Governance News

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Contents

Boards and Directors

The best way to lift governance standards? An expert panel suggests (among other things) introducing 50% board gender quotas and annual director elections

The AFR outlines some of the key points raised by members of an expert panel, (at the Wesley College Foundation's annual business breakfast) on the question of how best to improve the quality of boards and governance standards.

- Co-founder of private equity firm BGH Ben Gray reportedly suggested that the best way to improve the quality of boards is to:
    - **Impose 50:50 board gender quotas**

[Note: Among the broader policy response the Australian Council of Superannuation Investors (ACSI) has put forward in response to the Financial Services Royal Commission is a proposal that all listed entities should be required to set a time frame within which they will achieve board gender balance (40:40:20) and that if this is not achieved by 2025, regulatory intervention should occur. See: Governance News 08/05/2019. Separately, the Australian Institute of Company Directors supports a 30% female board representation target. See: AICD media release 30/01/2019]

- **Require 50% of board members to have 'real executive experience**, and particularly in the sector of the company they are actually on the board of' eg CEO experience
- **Consider annual board elections** (as are required in the UK). The AFR comments that this suggestion is 'gathering momentum in director circles' noting that the Australian Council of Superannuation Investors supports the move.

[Note: As part of its broader response to the Financial Services Royal Commission, ACSI has proposed (among other things) the introduction of annual director elections. AICD position. See: Governance News 01/05/2019]

- **Consider imposing new rules that to prevent a company Chair serving with fellow directors on the board of a separate entity**

- **Director (and immediate past president of the Australian Institute of Company Directors (AICD)) Elizabeth Proust reportedly emphasised the importance of financial literacy for directors**, adding that there is a 'huge pool of people who aspire to be directors and probably shouldn't be'. Ms Proust reportedly agreed that executive experience is a potential source of director candidates but said that financial skills are paramount. 'The C-suite is certainly one group of potential directors, but a level of financial literacy is required for all directors and there's still a small but significant percentage that don't have the financial skills to be a director' she is quoted as stating.
- **Australian Securities and Investments Commission (ASIC) Chair James Shipton is quoted as suggesting that standards could be improved by: a) increased focus on non-financial risk; and b) embracing 'professionalism'** which he said has two parts, competence and conscientiousness. 'If you can combine competence and conscientiousness in everything that you do as a corporate leader, and live that, and make that the culture of your organisation, then I think we've gone a long way to addressing a lot of the issues faster than we have to date' Mr Shipton reportedly said.

[Source: [registration required] The AFR 28/05/2019]

United States | Workers on US boards? The Washington Post reports that US Presidential candidate Bernie Sanders has outlined two measures to give US workers a greater ownership stake in companies

The Washington Post reports that US Presidential candidate Bernie Sanders has outlined two measures to give US workers a greater ownership stake in the companies they work for. The measures are as follows:

1. Introduction of a requirement for large companies to regularly contribute a portion of their stocks to a fund controlled by employees, which would pay out a regular dividend to the workers. According to the Washington Post the exact model for this is yet to be finalised. Among the options being

considered is a model that would increase employees' ownership stake in the company over time (making workers a powerful voting shareholder group).

2. Introduce a requirement for workers to be represented on company boards. The article comments that Senator Elizabeth Warren (also a Presidential candidate) has previously proposed a similar measures.

[Note: The revised UK Corporate Governance Code 2018 was released, following consultation in July 2018 (see: Governance News 15/12/2017; 23/07/2018). It applies to accounting periods beginning on or after 1 January 2019. Provision 5 of the Code outlines three possible options for companies to adopt to give the 'workforce' a voice: 'For engagement with the workforce one or a combination of the following methods should be used: a director appointed from the workforce; a formal workforce advisory panel; a designated non-executive director. If the board has not chosen one or more of these methods, it should explain what alternative arrangements are in place and why it considers that they are effective'. See: UK Corporate Governance Code 2018. Separately, a The UK Local Authority Pension Fund Forum (LAPFF) has conducted research showing that most UK issuers will not opt to appoint employees to boards, preferring instead to appoint a NED to represent worker interests. See: Governance News 08/05/2019.]

The Washington Post comments that neither of the measures is likely to be supported by the business community.

Separately, Mr Sanders reportedly reintroduced into the senate a number of measures (all of which are reportedly opposed by the republican controlled senate) designed to increase the percentage of the US workforce in 'employee owned' ownership models. These include: a) a $500 million bank to finance company transitions to worker cooperatives; b) new legal requirements that owners give their workers an opportunity to purchase firms that are closing; and c) federal funding to create centres in all 50 states that would encourage employee-owned businesses.

[Source: The Washington Post 28/05/2019]

Related News: Walmart shareholders have reportedly enlisted Mr Sanders to attend the upcoming shareholder meeting and present a proposal (filed by a Walmart employee and shareholder) seeking to add an hourly employee to Walmart's board of directors.

[Source: Arkansas Democrat Gazette 03/06/2019]

United Kingdom | ICSA is consulting on proposed changes to strengthen independent board evaluation

At the request of the UK Department of Business, Energy and Industrial Strategy (BEIS) (in its response to Carillion collapse), the UK Governance Institute (ICSA) has opened a consultation into the effectiveness of independent board evaluation in the UK listed sector. The review will: a) assess the quality of evaluations; b) assess the effectiveness (or not) of existing measures; and c) identify ways in which board evaluation might be improved, including (among other proposals) the potential development of a code of practice for external board evaluation.

In particular, ICSA seeks views on whether there is a need for:

1. a code of practice for the providers of board evaluation services, and formal arrangements for implementing and monitoring such a code;
2. voluntary principles to be applied by listed companies when engaging external reviewers to undertake board evaluations; and
3. guidance for listed companies on disclosure of the conduct and outcomes of their board evaluation, in accordance with the 2018 UK Corporate Governance Code.

The consultation document includes draft versions of a code of practice for independent reviewers and voluntary principles and guidance on disclosure for listed companies.

ICA emphasises that 'no decision has yet been taken on' whether the proposals should be introduced, but welcomes comments on the drafts.

Timeline: Submissions are due by 5 July 2019

Next Steps: After analysing the responses to the consultation and consulting fully with the Steering Group, ICSA will publish a report containing ICSA's recommendations and revised versions of the draft codes and guidance appended to this consultation paper (if it is concluded they are needed). The report will be formally submitted to BEIS, and it will be for the Department to consider whether, and how, to act on the recommendations.

[Sources: ICSA media release 29/05/2019; ICSA consultation document: Review of the effectiveness of independent board evaluation in the UK listed sector]

Diversity

Heidrick & Struggles predicts that based on current trends, gender parity on US Fortune 500 boards will be reached by 2023

Report Overview | Heidrick & Struggles Board Monitor 2019

Heidrick & Struggles have released their tenth annual report tracking trends in non-executive director (NED) appointments to US Fortune 500 boards.

