controversial) termination payment ($5.8m) to former CPA head, Alex Malley

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

Institutional Shareholders and Stewardship

State Street has released a suggested framework for directors (in all sectors) to assist them in better overseeing climate risk and to clarify investor expectations of board members on their responsibilities with regard to climate risk

Following the COP21 Paris Climate Accord, State Street Global Advisors (State Street) has issued a suggested framework for directors to oversee climate risk, which State Street writes, should be managed like any 'other significant risk to the business'. In addition, State Street has issued guidance to directors to clarify investor expectations of board members on their responsibilities with regards to climate risk

Suggested framework

The three primary climate-related risks State Street has identified are physical risk, regulatory risk and economic risk.

1. **physical risk:** the tangible risks of climate change eg rising sea levels, droughts, flooding, extreme temperatures, and increased frequency of extreme weather events

2. **regulatory risk:** regulatory change that could impact existing business operations or could increase the cost of operations

3. **economic risk:** the risks associated with changing consumer habits, reputational risk stemming from a company's sustainability practices relative to stakeholder expectations, and investment allocation decisions in companies and sectors that are 'better suited for a low carbon economy'

Relevant to every sector

State Street writes that it considers that the impact of these risks is not limited to any one sector, but is relevant to (ie creates opportunities and challenges for) 'any company in any sector'. State Street provides a number of examples of the possible risks facing different sectors.

For example:

- In the finance sector, State Street writes that physical risks might include financial investment/exposure to properties, infrastructure and businesses vulnerable to climate risk. Regulatory risks might include financial exposure to sectors that are vulnerable to changing regulations. Economic risks might include credit risk implications and larger insurance payouts due to climate related events.
- In the Information Technology/Telecommunications services sector, physical risks might include disruption to services as a consequence of climate events impacting infrastructure. Regulatory risks might include increased reporting of climate preparedness (given the sector's critical infrastructure status). Economic risks might include changes in consumer preferences for energy efficient products and reputational risks as environmentally conscious consumers assess a company's sustainability practices.

State Street's suggested guidance for directors

Based on engagement with companies on climate issues over the past three years, State Street has developed guidance for directors to clarify investor expectations of board members on their responsibilities with regards to climate risk. The guidance is as follows.

- **Assess the impact of climate risk on company strategy:** Analyse sector and company exposure to the different climate risks, inquire if the company has adequately mitigated potential risks, and assess the potential impact on the company's long-term strategy under different scenarios on a periodic basis
- **Review capital allocation and direct investment into technology and programs that may mitigate risks and/or give the company a competitive advantage amongst its peers**
- **Monitor regulatory developments** to understand the impacts of potential policy changes on long-term strategy
- **Expectation of engagement on strategy:** Companies should be prepared to discuss company's climate change strategy with investors
- **Companies in high-risk sectors should assess board composition and director expertise in relation to climate competence of the board** and establish mechanisms such as access to climate experts to help educate directors on evolving climate-related risks
- **Review shareholder proposals** that the company receives and evaluate the spirit of proposals in the context of the business risk

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 10/06/2019]

Meetings and Proxy Advisers

Meeting result: Facebook shareholder proposals defeated (for lack of management support); New York City Comptroller has called for the board to undertake an immediate governance review

At the 30 May Facebook AGM 68% of 'outside' shareholders reportedly voted in favour of a shareholder resolution to split the dual CEO/Chair roles at the company and install an independent Chair (ousting founder Mark Zuckerberg). This was an increase on 51% support for a similar resolution last year.

Despite the strong level of support, the proposal was unsuccessful because of the unequal voting structure at the company. For class A shareholders, one share equals one vote, but for class B shares (held by Mr Zuckerberg and senior Facebook executives) one share equals ten votes. Mr Zuckerberg reportedly holds 60% of the voting power.

A separate shareholder resolution to end the dual-class structure also received strong support but, also failed to pass for lack of Mr Zuckerberg's support as did all other shareholder proposals (none of which had management support).

Commenting on the result, New York City Comptroller Scott Stringer, said the result 'reveals vigorous demand among Facebook investors for independence, accountability, and greater oversight of the company's management and follows a crescendo in the frequency and intensity of controversies at the company'. Mr Stringer went on to say that Mr Zuckerberg's 'outsized role' at the company 'must end' on the basis that the company's overreliance on one person constitutes a risk to the business.

Call for an internal board review: Mr Stringer said that in a letter sent to Facebook's lead independent director on 15 April, he called for the Facebook board to commission an 'investigation and analysis of how governance arrangements have contributed to the development of Facebook's corporate culture'. Mr Stringer also said that he had called on the company to publicly release the findings and recommendations of the review.

[Sources: New York City Comptroller Scott M Stringer 04/06/2019; Facebook AGM results; Business Insider 04/06/2019; BBC 31/05/2019; Quartz 05/06/2019]

Disclosure and Reporting

Room to improve: The TCFD has released a second status report on current disclosure practices

The Task Force on Climate related Financial Disclosures (TCFD) has released a second status report providing an overview of current disclosure practices as they relate to the final TCFD recommendations released in June 2017. The report highlights key challenges associated with implementing the recommendations, and outlines some of the efforts the Task Force will consider undertaking to assist in addressing them.

[Note: Among other things, the fourth edition of the ASX Corporate Governance Principles and Practices, which come into effect for financial years commencing on or after 1 January 2020, encourage companies to improve climate and other non-financial risk disclosure by focusing on material environmental and social risks, including by reference to the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). See: Governance News 04/03/2019]

Some Key Points

There has been some progress:

- **Uptick in disclosure:** The review found the average number of the 11 recommended disclosures addressed by companies in their public reports grew each year between 2016 and 2018, from 2.8 in 2016, to 3.1 in 2017, and to 3.6 in 2018. However, only around 25% of companies disclosed information aligned with more than five of the 11 recommended disclosures and only 4% of companies disclosed information aligned with at least 10 of the recommended disclosures
- **Uptake appears to be increasing:** 91% of companies surveyed said that they have decided to fully or partially implement the TCFD recommendations; 61% plan to complete implementation within three years
- **There is evidence of an increase in the availability of climate related financial information:** 85% of users of financial information surveyed said that there is an increase in the availability of financial information and 75% reported an improvement in the quality of the disclosures. 76% of users said that they use climate related financial information in their decision making processes.

Progress needs to accelerate

Though progress has been made to improve the availability and quality of climate-related financial information, the TCFD found that 'disclosures remain far from the scale the markets need to channel investment to sustainable and resilient solutions, opportunities, and business models'.

The TCFD comments that given the speed at which changes are needed to limit the rise in the global average temperatures, more companies need to consider the potential impact of climate change and disclose material findings.