Some Key Points

- **Record number of seats were newly created/vacated last year:** US Fortune 500 companies filled a record 462 vacant or newly created board seats with independent directors in 2018 (up from 358 in 201)
- **On track to reach gender parity by 2023?** 183 women were appointed to US Fortune 500 boards in 2018, (a 34% increase on 2017). Based on this upward trend, it's predicted that companies will reach gender parity among the incoming class of directors by 2023
- **Progress on improving board gender diversity is slow — women account for less than 25% of board seats:** While the number of women board directors on Fortune 500 companies has steadily increased over the past ten years, and the female appointment rate increased slightly in 2018 to 40% (an improvement on 38% in 2017), the total share of seats held by women on these boards in 2018 was still less than 25% (22.5%)
- **Progress on improving racial/ethnic board diversity is static:** Racially and ethnically diverse new board appointments in 2018 remained unchanged from 2017's record high of 23%. African-Americans accounted for 11% of new board seats, which more than doubled over the past decade and equalled the all-time high from 2017
- **Most in-demand skills?** Demand for CEO experience hit an all-time high of 60% in 2018.
  - One third (90 of 276) of those with CEO experience were women
  - 20% with CEO experience were ethnic or racial minorities: 9% African-Americans, 4% Hispanics and 7% Asians and Asian-Americans
- **Consumer experience outpaced financial experience for the first time**: In 2018, newly appointed directors most frequently worked in the consumer sector (23%), surpassing financial services experience (21%), which had led in the previous four years. Consumer boards appointed the largest number of women overall in 2018 (although those appointments still totalled only 38% of all new board seats in the consumer industry, down from 47% in 2017)

[Note: In Australia, a recent joint report by Ernst and Young (EY) and the 30% Club analysing the experience and pathways to appointment to an ASX 200 board has identified senior executive experience, in particular roles with significant profit and loss (P&L) responsibility as the most important and desirable experience for board candidates. Prior 'boardroom experience might help to tip the scales in your direction but only in conjunction with strong executive skills'. See: Governance News 22/05/2019]

Vice Chairman and Co-Managing Partner of the CEO & Board Practice Bonnie Gwin commented that the findings are significant because they show the long term progress of gender, racial and ethnic diversity in the boardroom. 'Companies, now more than ever, are focused on including wide-ranging points of view and experiences by adding greater numbers of women and racially diverse members to their boards…Taken as a whole, these results are encouraging, but there's still much work to be done to reach gender parity by 2023 and to create more diverse boards' she said

In addition, she said that the increased appetite for consumer experience would be an 'interesting trend line to watch'.

[Sources: Heidrick & Struggles media release 29/05/2019; 2019 Board Monitor]

In Brief | The New York Times reports that JPMorgan Chase has settled a lawsuit brought by a father who was allegedly denied full paternity leave on the basis that he was not the primary caregiver. Reportedly, as part of the settlement, JPMorgan has agreed to offer employees leave policies on non-gendered basis

[Source: New York Times 30/05/2019]

In Brief | According to Quartz, of the 10 biggest US companies to have gone public or filed to go public this year, none is led by a woman, and the average number of women on their boards is less than two. Excluding WeWork, which filed its registration confidentially, the average number of women on the list of the highest paid executives disclosed in each company's S-1 filing, is 0.56

[Source: Quartz 28/05/2019]

In Brief | Age diversity in the workplace requires acceptance that age and ability/seniority are not necessarily linked and that mutual respect is needed on both sides for the new dynamic to work writes Bernard Salt

[Source: [registration required] The Australian 01/06/2019]

Remuneration

Top Story | The operation of the two strikes rule: Two strikes and….

The May issue of Listed@ASX features an article entitled *Two strikes and…* which discusses the evolution of the two strikes rule since its introduction in 2011, the impact of the rule on boards/governance and the way it is being utilised by shareholders. The article also discusses the AGM outcomes in 2018 in the wake of the Financial Services Royal Commission.

The full text of the article can be access on the ASX website here

Some Key Points

- **Increasingly being utilised as a mechanism to express dissatisfaction on any issue?** Commenting on the operation of the rule in practice, MinterEllison's head of remuneration governance, Jon Finlay is quoted as saying that 'The two-strikes rule was supposed to be a way of focusing boards on being accountable for executive pay…But it's being used by institutional shareholders to send a message they have issues with performance or strategy – for any reason at all.'
- **Driving increased engagement:** Mr Finlay said that the rule is driving increased engagement. 'Companies that want to improve their remuneration report voting outcomes are engaging with institutional shareholders, especially those who voted against [the remuneration report], discussing the issues and genuinely taking on board constructive feedback. Simple as that'. Mr Finlay added that on the company side, 'the engagement needs to be by appropriate board members and, on the investor side, it should be those who cast the votes. Not those who buy the shares.'

[Note: Mr Finlay's views are consistent with those expressed in MinterEllison's report on trends to emerge over the course of the 2016-2018 AGM seasons. See: Key trends to emerge from the 2016-2018 AGM season 23/01/2019]

[Source: Listed@ASX May 2019 edition: Two Strikes And…]

The Governance Institute's seventh annual board remuneration survey report has found board pay has increased overall (except in the financial sector)

In partnership with McGuirk Consultants, the Governance Institute has released the results of its seventh annual Australian Board Remuneration Survey report.

Some Key Points

- **Trending upwards overall:** One third of all the boards in the survey increased their board remuneration in 2018.
- **Scale of increases?** Overall, across all industries and organisation types, chairs and directors saw average remuneration increase by 3% and 4% respectively. CEO remuneration remained stable (with no change on last year). Remuneration for managing directors decreased by 1% and for company secretaries by 7%.
- **Larger companies?** Average remuneration for ASX 200 chairs declined by 7%, and for directors by 1%
- **Financial Sector (down except for company secretaries)?** Overall, average remuneration for board members, managing directors, and CEOs declined in financial sector organisations. For chairs and directors, average remuneration decreased 11% on 2018, for CEOs it decreased by 21% and for managing directors it decreased by 10%. However, average remuneration for company secretaries increased 24% on 2018 to $205,393.
- **Remuneration consequences are being felt (as a result of the Financial Services Royal Commission):** Megan Motto, CEO, Governance Institute of Australia commented that the results are an indication that 'the effects of the Banking Royal Commission are already being felt by Australia's financial institutions, as shareholders and their boards move to act upon Commissioner Hayne's recommendations'. Ms Motto added that the data is also consistent with the findings of the Governance Institute's latest risk management survey which showed that the financial services industry is extremely concerned about the regulatory effects, brand damage, and liability effects coming out the Hayne Commission. 'The leaders and boards of these organisations are seeing this reflected in their remuneration packages' Ms Motto said.

[Note: The Governance Institute's risk management survey referenced above is covered in a separate post in this issue of Governance News.]