Areas for improvement?

- **More clarity is needed on the potential financial impact of climate-related issues on businesses.** 'Without such information, users may not have the information they need to make informed financial decisions' TCFD writes.
- **The majority of companies (three out of five companies) using scenario analysis do not disclose information on the resilience of their strategies.** The TCFD comments that though this is an 'important gap in disclosure for companies with material climate related risks' the finding is consistent with the TCFD's understanding from discussions with various companies, industry associations, and other groups that companies are still early in the process of using climate-related scenarios internally, evolving their approaches, and learning how to integrate scenarios into corporate strategy formulation processes.
- **Mainstreaming climate-related issues requires the involvement of multiple functions within firms** including the involvement of risk management and finance functions the TCFD writes. The TCFD found that sustainability and corporate responsibility functions are the primary drivers of TCFD implementation efforts, but that risk management, finance, and executive management are increasingly involved.

Next steps?

The TCFD writes that based on the findings of the review, there is a need for continued efforts to support implementation of the TCFD recommendations, especially in terms of companies using scenario analysis to assess the resilience of their strategies under a range of plausible future climate states. On this basis, TCFD will continue to promote and monitor adoption of its recommendations and will prepare another status report for the Financial Stability Board in September 2020.

In addition, the TCFD is considering additional work in the following areas: a) clarifying elements of the Task Force's supplemental guidance contained in the annex to its 2017 report (Implementing the Recommendations of the TCFD); b) developing process guidance around how to introduce and conduct climate-related scenario analysis; and c) identifying business-relevant and accessible climate-related scenarios.

[Source: TCFD status report summary; TCFD Status Report (June 2019)]

[Note: Australian regulators have made clear that they expect the financial implications of climate risk to be reported in the same way as any other financial risk. For insights/guidance on the new/heightened expectations with respect to reporting on the financial implications of climate risk, see: Report preparers, assurers and auditors must approach climate change-related issues with the same degree of rigour as any other financial variable.

In a recent information paper, Climate Change: Awareness to Action, The Australian Prudential Regulation Authority (APRA) said it expects to 'observe a continuous improvement in the sophistication of entities' management of climate change risks and preparations for the transition to a low-carbon economy, including the adoption of the recommendations of the TCFD'. The same information paper also identifies (among other things) the barriers financial institutions identified to reporting under the TCFD recommendations (see: Governance News 27/03/2019).]

Regulators

Australian regulators lead to world on climate risk supervision?

The AFR reports that Jonathan Dixon, secretary-general the International Association of Insurance Supervisors (IAIS) (a global standard-setting body for insurance supervision), has praised Australian financial regulators for their stance on climate change.

Reportedly Mr Dixon said the Australian Prudential Regulation Authority's (APRA's) head of insurance, Geoff Summerhayes, had become an 'effective global leader among insurance supervisors in promoting a shift from awareness to action on climate risk' and that the Australian Securities and Investments Commission (ASIC) is also taking a leading role.

'It's fair to say there's varying degrees to which insurance supervisors around the world are viewing [climate risk] as a part of their core mandate. But there is a growing number of insurance supervisors who believe this is a clear and present financial risk like any other financial risk that needs to be properly managed… Australia is really taking some global leadership' he reportedly said.

Three key risks for insurers? The AFR goes on to quote Mr Dixon as saying that climate changes poses three risks for insurers: a) increased natural catastrophe claims; b) transition risk (ie the cost of transitioning to a low carbon economy); and c) liability risk (ie the risk of legal action over an organisation's failure to act on/disclose other climate risks).

Regulators appear to be out of step with government? The AFR suggests that the regulator's stance appears out of step with that of the government, which has taken a conservative approach.

[Source: [registration required] The AFR 05/06/2019]

IOSCO´s Growth and Emerging Market Committee has released a report setting out ten recommendations aimed at enhancing transparency and driving consistency in ESG disclosure

The International Organisation of Securities Commissions' (IOSCO´s) Growth and Emerging Market Committee (GEMC) has released a report setting out ten recommendations that member jurisdictions should consider when issuing regulations or guidance regarding sustainable instruments and additional disclosure requirements of ESG specific risks. Among other things, the recommendations include requirements for reporting and disclosure of material Environmental, Social and Governance (ESG) specific risks, aimed at enhancing transparency and driving consistency.

The recommendations are as follows.

Category	Recommendation
Integration by issuers and regulated entities of ESG-specific issues in their overall risk assessment and governance	▪ Recommendation 1: Integrating ESG-specific issues in overall risk assessment and governance.
Integration by the institutional investors of ESG-specific issues into their investment analysis, strategies and overall governance (Recommendation 2)	▪ Recommendation 2: Consistent with their fiduciary duties, institutional investors, including asset managers and asset owners, are encouraged to incorporate ESG-specific issues into their investment analysis, strategies and overall governance, and take into account material ESG disclosures of the entities in which they invest.
ESG-specific disclosures, reporting and data quality (Recommendation 3)	▪ Recommendation 3: Regulators should require disclosure with regard to material ESG-specific risks (including transition risks) and opportunities in relation to governance, strategy and risk management of an issuer.
Definition and taxonomy of sustainable instruments (Recommendation 4)	▪ Recommendation 4: Sustainable instruments should be clearly defined and should refer to the categories of eligible projects and activities that the funds raised through their issuance can be used for
Specific requirements regarding sustainable instruments (Recommendations 5 to 9)	▪ Recommendation 5: Funds raised through sustainable instruments should be used for projects and activities falling under one or a combination of the following broad ESG categories: Environmental (renewable resources; combatting/mitigating climate change; pollution and waste; and other environmental opportunities); Social (human capital; product liability; and other social opportunities); Governance (corporate governance; corporate behaviour). The list of eligible projects and activities should be determined by individual regulators, taking into account that an eligible project

Category	Recommendation
	or activity cannot, at the same time, do any significant harm to any of the other ESG categories. ▪ Recommendation 6: Regulators should establish requirements for the offerings of sustainable instruments including, among others, the use and management of the funds raised through the issuance of such instruments, and the processes used by issuers for project evaluation and selection. ▪ Recommendation 7: Regulators should establish ongoing disclosure requirements regarding the use of the funds raised through the issuance of sustainable instruments including the extent of unutilized funds, if any. ▪ Recommendation 8: Regulation should provide for measures to prevent, detect and sanction the misuse of the funds raised through the issuance of sustainable instruments. ▪ Recommendation 9: Issuers should consider the use of external reviews to ensure consistency with the definition of the sustainable instruments and eligible projects as provided in Recommendation 4 and 5.
Building capacity and expertise for ESG issues (Recommendation 10)	▪ Recommendation 10: Building capacity and expertise for ESG issues. Regulators should analyse the gaps in capacity and expertise with regard to ESG-related issues mentioned in the above recommendations and consider targeted capacity building to address these gaps. Regulators should also have appropriate monitoring mechanisms in place to encourage application of these recommendations.

[Source: IOSCO media release 05/06/2019; Sustainable finance in emerging markets and the role of securities regulators]

Corporate Social Responsibility and Sustainability

The argument for engaging with big tobacco rather than automatically excluding it: Why Robert Eccles (Founding Chair of the SASB) is working with Philip Morris International on sustainability, social impact and investor engagement

Founding Chairman of the Sustainability Accounting Standards Board (SASB) and one of the founders of the International Integrated Reporting Council (IIRC) Robert G Eccles has written an article making the case for investors actively engaging with big tobacco companies on sustainability issues, rather than automatically excluding them. In it, he also discloses his decision to work with Philip Morris International (PMI) on sustainability, social impact and investor engagement.

Some Key Points

- **An exclusion strategy won't eliminate cigarette smoking:** Mr Eccles argues that an exclusion strategy is unlikely to eliminate the social harm (ie eliminate cigarette smoking) given the financial strength of the tobacco industry and the fact that the market does not consider there to be any risk of it disappearing 'anytime soon'. In addition, he argues that investors who exclude tobacco miss the opportunity to pressure tobacco companies to transform their business models/develop strategies for eliminating cigarette sales.
- **Active engagement is more likely to deliver change?** By contrast, Mr Eccles argues that a strategy of longer term active engagement (over the next 10 years) is capable of, and necessary to, driving a transformation in business strategy across the industry away from selling cigarettes towards a model where success 'is not based on selling addictive, cancer-causing products'.   This strategy of engagement,

Mr Eccles argues, is successfully driving change in other sectors (eg the actions of Climate Action 100+ at Royal Dutch Shell) and is similarly, he argues, capable of driving change in tobacco.

- **With active investor engagement industry could be forced to take PMI's lead?** According to Mr Eccles, PMI (alone among other tobacco companies) has publicly committed to eliminate cigarette smoking by cannibalising its own product line as fast as possible by moving to replace cigarettes with new, less harmful products. He argues that by engaging with PMI to accelerate this shift, investors could 'create the right kind of nudge in the industry forcing the rest to follow PMI's lead and rid the world of cigarettes as soon as possible'. In addition, he argues that PMI investors stand to gain financially by supporting the company's transformation to a more sustainable model (as PMI stands to gain market share through their smoke-free products).
- **Keep an open mind?** Global Proxy Watch has expressed scepticism about Mr Eccles decision describing it as a 'shocker'. In response to critiques of his position Mr Eccles writes 'I am sure some will read this and remain skeptical, and I respect that. All I ask is that you keep an open mind. Let's see what progress can be made over the next couple of years, recognizing that this is a decades-long battle. I remain open to what I haven't been able to find so far: a theory of change for how the exclusion of all companies in the tobacco industry is the best way for the capital markets to create the required change in this industry's business model to solve one of the world's greatest health problems'.

[Sources: Barron's 31/05/2019; Solving the Cigarette Problem: Exclusion and Engagement in the Tobacco Industry LinkedIn; [registration required] Global Proxy Watch Vol 23 No 23 07/06/2019]

Royal Dutch Shell can both deliver high returns for shareholders and meet the challenges associated with climate change?

The WSJ reports that Royal Dutch Shell PLC Chief Executive Ben van Beurden is meeting with investors and analysts with the object of 'luring' them back to the company's traditional oil business with the promise of escalating shareholder payouts — at least $125 billion in dividends and share buybacks between 2021 and 2025 from returns on investments the company has already made in oil and gas production, retail gasoline, lubricants, trading and chemicals — in the face of a range of shareholder concerns.

Transitioning to a greener business model will take time: The WSJ reports that, in light of increasing shareholder concerns about climate risk, as well as broader concerns about the longer term sustainability of the business (eg low oil prices, near-term concerns about global economic growth and long-term fears about crude demand), Mr van Beurden has reassured investors that the company is committed to cutting emissions, and transitioning to a cleaner business model. However, he has reportedly said that the change will necessarily be slow for two reasons:

1. **Demand for oil and gas will continue:** 'For decades and decades to come, the industry will have to invest in [oil and gas] in order to basically supply demand, which will be there…And as long as we feel we can have competitive positions, as long as we feel we can do that in an environmentally competitive way, a low-carbon way, etc, sure we will want to participate' he is quoted as stating.
2. **Green investments will take time to deliver returns:** In addition, Mr van Beurden reportedly said that it will take a similar amount of time before investments for Shell's investments in a cleaner electricity business to produce a return (given for example, reliance on emerging technologies/new technologies). 'We better prove that first before we start putting billions and billions and billions of dollars in it.…It needs to be a gentle takeoff process…When we prove out that this business model that we have — which is a business model of a future green utility — actually works, yes, then we are going to step seriously on the accelerator' he is quoted as saying.

Promise of escalating returns? According to The WSJ, Shell plans to continue to escalating the shareholder payouts from its traditional oil business in order entice investors back to its traditional oil business. 'The sector at this time is still a little bit in the doghouse…At some point in time fundamentals are going to reassert themselves and people are going to say "Hey, if I get that type of yield on my investment, I better be part of the growth story that will bring"' he is quoted as stating.

According to the WSJ, Mr van Beurden's message does not appear to have had a marked impact on the share price to date which is reportedly down 20% over the last five years and has remained 'largely flat' for the past 18 month period.

[Source: [registration required] The WSJ 05/06/2019]

QBE has set a target to use 100% renewable electricity by 2025

QBE Insurance Group has set a target to source 100% renewable electricity across its global operations by the end of 2025 through RE100.

The Australian reports that the group plans to service its electricity needs using locally sourced renewables in each of its operating divisions where possible. If not possible, renewable energy certificates will be purchased to achieve the 100% target.

Commenting on the news, QBE CEO Pat Regan said the decision 'aligns with QBE's support for the objectives of the Paris agreement and our efforts to support the transition to a lower carbon economy'.

About RE100: RE100 is a global corporate leadership initiative led by The Climate Group in partnership with the CDP, which aims to bring together influential businesses committed to 100% renewable electricity and the zero-carbon transition. RE100 has 176 members globally including Apple, Microsoft, Atlassian, CBA, Westpac.

[Source: RE100; RE100 members; [registration required] The Australian 05/06/2019]

Related News: climate resolution at QBE

A shareholder resolution (coordinated by Market Forces) calling on QBE to set targets to phase out its exposure to all fossil fuels at its AGM on 9 May 2019 received only 7.83% proxy support.