About the survey: The 2019 Australian Board Remunerations Survey is based on remuneration data covering 1,545 boards, and is current to the year ending 30 June 2019. The Governance Institute and McGuirk collected data from 779 online contributors, 377 boards who are ongoing contributors to the survey, and 390 client boards.

[Source: Governance Institute media release 04/06/2019; [registration required] The Australian 04/06/2019; [registration required] The Age 04/06/2019]

In Brief | The UK Directors Remuneration Policy and Directors Remuneration Report Regulations 2019 come into force on 10 June. The regulations partially implement the Shareholder Rights Directive (including in relation to the content of the directors' remuneration policy and the remuneration report)

[Sources: Explanatory Memorandum; Transposition note; The Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019]

Shareholder Activism

Exxon Mobil 2019 AGM result: A shareholder proposal to separate the board chair and CEO roles secured 41% shareholder support

Key Takeouts

- Forty one per cent of Exxon Mobil investors voted in support of a shareholder proposal filed by the Kestrel Foundation, to separate ExxonMobil's board chair from its CEO at the AGM.
- More than 42% of investors backed a proposal making it easier for them to call special meetings

- Neither proposal was supported by the Exxon board

Protest? Climate Action 100+ said that the high level of support the proposal received is a reflection of shareholder dissatisfaction with the Exxon board, following its successful petition to the Securities and Exchange Commission (SEC) to exclude a Climate Action 100+ backed proposal from consideration at the meeting (see: Governance News 29/05/2019). The co-filers of the Climate Action 100+ backed proposal, Church of England and New York State Comptroller Thomas DiNapoli, had publicly declared their support for the proposal to separate the board chair and the CEO and vowed to vote against Exxon's entire board prior to the meeting.

Commenting on the result, the Head of Responsible Investment at the Church of England said, 'This has been a very difficult Annual General Meeting for Exxon and a warning shot to management…The result of Exxon refusing to put our shareholder proposal to the vote is that investors have simply expressed their frustration at Exxon's governance on other ballot items. Today's increased support for the separation of chair and chief executive, in the face of board opposition, is a measure of investors' profound dissatisfaction. We now expect the company immediately to institute the intensive, meaningful engagement on climate strategy with Climate Action 100+ investors that it has delayed for too long.'

New York State Comptroller Thomas DiNapoli expressed a similar view stating, 'Shareholders sent a strong message that they are dissatisfied with Exxon's poor governance, which is preventing the company from adequately addressing climate risk…Exxon would ignore this level of support for an independent board chair at its own risk.'

Out of step with other companies? Senior director of oil and gas at the sustainability nonprofit organization Ceres Andrew Logan said that Exxon's lack of engagement on climate issues is out of step with peer organisations and the protest vote is explicable on that basis. 'While peer companies such as Shell, BP, Equinor and Occidental Petroleum have taken steps to respond to investor concerns on climate, Exxon has done the exact opposite. It's not hard to see why investors would vote for a change in the company's governing body when Exxon's board has refused to meaningfully engage on such a serious issue. Left with few other avenues through which to voice their displeasure and concern, they've sent a very strong — and very public — rebuke to Exxon, not to mention a warning shot to other fossil fuel companies that fail to address climate-related risks' he said.

[Sources: Climate Action 100+ media release 29/05/2019; Exxon Mobil: 2019 proxy voting results 29/05/2019; WorldOil 29/05/2019; [registration required] The Australian 30/05/2019]

Bed Bath and Beyond has reportedly reached a settlement with activist investors pushing for board renewal

The WSJ reports that in a settlement with three activist investors (Legion Partners, Macellum Advisors and Ancora Advisors) pushing for board change, Bed Bath & Beyond Inc has appointed four new independent directors — John Fleming (previously global e-commerce chief executive of Uniqlo Co Ltd); Sue Gove (president of retail consulting firm Excelsior Advisors LLC); Jeffrey Kirwan (former global president and CEO of The Gap Inc's Gap division); and Joshua Schechter (private investor and experienced Chair) — all of whom were a part of the activist group's slate of nominees.

Reportedly, the activists had proposed a slate of ten nominees, but have agreed to withdraw it and vote for the four nominees the company has recommended at the upcoming annual shareholder meetings.

The WSJ notes that with the appointment of the four new directors, 12 of a total of 13 board members have now joined the company over the past two years. Bed Bath & Beyond is also still looking for a permanent CEO after its former CEO resigned earlier this month.

[Source: [registration required] The WSJ 29/05/2019]

In Brief | UK MPs Call for Parliament's Pension Fund to Divest Fossil Fuels? Reportedly, more than 250 UK parliamentarians have called for their pension fund to disclose its carbon intensive investment and to quickly phase out fossil fuel investments including (BP and Royal Dutch Shell Holdings)

[Source: Chief Investment Officer 30/05/2019]

United Kingdom | BlackRock has reportedly cautioned that proposed changes to the UK Stewardship Code (and more particularly, proposed changes to disclosure rules) could deter companies from listing in the UK

BlackRock's submission in response to UK Financial Reporting Council's (FRC's) proposed changes to the UK Stewardship Code, though supportive of the 'general design of the proposed Code', has raised a number of concerns about the way in which some proposed changes are 'currently framed'. Among other things, BlackRock has raised concerns about proposed increased disclosure of stewardship activities.

[Note: For an overview of the proposed changes to the UK stewardship code see: Governance News 13/02/2019.]

- **Context:** BlackRock summarises the proposed increased disclosure requirements as follows. Under the proposed approach, signatories would be expected to: a) publicly disclose both a Policy and Practice Statement; and b) provide an annual Activities and Outcomes Report (which would require signatories to make publicly available not only details of their compliance with their Policy and Practice Statement, but also an evaluation of how well stewardship objectives have been met (and/or enabled client to meet their own objectives) and the outcomes achieved.
- **Increased public reporting would 'erode' the quality of engagement?** BlackRock writes that though it is supportive of the FRC's 'desire to increase transparency of stewardship activities', it already provides considerable information on its stewardship approach/activities and questions whether the proposed increased public reporting requirements will in practice, 'erode' the quality of engagement activities. BlackRock states that it's current 'approach seeks to provide a balanced mix of public and private reporting, reflecting our fundamental belief that keeping the details of our engagements with issuers private between the asset manager and the asset owner builds the trust necessary to support effective dialogue.' BlackRock adds that in its view there is 'a coherent distinction between what can reasonably be made public without undermining the trust on which engagement is based, and what is best kept private between the parties in order to best promote change. Were the Code not to make such a distinction, we would be concerned that the drive to more effective stewardship could be undermined. There is a clear need to encourage practices which support long-term effective dialogue with issuers, and if aspects of a revised Code are perceived as eroding the quality of engagement, this will impact the credibility of the Code'.
- **In practice, the proposed changes may prompt companies not to list in the UK?** BlackRock argues that rather than having the effect of 'raising the bar' across the markets, some market participants may 'opt out entirely…This could include companies considering whether to list in the UK. If such companies believe that, were they to become a public company, any attempts to engage on difficult issues with shareholders will become the next case study in those shareholders' public disclosures, there is a real risk not only that they will be disinclined to have those conversations, but also that they will not put themselves in a position of having to hold the conversations in the first place'.
- **BlackRock's preferred approach?** BlackRock suggests that to 'preserve the benefits associated with a balanced approach' the proposed changes to the Code could be better informed by the reporting requirements under the EU Shareholder Rights Directive II. 'While we are broadly supportive of the FRC's desire with the proposed revisions to the Code that SRD II should form a minimum baseline upon which the revisions would build, the approach taken in SRD II appears to be designed to respect the fact that certain information may be of wider public interest, but that it is appropriate for other information flows to be kept private between the parties directly involved (in this case, the asset manager and the asset owner). We see this as supportive of what we consider to be a fundamental aspect of effective engagement'.