Market Forces suggests that the result indicates that shareholders were satisfied with the company's commitment ahead of the meeting, to phase out its entire thermal coal business by 1 January 2030.

[Sources: QBE Insurance Group Ltd 2019 AGM results 09/05/2019; Market Forces media release 10/05/2019]

Financial Services

APRA has cautioned insurers against complacency given the risks currently facing the industry

Following a letter to private health insurers (PHIs) by the Australian Prudential Regulation Authority last week, calling on them to take steps to proactively develop recovery options, including having in place a Plan B (see: Governance News 05/06/2019), the regulator has released a speech given by Senior Manager Peter Kohlhagen at the Health Insurance Summit.

Mr Kohlhagen's speech focused on three issues: 1) the need for insurers to materially 'uplift' strategies to manage the key risks facing the industry namely affordability and policy change risks; 2) the need for insurers to have a 'sound Plan B' (eg a merger 'with a like-minded partner') to ensure they are prepared should their business model come under 'sustainability pressures'; and 3) APRA's review of capital requirements.

Key Takeouts

- **APRA has reiterated its expectation that PHIs take a proactive approach to mitigating and planning for key risks** (affordability and policy risks) facing the industry and more particularly, has underlined its expectation that insurers develop a sound 'Plan B' (for example, a recovery plan which could include a merger with a 'like minded firm')
- **APRA will step in if industry fails to act:** 'APRA will not hesitate to act to protect the interests of policyholders should it become necessary due to viability concerns with an insurer. That can take the form of an orderly merger or other exit from the market. Importantly, an insurer that has a plan and executes it when it becomes necessary can control its own destiny; an insurer that fails to plan will find that it loses that opportunity' Mr Kohlhagen said.
- **Capital requirements?** APRA intends to consult on proposals to adapt the capital framework already in place for the life and general insurance sectors – or LAGIC – for the private health insurance industry in the coming months. APRA does not expect that a revised capital framework would be implemented before the end of 2021

Affordability and policy change risks — 'no one can yet lay claim to a genuinely Resilient approach'

Mr Kohlhagen said that in 2018, the regulator requested a range of information from insurers about how affordability and policy change risks are being managed. The review found that though there is a 'high degree of awareness' of both policy change and affordability risks, 'few insurers are translating their awareness or understanding into actionable plans'. More particularly, and as flagged in a recent letter to industry (see: Governance News 05/06/2019), 'the headline story is that while some insurers are more advanced than others, we aren't convinced that any insurer yet has a robust strategy for managing the risks'. He added that though aspects of these risks are outside insurers' direct control, 'preparation is always better than cure and there is still opportunity for insurers to become more resilient through robust approaches to these issues'.

Affordability risk: With respect to affordability risk, APRA found that insurers are considering a diverse range of strategies but that these were often 'vague, fail to address the material risk or rely heavily on actions by others'. Mr Kohlhagen said that APRA's expectation is that insurers 'quantify the impact of an adverse affordability scenario at meaningful extremes and start implementing actions to address the materialising risk. Deferring action or waiting for a third party to "serve-up" a solution is not a defensible strategy'. He added that in terms of mitigating affordability risk, APRA considers promising strategies are those where the insurer is actively changing how they provide services to their members eg where insurers are facilitating substitutes for traditional in-hospital services, revising their health supplier contracts or developing preventative health and well-being offerings for members.

Policy change risk: Mr Kohlhagen said that APRA welcomes steps insurers have taken to 'understand and model scenarios for the most evident policy change: a period of premium increases being constrained below increases in claims costs' but said that more needed to be done. 'Shocks to the system rarely follow expectations. Insurers that are not thinking broadly about how policy change may impact their business therefore risk encountering their own "winter of despair"' he said.

Mr Kohlhagen rejected the idea that because policy settings are outside insurers' direct control there is little that can be expected in terms of planning. 'APRA's view is that this does not preclude actions by insurers to mitigate the impact of changes. So it is concerning to APRA that we see passivity among insurers' he said. Mr Kohlhagen said that APRA expects to see insurers taking a proactive approach, 'drawing on their expertise to develop specific policy proposals, undertaking evidence-based analysis and using these insights to engage with policy makers and others in the health care system on reform proposals'. He added that APRA expects that 'better prepared insurers are taking actions to improve the value of services for members' for example through service quality offerings, non-PHI benefits or strategies that can control costs. 'Together these types of actions may help insurers address affordability risk and so position them to tolerate policy changes' he said.

Recovery planning: APRA's work on recovery plans will 'continue to intensify'

Mr Kohlhagen said that APRA has already commenced bilateral discussions with a number of insurers that have been identified as the most likely to face sustainability challenges.

'Our key message is that insurers should proactively develop recovery options, including a Plan B. For many insurers, the likely Plan B will be a merger with a like-minded partner. APRA will not hesitate to act to protect the interests of policyholders should it become necessary due to viability concerns with an insurer. That can take the form of an orderly merger or other exit from the market'. Importantly, an insurer that has a plan and executes it when it becomes necessary can control its own destiny; an insurer that fails to plan will find that it loses that opportunity' he said.

Mr Kohlhagen added that APRA will follow up on the letter to industry 'with further detailed guidance on an insurer-by-insurer basis, together with clear timeframes for each insurer to respond'. 'I urge insurers to consider that guidance seriously, engage openly with APRA and to put in place a plan well ahead of any urgent need for action' he said.

Mr Kohlhagen added that 'APRA will not hesitate to act to protect the interests of policyholders should it become necessary due to viability concerns with an insurer. That can take the form of an orderly merger or other exit from the market. Importantly, an insurer that has a plan and executes it when it becomes necessary can control its own destiny; an insurer that fails to plan will find that it loses that opportunity'.

Review of capital standards

Mr Kohlhagen said that APRA intends to consult on proposals to adapt the capital framework already in place for the life and general insurance sectors – or LAGIC – for the private health insurance industry in the coming months. The review is an opportunity, Mr Kohlhagen said, to ensure that capital standards in the industry provide for an appropriate level of resilience to protect policyholders.

In particular, APRA is considering adjustments to reflect: a) the characteristics of insurance risk in the industry (eg the short-tail nature of claims, risk equalisation, health-related business and the constraints on premium setting and product design); b) how to think about potential insurance concentration risks and c) how to address policy change risk in the capital framework.

Mr Kohlhagen said that the Actuaries Institute is assisting APRA in this, by providing early advice on these issues via a technical working group. In addition, he said that APRA is engaging broadly through industry roundtables and bilateral discussions with a range of interested parties.

Timing of the formal consultation? Mr Kohlhagen said that APRA expects to release an initial discussion paper 'in the coming months outlining in principle APRA's proposed new capital framework for private health insurers'. He added that APRA does not expect that a revised capital framework would be implemented before the end of 2021.

[Sources: Australian Prudential Regulation Authority (APRA) senior manager Peter Kohlhagen, speech to the Health Insurance Summit: A tale of two insurers 05/06/2019; [registration required] The SMH 06/06/2019]

Treasury's proposals to increase supervisory levies on financial institutions disproportionately and unfairly impact smaller banks COBA says

In a statement, responding to the Treasury's proposal to increase supervisory levies on financial institutions (see: Governance News 05/06/2019), the Customer Owned Banking Association (COBA) said that the proposed plan will disproportionately and unfairly impact smaller banks and calls on the Treasurer to intervene to 'rule them out' on this basis.

'Treasury is proposing dramatic increases in levies on customer owned banks and smaller listed banks while gifting the big four a $3 million levy reduction' COBA states.

COBA argues that as the increased levies are intended to cover the regulatory costs for the Australian Prudential Regulation Authority (APRA) flowing from the Financial Services Royal Commission, smaller organisations (COBA members) who did not engage in the misconduct, should not be 'forced to pay the price'. This approach sends 'a very confusing signal about the Government's intention to hold the major banks accountable for their conduct' COBA states.

In addition, the statement argues that the proposed levies will negatively impact competition, 'Major banks already have a head start on their smaller competitors through various aspects of the regulatory framework. They don't deserve the extra help of a cut in their APRA levies while their much smaller competitors are hit with huge increases' COBA states.

The statement calls on the Treasurer to intervene and 'rule our these grossly unfair increases'.

[Source: COBA media release 05/06/2019]

Cooperate or face (potentially) harsher penalties? The AFR reports that ASIC deputy Chair Daniel Crennan has said firms should adopt a different (and more cooperative) approach to engaging with ASIC in the post-Hayne world

The AFR reports that Australian Securities and Investments Commission (ASIC) deputy chair Daniel Crennan has said that in light of the Hayne Royal Commission and ASIC's new enforcement approach, firms involved in litigation with the regulator should adjust their approach.

'Unfortunately there is long history of litigation in this country of taking steps to either slow down or interfere with the natural course of litigation' he is quoted as stating. In addition, he said that ASIC would be less willing to cut a deal at the last minute.

More particularly, Mr Crennan is quoted as cautioning entities against resisting or engaging in delaying legal tactics, on the basis that doing so could attract higher penalties. 'What they should not be doing is engaging in years of litigation, using an asymmetry of funding to engage in endless interlocutory stoushes with ASIC and then look to settle on the courthouse steps. It's bad for society, it's bad for them frankly, and it's bad for us' Mr Crennan reportedly said. 'In appropriate circumstances it's better off…to make admissions early, move to the penalty phase early and move on. Particularly when there has been a systematic failure' he reportedly said.

In addition, the AFR reports that Mr Crennan said ASIC plans to continue to push for new search warrant and wiretap powers. Reportedly, Mr Crennan said the changes would give ASIC more scope to investigate those actively engaged in misconduct and to more easily identify those involved in criminal activity, such as insider trading.

[Source: [registration required] The AFR 05/06/2019]

ASIC's market manipulation case unsuccessful: Australian Securities and Investment Commission v Whitebox Trading Pty Ltd (No 7) [2019] FCA 849

In *Australian Securities and Investment Commission (ASIC) v Whitebox Trading Pty Ltd (No 7) [2019] FCA 849* the Federal court of Australia found that the ASIC failed to make out its case that that Whitebox Trading Pty Ltd (a financial services firm then working for NAB) and its sole director and principal, Johannes Boshoff, engaged in market manipulation in contravention of section 1041A, and contraventions of 1041B, of the *Corporations Act 2001 (Cth)*. The court also found that Mr Boshoff did not fail in the discharge of his duties as a director of Whitebox under s180 by allowing the (alleged) breaches by his company under s1041A and 1041B.

ASIC's allegations:

- ASIC alleged that it was likely artificial prices for trading Index Securities would be created by certain order activities of Mr Boshoff and Whitebox on five occasions in 2012.
- ASIC also alleged that false or misleading appearances as to market for Index Securities were created by the orders that Mr Boshoff and Whitebox had placed on the ASX but did not intend to trade.

The Court found that ASIC failed to establish a contravention of either 1041A or 1041B. 'I am not persuaded on the balance of probabilities that the Buy Orders, the Amended Sell Orders and the Incremental Reductions were not placed with any genuine intention that they should be traded but, rather, with the knowledge that, ultimately, they would be cancelled or substantially reduced in volume so as to manipulate the Opening Price for each of the XJO Securities in their respective Rotations in the OSPA' Justice Yates found.

In a statement, ASIC said that it is 'considering the judgment'.

[Sources: Australian Securities and Investment Commission v Whitebox Trading Pty Ltd (No 7) [2019] FCA 849; ASIC media release 11/06/2019; ASIC originating process and concise statement; The SMH 11/06/2019]

The ABA has defended the decision of two big lenders not to pass on the recent interest rate cut to customers in full, on the basis that the interests of borrowers and depositors are also relevant considerations when determining lending rate

Head of The Australian Banking Association (ABA) Anna Bligh has reportedly defended the decision of two big lenders not to pass on the recent interest rate cut to customers in full, on the basis that the interests of borrowers and depositors are also relevant considerations when determining lending rates.

'Banks are determined to earn back the trust of the Australian people, both with borrowers and depositors' she is quoted as stating.

Separately, Ms Bligh also reportedly said that:

- the banking industry is committed to working with the government to implement the Prime Minister's election promise to make it easier for first home buyers to enter the market (ie the government will guarantee 15% of the loan for 10,000 first home buyers, meaning that buyers would only require a 5% deposit and would avoid the cost of mortgage insurance).
- called on the government to prioritise implementation of the financial services royal commission recommendations, though cautioned against taking action that would 'stifle lending'.

'There is a lot to be done and some of it has to be done in active working partnership with the Government and we want to make that happen as quickly as we can. What the industry wants is for banks to not be the political issue at the end of this three years as they have been over the last three years' Ms Bligh reportedly said.