Reuters reports that BlackRock was not alone in raising concerns. Reportedly, Allianz Global Investors and Jupiter Fund Management were also among those warning against imposing 'overly prescriptive rules' which could drive an undesirable focus on short term engagement wins at the expense of longer term efforts that deliver greater shareholder value.

Reuters also comments that based on its own analysis of disclosures from some of the world's biggest asset managers 'just a fraction' of talks on issues such as boardroom diversity or labour conditions are made public.

[Note: As part of its broader policy response to the Financial Services Royal Commission, the Australian Council of Superannuation Investors (ACSI) has called on the incoming government, regulators and investors to commit to strengthen investment stewardship and to mandate the integration of environmental, social and governance (ESG) considerations into investment decision making. ACSI proposes (among other things) that consideration should be given to the appropriate minimum standards and reporting, the regulatory framework and a stewardship code for institutional investors) See: Governance News 08/05/2019].

[Sources: BlackRock submission to the FRC consultation on proposed changes to the UK Stewardship Code 29/05/2019; The Times 29/05/2019; CityAM 29/05/2019; Reuters 28/05/2019]

United Kingdom | Investor engagement on governance issues is not 'always consistent with the high level of public commitment'? The UK Investor Forum has released a report calling for 'significant improvements' to be made to the way in which investors and companies currently engage on governance issues

The UK Investor Forum has released a report into how effectively companies and investors engage on governance issues, including environmental, social and governance (ESG) issues.

Some Key Points

- **The report found that there is a 'disconnect' between the way that companies and investors view engagement on governance issues**
- **Governance issues aren't a priority (for investors) in engagement discussions in practice?**
  - Many companies find it more challenging to have meaningful discussions with investors on governance matters, as compared with discussions on short term results
  - Substantive discussions on longer-term, strategic governance issues tend to be 'crowded out' by the emphasis placed on short term reporting, modelling and checklists for AGM voting
  - The dialogue between investors and companies on governance issues tends to be primarily focussed on 'box-ticking' in relation to a standard set of topics. Though companies are 'generally willing to engage and explain or discuss their governance, their pro-active attempts to do so are often rebuffed, the report found. In addition, where there is engagement, it is often formulaic and checklist based, managed by advisers, without meaningful direct interaction between directors and investors' the report states. As such, investor behaviour was assessed to be not 'always consistent with the high level of public commitment' to governance issues
  - The report suggests that without a clear link to the long-term value creation for the company, its more difficult to have 'meaningful dialogue' on governance issues. 'There is clearly scope for more transparently integrating Governance factors into the valuation' the report states.
- **Proposed changes to improve engagement on governance issues:** Among other things, the report suggests that:
  - investors should make a commitment to a regulator ongoing dialogue on strategic long-term governance issues (outside the AGM)
  - companies should 'provide regular, structured access for investors to key board members, including the Chair and heads of key board committees'
  - investors should be clearer about how they integrate governance factors into their investment decisions and stewardship responsibilities
  - the role of intermediaries involved in governance discussions should be clarified. 'Companies and Investors should own the dialogues'

[Source: UK Investor Forum: The Four Dialogues Summary Report April 2019]

Markets and Exchanges

Commencement deferred: Commencement of changes to ASX Listing Rules deferred until December 2019

In a compliance update released on 30 May, the ASX has announced that it has deferred the implementation date for proposed changes to the ASX Listing Rules (as proposed in ASX's consultation paper: Simplifying, clarifying and enhancing the integrity and efficiency of the ASX Listing Rules) from 1 July 2019 to 1 December 2019.

[Note: For an overview of key proposed changes see: 'Proposed Changes to ASX Listing Rules in July 2019' 30/01/2019]

The ASX states that subject to receipt of the necessary regulatory approvals, it expects to release a consultation response and the final version of the listing rule changes and associated guidance note changes in late September/early October 2019.

ASX plans to conduct a national roadshow about the rule and guidance changes in late October/early November 2019.

[Source: Listed@ASX compliance update no 05/19 30/05/2019]

Corporate Social Responsibility

UN Principles need to be tougher to be meaningful? 45 civil society organisations have called for a rewrite of the Principles for Responsible Banking

In a submission coordinated by BankTrack, forty-five civil society organisations from fourteen countries have called on the United Nations Environment Programme Finance Initiative (UNEP FI) to strengthen the proposed Principles for Responsible Banking (PRBs).

Context: The PRBs were first announced in Paris in November 2018 and are to be formally launched on September 22nd at the United Nations General Assembly in New York. Over 100 banks are expected to have adopted the Principles by the launch in September.

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

Proposed Changes

The group proposes a range of changes including the following.

- **Require an upfront commitment:** Under the proposed framework, entry into the PRBs only requires that bank CEOs issue a public statement endorsing and signing their bank onto the initiative. Depending on their self-categorisation as a starter, intermediate or advanced bank, the bank may then take up to four years to deliver on their self-defined goals. The group argues that a better approach would be to make becoming a 'PRB bank' contingent on an entity publicly committing upfront 'concrete, ambitious and time-bound commitments' to targets in line with the Paris Climate Agreement, Sustainable Development Goals, the UN Guiding Principles on Business and Human Rights and other relevant frameworks. Only if assessed by the by UNEP FI to be eligible would the entity be admitted.
- **UNEP F1 to assess eligibility (as opposed to self-assessment):** The proposed assessment process would also require that UNEP FI establish 'firm baselines' that all banks will be required to meet for eligibility for admission, rather than relying on signatories self-assessing. The group suggests that the assessment should include 'baselines' around key issues including (among others): divestment from fossil fuel projects, 'respecting livelihoods and community interests when considering finance for business activities' and Indigenous rights.

Director of BankTrack Johan Frijns said that the proposed changes are necessary in light of the 'outright emergency situation' facing society (eg widespread poverty, issues caused by climate change). 'In such an outright emergency situation we expect a bank initiative that meets these challenges head on, not something that allows banks to spend years pondering their next steps without making concrete commitment upfront, all the while publicly posing as UNEP-certified responsible bank. Without fundamental changes in the adoption process the very credibility of the PRBs is at risk right from the start'.

The group urge that the PRBs are strengthened in line with the proposal ahead of their planned launch in September.

[Source: BankTrack 29/05/2019; Joint Civil Society Submission: Draft Principles for Responsible Banking]

Financial Services

Top Story | 'APRA has provided the platform and handed over the microphone; actuaries need to turn it on and speak up' says APRA Deputy Chair John Lonsdale

Overview | APRA deputy chair John Lonsdale's speech to 2019 Actuaries Summit, The story behind the numbers: Combatting the high cost of non-financial risks

In his speech to the 2019 Actuaries Summit, Australian Prudential Regulation Authority (APRA) Deputy Chair, John Lonsdale spoke on the importance of the role of actuaries in holding boards to account and the 'crucial' role actuaries play in identifying and calling out non-financial risk. Referencing APRA's new cross industry standard (CPS 320 Actuarial and Related Matters) which will come into effect on 1 July 2019, he said, 'APRA has provided the platform and handed over the microphone; actuaries need to turn it on and speak up'.

Key Takeouts

- **APRA considers that there is a need to improve management of non-financial risk across the financial sector and the regulator considers that actuaries have a key role to play.**
- **Actuaries need to expand their focus to include non-financial risk (and be prepared to speak up).** 'To be truly effective, actuaries must be prepared to probe, test and challenge boards and management about the wisdom of their decisions, and potential risks they may not have fully considered. Vitally, actuaries need the ability to do this beyond the realm of traditional financial risks. We want them to broaden their thinking about what constitutes a financial risk into areas such as culture, governance, remuneration and consumer outcomes. This applies not only to Appointed Actuaries, but all actuaries, and across all APRA-regulated industries'.
- **Companies need to be prepared to listen**: 'Where actuaries need the courage to speak up, the companies they work for need the wisdom to listen, and the foresight to act when new risks are presented. The numbers always tell a story, and it is far safer – and less costly – if it is uncovered by an Appointed Actuary than an investigative journalist or a regulator with an enhanced appetite for enforcement' Mr Lonsdale said.

Introduction

In his speech to the 2019 Actuaries Summit, Australian Prudential Regulation Authority (APRA) Deputy Chair, John Lonsdale spoke on the importance of the role of actuaries in holding boards to account and the 'crucial' role actuaries play in identifying and calling out non-financial risk.

A high level overview of some of the key points Mr Lonsdale made is below.

- **Overall, there is a need to improve management of non-financial risk across the financial sector (and a need for actuaries to be more vocal):** Citing the themes to emerge from APRA's analysis of the self-assessments recently completed by 36 financial institutions in response to the findings of the CBA prudential inquiry, Mr Lonsdale said that that there is 'clear evidence that risk management remains weak in financial institutions' and that it is 'is apparent that boards and senior managers need a stronger, louder and more insistent voice on their shoulder urging them to think again. Someone senior and trusted. Someone independent. Someone with expertise in identifying and assessing risks'.
- **Actuaries need to expand their focus to include non-financial risk:** Given the current risk environment, Mr Lonsdale said that role of actuaries takes on heightened importance. He emphasised that APRA's expectation is that actuaries not confine themselves to financial risk: 'My message today is that this influence cannot be confined to traditional financial risks, given the substantial damage to prudential soundness that can arise from the poor management of non-financial risks. Actuaries must learn to find the story behind the raw numbers – and then have the courage to speak up – if they are truly to fulfil their role of assisting with the sound and prudent management of an insurer, and ensuring the protection of policyholder interests is adequately considered'.

- **Financial risk is no less important:** Mr Lonsdale said that in calling on actuaries to broaden their focus, he is not implying that the focus on financial risk is any less important. He acknowledged that the financial environment remains 'challenging', especially in the insurance space. However, he said that the issues that have caused 'industry the most grief over recent years stem from the failure to identify and mitigate against non-financial risks' and the failure to do so in a timely way. For example, 'too often the misconduct or poor industry practices highlighted by the Royal Commission [Hayne Commission] were well-known, yet companies had failed to address them' often at later significant financial cost eg the cost of remediating customers. As such he suggested that non-financial risk is misnamed as, if 'left unaddressed, the consequences [of failing to address non-financial risk] become distinctly financial in nature'.

- **APRA is not asking actuaries to 'go beyond their training and expertise':** Mr Lonsdale rejected the idea that the regulator is asking actuaries to go beyond their training and expertise. He said 'APRA doesn't expect actuaries to be running their eye over marketing campaigns, signing off on board appointments or conducting staff surveys seeking signs of a poor culture. We understand that actuaries are focused on numbers, but numbers can tell a story beyond simply profit or loss'. To illustrate, he gave as an example 'If your life insurer is taking an average of eight months to pay death cover claims, or accepting only one in four total and permanent disability claims, does that raise alarm bells for you?'. He went on to say that APRA does not expect 'actuaries to always know what the precise story behind the numbers is, but we do believe they need the nous to recognise there may be a problem, and the courage to push boards and senior executives to examine and address it'.

- **Not new?** Mr Lonsdale said that the need to manage non-financial risk is not new, but that the environment has changed and the 'consequences of failing to properly identify, assess and mitigate risks, especially non-financial risks, are higher and potentially more expensive than they have been for many years'. More particularly, he said the following factors have contributed to the changed risk environment.

  - **Technology and the proliferation of online news/social media** has meant that the speed with which non-financial risks can 'undermine the prudential soundness of a business' had 'perhaps never been greater. 'Society's tolerance for egregious practices is much lower than it once was, while society's ability to see and to call out unacceptable practices, and to highlight poor outcomes, is much more powerful. With financial sector trust damaged, it only takes one media exposé or social media outcry to cause a company serious financial damage, often in the space of days or hours, rather than weeks or months'.

  - **Regulators (including APRA) have a lower tolerance for misconduct** or poor risk management, and a higher appetite for exercising their formal enforcement actions.

  - **Entities must also contend with the Banking Executive Accountability Regime (BEAR),** which applies to all authorised deposit-taking institutions from 1 July, and will soon be expanded to cover insurance and superannuation. 'Not only does this regime make boards and executives (including – potentially – senior actuaries) more accountable for their individual performance, companies themselves face penalties for failing to meet their obligations under the BEAR, or whatever threatening-sounding acronym is created for the insurance and super sectors'.

  In such a high risk environment, 'the role of the Appointed Actuary becomes more crucial to protect both the interests of the institution and its customers' he said.

- **The new cross industry standard is intended to strengthen actuaries influence within insurers:** Mr Lonsdale said that APRA's new cross-industry standard, CPS 320 Actuarial and Related Matters, comes into effect on 1 July 2019. He explained that APRA's purpose in introducing the standard is to strengthen the influence of the Appointed Actuary in general, life and private health insurers, especially on 'the most material matters' (including non-financial risk).