[Source: [registration required] The West Australian 06/06/2019]

In Brief | Lower shareholder returns to be expected post-Hayne? A panel of experts has discussed the impact of the Royal Commission and suggested, among other things, that the shift to a customer focus will result in a lower line of profit for shareholders over the longer term

[Source: Investor Daily 06/06/2019]

In Brief | ASIC issued a statement confirming that CBA's financial planning arm, Commonwealth Financial Planning (CFPL) has complied with the Court Enforceable Undertaking (CEU) entered into with ASIC in April 2018 regarding CFPL's fees for no service conduct

[Sources: ASIC media release 11/06/2019; [registration required] The AFR 11/06/2019]

Accounting and Audit

Push for transparency on audit quality gaining pace? EY has reportedly followed PwC in disclosing details of ASIC's latest audit inspections

The AFR reports that Ernst and Young (EY) has reportedly followed PwC (see: Governance News 05/06/2019) in publicly disclosing details of ASIC's latest audit inspections including ASIC's anonymised feedback on areas in which EY could improve.

Commenting on ASIC's approach to reporting on audit findings, EY's assurance leader Glenn Carmody is quoted as stating, 'We need a more balanced perspective of audit quality indicators to give the market a true picture of a firm's audit quality, for example a scale of severity of findings in future [ASIC] audit inspection reports, similar to the US. The recent review covered 20 audits over 18 months. We signed over 3500 audit opinions in that period.'

ASIC's approach to audit questioned?

Separately, The AFR reports that Deloitte has 'attacked' the way ASIC assesses audit quality as inaccurate, 'not fit for purpose' and too volatile'. Jamie Gatt, Deloitte's managing partner of audit and assurance is quoted as stating, 'We are on record in saying that we do not believe individual inspection reports provide an accurate picture. The approach by ASIC can and has resulted in significant volatility in results'.

In addition, the firm has reportedly suggested that the regulator needs to put more resources into the inspection regime and to hire more skilled staff.

According to The AFR other firms share some of Deloitte's concerns.

ASIC is reportedly confident in its approach

In response, ASIC has reportedly defended the quality of its inspection regime and its risk targeted approach to assessing audit quality. An ASIC spokesperson is quoted as saying that the audit inspection findings show that firms needed to improve their audit practices. In addition, he is quoted as saying that 'The nature of our findings is consistent with the findings of audit regulators in other jurisdictions, as reflected in the inspection findings survey results recently published by the International Forum of Independent Audit Regulators'.

Naming firms? Commenting on the question of whether ASIC will name entities in reports going forward, the ASIC spokesperson did not commit themselves. Reportedly he said that the regulator is still 'developing criteria for assessing when to name entities in our reports on compliance across all regulated populations. This work will continue over the next couple of months.'

[Source: [registration required] The AFR 05/06/2019; 05/06/2019]

United Kingdom | PwC has reportedly instituted an operational split of its UK audit business

PwC UK has reportedly said it will split its audit practice, with one business to focus on external audits, and the other on internal audits and issues such as cybersecurity and technology risk.

In addition, the firm has reportedly: a) committed £30 million per annum to train staff and introduce new technology initiatives to improve audit quality; b) look to add more than 500 experienced auditors to its ranks; and c) increase the number of specialists in its audit quality control team by two thirds.

The firm's moves come amid intense scrutiny from the UK's Competition and Markets Authority, which has called for the big four to undergo an operational split to ensure that the audit arms are under separate management from the rest of the firms' business.

Australia? Reportedly PwC Australia has not committed itself on whether the Australian business will follow its UK counterpart, noting that the two businesses operate in 'different regulatory environments'.

[Source: Accountants Daily 07/06/2019; [registration required] The FT 05/06/2019]

Risk Management

Top Story | The governance implications of AI in the financial services context: The increased automation of systems in the financial services sector poses new governance challenges for boards (and for regulators) cautions Bank of England Executive Director James Proudman

Speech Overview | Speech by Bank of England Executive Director James Proudman, Managing Machines: the governance of artificial intelligence

The increased automation of systems in the financial services sector poses new governance challenges for boards (and for regulators) Bank of England Executive Director James Proudman has cautioned.

Key Takeouts

- The Bank of England considers oversight of technology to be a strategic issue for boards, and 'since it is a mantra amongst banking regulators that governance failings are the root cause of almost all prudential failures, this is also a topic of increased concern to prudential regulators'
- 'Indicative results' of a survey conducted by the Bank of England into the scale of uptake/oversight and use of Artificial Intelligence (AI) and machine learning (ML) in the UK financial services sector indicates that the majority of firms are already using AI in some form and that they intend to ramp up their usage/deployment over the next three years
- Mr Proudman said that increase automation entails a number of challenges for boards including with respect to accountability. For example, relying on algorithms and thereby removing human judgement, he said could make identifying the root cause of problems more difficult (which has implications for attributing individual accountability under the senior managers regime)

In a speech at the UK Financial Conduct Authority's (FCA's) conference on Governance in Banking, Bank of England (BoE) Executive Director James Proudman talked about the governance challenges associated with the automation of tasks — and more particularly the implementation of artificial intelligence (AI) and machine learning (ML) — for the financial services sector. In addition, Mr Proudman identified three 'principles for governance' derived from them.

A high level overview of his comments is below.

Why uptake of AI is of concern to the prudential regulator

Mr Proudman prefaced his comments by stating that 'The art of managing technology is an increasingly important strategic issue facing boards, financial services companies included. And since it is a mantra amongst banking regulators that governance failings are the root cause of almost all prudential failures, this is also a topic of increased concern to prudential regulators'.

[Note: In his Final Report on the Financial Services Royal Commission, Commissioner Hayne identified lack of sufficient oversight of technological systems/processes as a cause of some of the misconduct (including fee for no service conduct) and as unacceptable. See: Financial Services Royal Commission Final Report, Vol 1 at 112-116, 138-139. See also: FSRC Final Report: technology and data implications]

Scale of uptake: 'Indicative' results of a systematic survey into AI adoption in the UK financial services sector

Mr Proudman said that in March 2019, the Bank of England and the Financial Conduct Authority (FCA) sent a survey to more than 200 financial firms (including the most significant banks, building societies, insurance companies and financial market infrastructure firms) to gather evidence about the extent of adoption of AI/ML in the UK financial services sector.

The focus of the survey was to gain insight into the following.

- the extent to which firms have adopted (or are intending to adopt) artificial intelligence (AI) and machine learning (ML) within their businesses
- the extent to which firms have clearly articulated strategies towards the adoption of AI/ML
- the extent of barriers to adoption and what techniques and tools could enable safer use of the technology
- an assessment of firms' perceptions of the risks, to both their own safety and soundness as well as to their conduct towards customers and clients, arising from AI/ML
- the extent to which the appreciation of these risks has given rise to changes in risk management, governance and compliance frameworks

Some indicative results

Though the full survey results will not be released until Q3 2019, Mr Proudman outlined some 'indicative' results including the following.