- **APRA's expectation of actuaries?** Actuaries need to be prepared to speak up: 'APRA has provided the platform and handed over the microphone; actuaries need to turn it on and speak up' Mr Lonsdale said. 'To be truly effective, actuaries must be prepared to probe, test and challenge boards and management about the wisdom of their decisions, and potential risks they may not have fully considered. Vitally, actuaries need the ability to do this beyond the realm of traditional financial risks. We want them to broaden their thinking about what constitutes a financial risk into areas such as culture, governance, remuneration and consumer outcomes. This applies not only to Appointed Actuaries, but all actuaries, and across all APRA-regulated industries'.

- **APRA's expectation of companies?** Companies need to be prepared to listen: 'Where actuaries need the courage to speak up, the companies they work for need the wisdom to listen, and the foresight to act when new risks are presented. The numbers always tell a story, and it is far safer – and less costly – if it is uncovered by an Appointed Actuary than an investigative journalist or a regulator with an enhanced appetite for enforcement' Mr Lonsdale said.

[Sources: APRA Deputy Chair, John Lonsdale, speech to the 2019 Actuaries Summit 03/06/2019; [registration required] The Australian 04/06/2019]

PHIs cannot continue to take a passive approach: APRA has directed PHIs to take steps to implement 'robust strategies' to improve their resilience to sustainability challenges facing their sector or expect more assertive action from APRA

Following the completion of a review by the Australian Prudential Regulation Authority (APRA) into the resilience of private health insurers (PHIs) with respect to managing a range of sustainability risks facing the sector (eg declining affordability, a shrinking and ageing membership base and changes in government policy), APRA has written to PHIs directing them to take a more proactive approach.

APRA Executive Board Member Geoff Summerhayes said 'Despite APRA's work with industry to improve governance and risk management capability over recent years, it is frustrating to see little evidence that insurers are taking actions that reflect their own assessment of the heightened risks in this challenging environment...APRA recognises the industry has been under duress for some time, and the main factors, such as rising demand for health services and the soaring cost of treatments, are beyond insurers' direct control. But that's not an excuse for doing nothing and hoping the Government will fix everything'.

APRA has called on PHIs to:

1. 'swiftly develop robust, actionable strategies to address sustainability risks'
2. develop a recovery plan that outlines 'how they will respond if their strategy is not successful or other material risks threaten their solvency'

Mr Summerhayes added: 'Our message to private health insurers is simple: they must step-up and implement robust strategies to deal with these challenges. Insurers that continue to take a passive approach can expect more assertive action from APRA via entity-specific supervisory action.'

[Sources: APRA media release 03/06/2019; Letter to PHIs: Financial Sustainability challenges in private health insurance 03/06/2019; [registration required] The Australian 04/06/2019]

ASIC Commissioner Cathie Armour has identified enhanced supervision, the crypto-asset market, and market 'cleanliness' as some of the specific areas of focus of the regulator in the wake of the Financial Services Royal Commission

In a speech at the Australian Regulatory Summit, Australian Securities and Investments (ASIC) Commissioner Cathie Armour outlined some 'specific topics at the forefront of our minds in market regulation' in the aftermath of the Financial Services Royal Commission.

ASIC's approach to surveillance and enforcement

- **ASIC's expectation of professionalism and fairness:** Ms Armour said that in the wake of the Financial Services Royal Commission, the regulator has been emphasising the need for professionalism and fairness in Australian markets. 'These imperatives need to be prioritised for there to be meaningful cultural change in the industry. And remember – as Commissioner Hayne emphasised – meaningful change is the ultimate responsibility of financial institutions' she said.
- **'Fairness' at the heart of community standards and expectations about dealing with customers:** She added that, consistent with Commissioner Hayne's comments that fairness 'may lie at , or at least close to, the heart of community standards and expectations about dealings with customers', 'ASIC's focus is on making Australia's financial system a fair, strong and efficient one for all Australians. We apply this lens to our work; we expect the firms we regulate to also do this.'
- **ASIC's new enforcement approach:** Speaking briefly on ASIC's new enforcement approach, Ms Armour reiterated that ASIC's new 'why not litigate?' approach does not mean 'litigate first' or 'litigate everything'. Rather, Ms Armour said 'It does mean that where ASIC is satisfied breaches of the law are more likely

than not; and the facts of the matter show pursuing it would be in the public interest then we will actively ask ourselves: 'Why not litigate this matter?'

[Note: ASIC Chair James Shipton made a number of similar points with respect to 'fairness' and ASIC's enforcement approach in his comments at the ASIC Annual Forum, calling on firms to embrace the 'fairness imperative'. See: Governance News 22/05/2019]

Specific areas of focus

- **Enhanced supervision: CCM program and review of corporate governance practices:** Ms Armour said that there are two elements to ASIC's new supervisory program: 1) The Close and Continuous Monitoring (CCM program) which commenced last October (ie the in-depth supervision of the big four banks and AMP); and 2) ASIC's review of governance practices.

  - **Update on ASIC's CCM program:** Ms Armour said that to date: ASIC has conducted over 250 onsite interviews with banking staff at all levels; ASIC staff have been onsite for more than a total of 95 days since the program was launched; and feedback is being provided to CEOs and other business leaders on concerns ASIC is identifying in their management reporting and control systems. In addition, Ms Armour said that ASIC has introduced a more tailored enhanced supervisory approach for 'high risk or complex market intermediaries'. She said that these reviews are more intensive than previous reviews. One of the first reviews was a review of practices in the foreign exchange businesses of some firms. Ms Armour said that ASIC plans to provide firms with detailed feedback.

  - **Review of corporate governance practices:** Ms Armour said that ASIC is examining the big four banks and AMP as well as other financial services firms and 'selected ASX 100 entities'. Key areas of focus are the governance processes and practices on the oversight of non-financial risks and issues around variable remuneration to key management. Ms Armour said that ASIC will 'report publicly on the corporate governance program – our aim is to highlight better practices and areas of weaknesses to assist listed firms build rigorous governance models'.

- **Crypto-asset market**: Ms Armour said ASIC has observed a number of 'concerning' examples of offers for crypto assets 'that appear to involve misleading or deceptive conduct, or that are promoted in a way that does not comply with the regulatory framework'. In addition, she said that ASIC continues to identify 'many scams' involving 'imaginary' crypto-assets. In response, she said that ASIC has recently updated Information Sheet 225 on initial coin offerings and crypto-assets to 'clearly prompt businesses' seeking to issue/promote crypto-assets to better understand their obligations under relevant Australian laws. In addition, she said that ASIC is working with/sharing information with other domestic/international regulators as they clarify how crypto-assets are regulated across taxation, anti-money laundering, payment systems and financial services. 'So my message, if you are issuing a crypto-asset or your business is involved with a crypto-asset, is read and apply INFO 225 so you are clearly distinguished from any scams trying to capitalise on speculative hype around crypto-assets. Scams clearly do not reflect the level of fairness we expect for investors'.

[Note: The information sheet referred to is covered in a separate post in this issue of Governance News.]

- **High frequency trading:** Ms Armour said that though high frequency trading (HFT) remains an area of interest to ASIC, the regulator does not consider 'there is reason to be concerned by the HFT we have observed' in Australian markets. ASIC's reviews of high frequency trading, Ms Armour said, 'reinforce the strength of the Australian market structure and the importance of having a varied mix of traders and investors in our markets. At this stage, we think the balance of fairness for investors is appropriate'.

- '**Market cleanliness'**: Ms Armour said that over the period 2016-2019 ASIC has been measuring and monitoring 'market cleanliness' ie the risk of possible information leakage and likely insider trading before material price sensitive announcements. Ms Armour outlined a number of observations from this review, including the following.

  - ASIC considers that the overall cleanliness of the market in the 2016 – 2019 review period was stable.

- ASIC observed that there was more suspicious trading before announcements related to mergers and acquisitions than other types, however the suspicious trading was generally not accompanied by abnormal price action.
- There was more suspicious trading and abnormal price action before unscheduled announcements than scheduled announcements. Ms Armour said that suspicious trading and/or abnormal price action before unscheduled announcements are less likely to be driven by normal speculation than scheduled announcements.
- Announcements by smaller companies are more likely to be unclean. Many of these smaller companies are in the materials sector.
- Ms Armour said that as a result of the findings, ASIC will increase its 'monitoring of brokers with high concentration of anomalous order flow and clients with repeat patterns of anomalous trading. We are determined to ensure our equity market operates fairly'.
- Ms Armour said that a 'key takeaway' from the findings is that those involved in potential M&A activity should put in place robust information security measures as early as possible in the transaction cycle.

- **Over the Counter (OTC) derivatives market:** Ms Armour said that ASIC has conducted reviews, enhanced surveillance and taken enforcement action in this sector and remains concerned about consumer harm resulting from the way these products are offered and structured. Ms Armour noted that ASIC recently warned Australian issuers that they may be dealing with overseas investors illegally and to cease any non-compliant activities immediately. Noting that there could be consequences overseas for potential breaches of overseas laws, Ms Armour cautioned that ASIC would consider 'whether breaching overseas law is consistent with obligations under Australian law to provide services "efficiently, honestly and fairly"'. ASIC is also concerned, Ms Armour said, that some Australian Financial Services (AFS) licensees may be making misleading or deceptive statements about the scope or application or effect of an AFS licence. She said that ASIC intends to continue to be active in the sector.
- **LIBOR:** Ms Armour called on firms to take steps to ensure they are preparing sufficiently for the end of LIBOR. More particularly, Ms Armour suggested that firms assess whether they are: a) aware of the size and nature of your exposure to LIBOR; b) putting in place robust fall-back provisions in contracts referencing LIBOR; and c) taking action to transition to alternative rates. 'I urge you all to assess the extent of your use of LIBOR and to take timely action to plan for a world in which LIBOR is no longer available' she said.

[Source: Speech by ASIC Commissioner Cathie Armour at the Australian Regulatory Summit 2019: Insights on regulatory and market developments in Australia 04/06/2019]

ASIC Market Integrity Report July to December 2018: conduct governance, technology and resilience and effective capital markets are highlighted as ASIC's three areas of continuing focus

Report Overview | Report 619 Market Integrity Report July to December 2018

The Australian Securities and Investments Commission (ASIC) has released its latest report on market integrity for the period 1 July to 31 December 2018. The report looks at ASIC's recent focus on high-frequency trading, changes to reporting requirements, and enhanced supervision and onsite reviews. It also looks at some of the regulator's key activities over the last six months in areas such as Bank Bill Swap Rate (BBSW) surveillance, FX margin practices, and misleading initial coin offerings (ICOs) and crypto-asset funds.

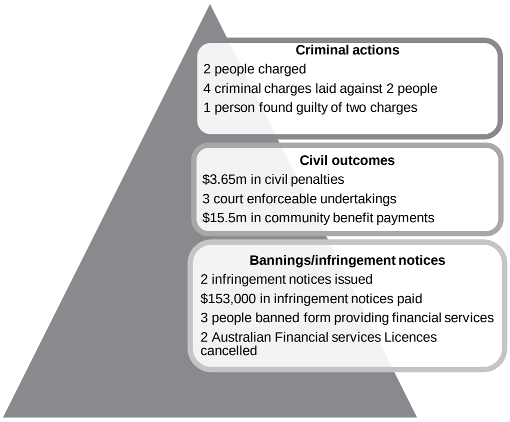
Continuing areas of focus

1. **Conduct governance:** ASIC is enhancing its supervision of the 'highest risk firms' with a greater focus on governance and the systems and controls that prevent poor conduct. ASIC's focus includes fixed income, commodities and currencies, retail over-the-counter (OTC) derivative providers, ICOs and client money
2. **Technology risk and resilience:** ASIC states that it supports the opportunities and economic benefits of innovation in financial markets while managing the risks. It will focus on poor technological controls including for cybersecurity and the use of artificial intelligence.

3. **Effective capital markets:** ASIC is reviewing high frequency trading in FX markets retesting the 'cleanliness' of Australia's markets and continuing to enhance market integrity rules.

[Note: In a speech at the Australian Regulatory Summit, Australian Securities and Investments (ASIC) Commissioner Cathie Armour highlighted market cleanliness as an area of immediate focus for the regulator. Ms Armour's speech is covered in a separate post in this issue of Governance News.]

Some Key Outcomes



ASIC Commissioner Cathie Armour said that 'maintaining the integrity of Australia's financial markets is crucial to a prosperous economy' and that ASIC do this 'setting standards and educating stakeholders, pursuing behavioural change and taking enforcement action to disrupt market misconduct.' The report sets out a number of examples of ASIC's actions over the last 6 months in relation to each of these areas.

- **Standards and education:** ASIC states that it its observations of different behaviours in Australia's markets informs the standards it sets. ASIC highlights a number of examples of recent efforts including among others: the release of reviews into high frequency trading (ASIC report 597), allocation practices in equity raising transactions (Report 605) and proposed reporting changes for several derivative products.