- **Most firms are using AI in some form (but they expect use to ramp up over the next three years):** Mr Proudman said that AI implementation amongst firms appears to be 'strategic but cautious' at this stage with many firms reporting that they are currently in the process of building the necessary infrastructure necessary for larger scale AI deployment. He said that 80% of respondents said that they are using ML applications in some form. The 'median firm' reported deploying six distinct such applications currently, and expected three further applications to go live over the next year, with ten more over the following three years.
- **Large established firms seem to be most advanced in deployment.**
- **There is some reliance on external providers** at various levels, ranging from providing infrastructure, the programming environment, or specific solutions.
- **Barriers to AI deployment?** Barriers to AI deployment appear to be predominantly internal to firms (eg legacy systems and unsuitable infrastructure) rather than stemming from regulation.
- **Approaches to testing and explaining AI are under development** and it appears that there is currently a range of approaches in use. Firms said that ML applications are embedded in their existing risk frameworks but many said that new approaches to model validation (which include AI explainability techniques) are needed in the future.
- **AI is mostly being deployed in risk management/compliance areas:** 57% of firms regulated by the BoE reported that they are using AI applications in risk management and compliance areas, including anti-fraud and anti-money laundering applications. 39% of firms said that they are using AI applications in customer engagement, 25% in sales and trading, 23% in investment banking, and 20% in non-life insurance.
- **Self-assessment of the impact of AI?** Mr Proudman said that 'by and large', firms were of the view, that properly used, AI and ML would lower risks for example, in anti-money laundering, Know Your Customer (KYC) and retail credit risk assessment. However, he added that some firms said that, incorrectly used,

AI and ML techniques could give rise to new, complex risk types - and that could imply new challenges for boards and management.

Three governance challenges: data, accountability, pace of change

1. Data governance: risks associated with data quality and data use

The introduction of AI/ML poses significant 'ethical, legal, conduct and reputational issues' challenges around the collection and proper use of data, Mr Proudman said. For example, questions arise as to the accuracy of data and the accuracy of the models being used to analyse it, as well as questions of bias within the models, (eg is data being used unfairly to exclude individuals or groups, or to promote unjustifiably privileged access for others).

Implication for boards? The governance principle to emerge from these challenges is that boards should attach priority to the governance of data and more particularly should attach priority to: a) what data should be used; b) how should it be modelled and tested; and c) whether the outcomes derived from the data are correct.

2. Accountability challenges (including attributing individual accountability under the SMR)

Relying on algorithms and thereby removing human judgement could make identifying the root cause of problems more difficult Mr Proudman said. 'How would you know which issues are a function of poor design [inherent bias] — the manufacturer's fault if you have bought an "off the shelf" technology product — or poor implementation — which could demonstrate incompetence or a lack of clear understanding from the firm's management'. He added that in the context of decisions made by machines which themselves learn and change over time, defining what it means for the humans in the firm to act with "reasonable steps"/"due skill, care and diligence" could become more challenging.

Mr Proudman said that these questions are questions boards not just regulators 'will need to consider and be on top of'. More particularly he said that 'firms will need to consider how to allocate individual responsibilities, including under the Senior Managers Regime'.

Implication for boards? The governance principle to emerge from these challenges is that 'the introduction of AI/ML does not eliminate the role of human incentives in delivering good or bad outcomes, but transforms them, implies that boards should continue to focus on the oversight of human incentives and accountabilities within AI/ML-centric systems'.

3. Rate of change

As the rate of introduction of AI/ML in financial services looks set to increase, so too does the extent of execution risk that boards will need to oversee and mitigate Mr Proudman said. More particularly, he said that the transition to greater AI/ML-centric ways of working has 'major risks and costs arising from changes in processes, systems, technology, data handling/management, third-party outsourcing and skills' which will create demand for new skill sets on boards/senior management and necessitate changes in control functions/risk structures.

In terms of oversight, he said that given the complex interdependencies across firm functions entailed in the shift towards greater automation, there will be a need for a shift in approach — 'many of these interdependencies can only be brought together at, or near, the top of the organisation' he said.

Implication for boards? The governance principle to emerge from this is that boards should reflect on the range of skill sets and controls that are required to mitigate these risks both at senior level and throughout the organisation.

[Source: Speech at the FCA Conference on Governance in Banking, James Proudman: Managing machines: the governance of artificial intelligence]

Agility/adaptability is key? KPMG's global CEO outlook survey has found among other things, that there has been an overall shift in towards companies electing to actively 'disrupt' their own sector rather than waiting to be disrupted

Report Overview | KPMG 2019 Global CEO Outlook: Agile or irrelevant

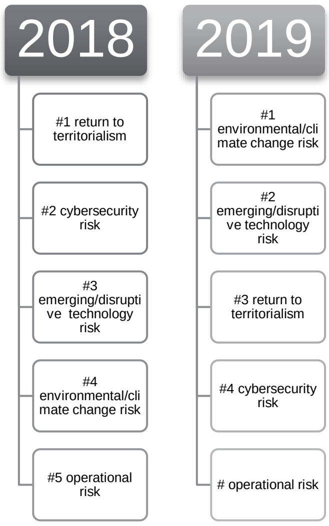
KPMG has released its fifth annual survey into CEO perspectives on managing risks and opportunities facing their organisations.

Agility is the new business currency? KPMG identifies the change in the way CEOs perceive 'agility' — the need to adapt quickly and continually to a changing business environment or risk irrelevancy — and the value placed on it by CEOs, as a key finding to emerge from the survey.

Some Key Points

Confidence in the global economy is declining: Though 94% of respondents said that they are confident in their own business' growth prospects, only 62% said they have similar confidence in the global economy. In four major economics — Australia, the UK, France and China — less than half of CEOs are confident in growth prospects for the global economy.

- **Top three threats to business growth?** In 2019, the top risk to growth was identified as environmental/climate change risk (up from a ranking of 4 in 2018). Emerging/disruptive technology risk ranked 2 (up from a ranking of 3 in 2018) and return to territorialism ranked 3 (which ranked 1 in 2018). Cybersecurity slipped from a ranking of 2 in 2018 to 4 in 2019.



- **Shift in approach to risk:** In the past, KPMG comments, organisations tended to look to defend their positions and use scale to maintain their competitive advantage. The survey found that there has been an overall trend away from this approach across sectors, towards companies electing to actively 'disrupt' their own sector rather than waiting to be disrupted. Overall, 63% of CEOs indicated that they are actively looking to 'disrupt' (an increase from 54% in 2018). This trend was found to be most marked in the technology sector where 69% of CEOs said that this was the case, but was also evident across other industries for example in the banking sector 59%, insurance sector 62% and telecommunications sector 59%.

- **CEOs perceive they have less time make an impact:** CEOs perceive that the average CEO tenure period has shortened — 74% agreed that it is now shorter than when they began their careers, around 5 years. 67% of CEOs said that the shorter average CEO tenure meant there is more urgency to make decisions.

- **'Agility' emerged as a key focus for CEOs:** KPMG found that CEOs are increasingly focused on adaptability/agility with 67% of CEOs identifying being too slow to adapt/ability for organisations to act with agility as 'the new currency of business' (up from 59% in 2018). KPMG found that this desire for agility — to transform business models quickly — is driving an uptick in M&A appetite with 84% of organisations indicating they have moderate/high M&A appetite over the next three years (based on their desire to transform quickly).

Practical impacts?

- **Focus on upskilling the workforce/C-suite**: 84% of CEOs indicated that they are actively transforming their leadership team to build resilience by incorporating new skills and expertise eg digital expertise. In addition, 56% of CEOs indicated that they planned to upskill their workforce overall in new digital capabilities. However, the majority of capital investment was found to be going into buying new technology (68%) rather than into workforce training/development (32%).

- **Cybersecurity**

  - **Cybersecurity is viewed as a strategic function:** 71% of CEOs said that their organisation seeks information security as a strategic function and a source of competitive advantage. 69% of CEOs view cybersecurity strategy as critical to driving trust with key stakeholders (an increase of 14% on 2018)

  - **Risk preparedness?** 68% of CEOs overall, said that their organisation is prepared to face a future cyber-attack (up from 51% in 2018). Public companies rated themselves as more prepared (72%) than private companies (62%).

[Sources: KPMG Global Outlook 2019: Agile or irrelevant; [registration required] The Australian 05/06/2019]

Unprepared? Two thirds of financial professionals are insufficiently prepared for a future cyber-attack according to Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand (CA ANZ) have released a statement presenting the results of a global survey of more than 1500 financial professionals conducted in conjunction with the Association of Chartered Certified Accountants, Macquarie University and Optus, which found that two thirds of businesses are insufficiently prepared for a cyber-attack despite the scale of the risk. According to the statement, cybersecurity is one of biggest risks to businesses to date with estimated costs to reach $6 trillion globally by 2021.

Some Key Findings

- Cyber security is not managed as a business risk and is too often left to IT specialists alone to handle.
- CFOs were responsible for the strategic direction of cyber security in only 8% of organisations.
- 83% of respondents have no cyber insurance in place.
- 41% of respondents said that they had governance policies but that they could be improved.
- One third of survey respondents did not know whether their organisation has been the subject of a cyber-attack.
- Financial services sector respondents rated their cyber risk as greater than other industry groups, with 68% placing the risk as very high or high.

CA ANZ Thought Leadership & Research Leader Geraldine Magarey commented that business and finance professions need to recognise that cyber-risk is 'very relevant to them' and that the costs which can be measured in reputational damage, fines and the impact on shareholder and company value can be high. She added 'The quantification of cyber risk is not easy, but this is an area where financial professionals must take the lead given cyber-attacks are a constant and success almost a given.'

The survey was conducted in conjunction with the Association of Chartered Certified Accountants, Macquarie University and Optus, with more than 1500 financial professionals from around the world.

[Source: [accessed via LexisNexis Capital Monitor — registration required] Chartered Accountants Australia New Zealand media release 04/06/2019]

How leaders around the world build trust with international colleagues across cultures: Harvard Business Review identifies three things top executives do to build trust across cultures

HBR has released a summary of the findings of research into how leaders can build trust with international colleagues across cultures. Building trust may require, the researchers suggest, that leaders adapt their leadership style to take account of the trust culture of a particular individual or team.

Some Key Points

Based on focus group interviews with 400 managers and executives in America, Asia, Latin America, and the Middle East, the researchers found there were three things executives could do to build trusting relationships.

- **'Start with the right mindset':** Executives successful in building trusting relationships across diverse cultures took time to understand their own 'trust culture' — whether it was more or less trusting — and appreciated that the process of trust building could be slower/quicker according to the 'trust culture' of those they are engaging with. This is important, the researchers observed because people from highly trusting cultures working in low-trust environments may have a tendency to become frustrated by the time it takes to build trust with employees. For those who are less naturally trusting or who come from cultures that are warier, their style, though familiar to colleagues who have backgrounds of similar levels of trust, could be alienating/challenging when attempting to connect with more trusting colleagues.
- **Learn about their colleagues' backgrounds**: Executives most successful in building trust with international colleagues spent time learning about their employees' cultures. In particular, they took time

to understand how trusting their culture is; how performance oriented it is; and to observe how people in that culture build trust themselves.

- **Understand the importance of results and character in building trust**: The researchers observe that generally cultures place emphasis on either the achievement of results or character in building trust. For example, in US workplaces trust is generally based on the achievement of results. In this situation, successful managers emphasise the idea of interdependence and spelled out, how the team was more likely to achieve group goals when they pulled together in the same direction. By contrast in the Middle East, character is generally more important eg having a family member or trusted person vouch for the integrity (regardless of the expertise) of an individual 'goes a long way in building automatic trust'. Where character is more important than results, managers earned trust by showing their commitment through their willingness to make financial, personal and emotional investments for the well-being of the individual/group. For example: by making small promises and delivering on them, preferably soon after they were made or finding commonalities/shared experiences and taking actions that showed that they trusted their employees.

[Source: Harvard Business Review 27/05/2019]

Other News

Top Story | MinterEllison's Australian renewable energy investment trends and outlook report

From January to February 2019, MinterEllison commissioned Acuris Studios, the publishing division of Acuris, to canvas the opinions of 100 renewable energy investors to gauge their opinions on the investment opportunities, trends and challenges in Australia.

The report looks at current and future investment levels, foreign investment trends and expectations, and examines barriers to investment in Australian renewables (like high valuations, tech disruptions, and political and regulatory challenges).

The full text of the report can be accessed on the MinterEllison website here: https://www.minterellison.com/articles/australian-renewable-energy-sector-investment-outlook

Some Key Findings

- 68% of respondents said they will increase investments in the year ahead. A further 22% said they will at least maintain current investment levels – and none are planning to decrease their spending
- Political and regulatory stability is Australia's top advantage, according to 81% of respondents, followed by climate and topography (78%) and legal certainty (74%)
- 93% of respondents say Australian government policies toward renewables will be supportive in the year ahead
- The US, China and Germany will be the most active inbound investors from their respective sub-regions
- Top opportunity sectors include energy storage (86%), thermal solar (82%) and biomass/biogas/waste-2-energy (80%)