- **Behavioural change:** ASIC writes that achieving behavioural change is an important aspect of its work, noting that by changing behaviour ASIC may be able to avoid future instances of risk conduct and breaches, and prevent investor losses before they occur. Among other things, ASIC highlights its work in reviewing the ASX Group's technology governance and operational risk management arrangements (Report 592), the commencement of onsite reviews into the management of conflicts of interest and confidential information in wholesale FX businesses in Australia and the continuing development of ASIC's supervision and surveillance of the Bank Bill Swap Rate (BBSW) benchmark process among the regulator's areas of focus. In addition, ASIC highlighted its increased engagement with market intermediaries. The report states that ASIC has 'enhanced' its approach to supervising the 'most significant market intermediaries' to gain a better/deeper understanding of their business models, culture and behavioural drivers. Consistent with the regulator's broader shift to close and continuous monitoring of significant financial institutions, in addition to conducting annual compliance liason meetings with market intermediaries, ASIC has increased engagement with them through additional onsite visits, requests to meet with a wider range of people within the business and requests for demonstrations of systems and processes and for books/records. 'This enhanced supervision approach aligns with our broader shift to close and continuous monitoring of significant financial institutions and other initiatives'.

- **Disruption:** ASIC writes that where 'we see poor conduct, we take action' and the report gives a number of examples of this. These include: accepting a court enforceable undertaking from the CBA in relation to their bank bill trading business and their participation in setting the BBSW, commencing a project to verify bank stakeholders are adhering to the FX global Code, acting against misleading ICOs and crypto asset funds and cancelling the AFSL of two retail OTC derivatives providers and disqualifying their former directors from providing financial services for a set period.

[Sources: ASIC media release 31/05/2019; Report 619 Market Integrity Report July to December 2018; Investor Daily 03/06/2019]

Treasury is consulting on proposed financial institutions supervisory levies that will apply for the 2019-20 financial year

Treasury is consulting on proposed financial institutions supervisory levies that will apply for the 2019-20 financial year.

The financial industry levies are set to recover the operational costs of the Australian Prudential Regulation Authority (APRA) and other specific costs incurred by certain Commonwealth agencies and departments, including the Australian Securities and Investments Commission (ASIC), the ATO, and the Australian Competition and Consumer Commission (ACCC).

The total funding required for these agencies is $236m for 2019-20. This is a $22.6m (10.6 %) increase from the 2018-19 requirement.

Submissions are due by 14 June 2019.

'Hayne levy'? The AFR has branded the proposed increased funding for the regulators a 'Hayne levy' noting that the additional funding will be used to fund the regulator's new and more active approach to surveillance and enforcement.

[Sources: Treasury media release 04/06/2019; Discussion paper: Proposed Financial Institutions Supervisory Levies for 2019-2020 June 2019; [registration required] The AFR 04/06/2019]

ASIC has released updated ICO guidance to assist businesses in complying with their obligations under the Corporations Act

The Australian Securities and Investments Commission (ASIC) has released an updated information sheet: *Information Sheet 225 Initial coin offerings and crypto-assets (INFO 225)*. The information sheet has been updated to include information on how the Corporations Act 2001 (Cth) may apply to businesses that are considering raising funds through an Initial Coin Offering (ICO) and to businesses involved with crypto-assets and more particularly, is intended to assist businesses to 'consider their legal obligations and satisfy themselves that they are operating lawfully'.

ASIC says that the updates have been made based on ASIC's recent experiences with ICOs and crypto-assets, which indicate that they will often be financial products or involve financial products that are regulated under the *Corporations Act 2001 (Cth)*. ASIC adds that in an issues paper issued in January Treasury noted that many ICOs have turned out to be scams and comments that businesses seeking to operate 'lawfully and legitimately need to distinguish themselves' from these.

ASIC Commissioner John Price said, 'Businesses offering crypto-assets, or offering services in relation to crypto-assets, need to undertake appropriate inquiries to satisfy themselves they are complying with all relevant Australian laws. As a minimum, regardless of whether a financial product is involved in the fundraising, the prohibitions against misleading or deceptive conduct under Australian Consumer Law apply. Australian laws will also apply even if the ICO or crypto-asset is promoted or sold to Australians from offshore. Issuers of ICOs, crypto-assets and their advisers should not assume the use of these structures means that key consumer protections under Australian laws do not apply or can be ignored'.

[Sources: ASIC media release 30/05/2019; Updated information sheet: Information Sheet 225 Initial coin offerings and crypto-assets]

IOSCO is consulting on the approach regulators should take when regulating the trading of cryptoassets on CTPs

The International Organisation of Securities Commissions (IOSCO) has released a consultation report: *Issues, Risks and Regulatory Considerations Relating to Crypto Asset Trading Platforms*, describing issues and risks associated with the trading of crypto-assets on crypto-asset trading platforms (CTPs). The focus of the report is on the trading of crypto-assets on CTPs once a regulatory authority has determined that it has the legal authority to regulate those assets or the specific activity involving those assets.

In this context, the report identifies a number of key considerations and provides related 'toolkits' (ie examples of measures that can be used by regulatory authorities to address the key considerations) intended to assist regulatory authorities in evaluating CTPs within the context of their regulatory frameworks.

The list of suggested key considerations relate to the following.

- Access to CTPs
- Safeguarding participant assets
- Conflicts of interest
- Operations of CTPs
- Market integrity
- Price discovery
- Technology

IOSCO notes that the key considerations and toolkits put forward in the report are not intended to 'suggest or mandate any particular regulatory action or requirement but rather represent specific areas that IOSCO believes jurisdictions could consider in the context of the regulation of CTPs'.

IOSCO adds that 'many of the issues related to the regulation of CTPs are common to traditional securities trading venues, but may be heightened by how CTPs are operated. Where a regulatory authority has determined that a crypto-asset is a security and falls within its remit, the basic principles or objectives of securities regulation should apply'.

Timeline: Submissions are due by 29 July 2019

[Sources: IOSCO media release 28/05/2019; IOSCO Consultation Report: Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms]

APRA has released updated to frequently asked questions on the implementation of Protecting Your Super legislative amendments

The Australian Prudential Regulation Authority (APRA) has updated its frequently asked questions (FAQs) on the implementation of the *Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019*. The changes will require all Registered Superannuation Entity (RSE) licensees to implement a number of reforms to address account erosion due to excessive fees or unnecessary insurance.

The updates relate to fees charged to superannuation members (section 1 of the FAQs) and insurance for inactive accounts (section 2 of the FAQs).

[Source: APRA media release 03/06/2019]

In Brief | Not a good deal for everyone? The Centre for Independent Studies has issued a policy paper that makes the case for a shift to a voluntary superannuation model. The report argues the current system was not designed to account today's conditions (eg the increase in the prevalence of part time work) and that as such it disadvantages low income workers/millennials, for example by making it harder for them to save a deposit for a home. 'A voluntary system, or at a minimum one that has a far higher threshold for compulsory participation, would give millennials and low income workers greater flexibility in their savings choices' the report argues

[Sources: InvestorDaily 31/05/2019; The ABC 28/05/2019; Centre for Independent Studies media release 28/05/2019; Centre for Independent Studies policy paper: of Independent Studies, Millennials and Super: The Case for Voluntary Superannuation]

Accounting and Audit

PwC has released a 'balanced scorecard' on audit quality including the firms' individual audit results from ASIC's latest audit inspection findings

PwC Australia has released a 'balanced scorecard' on audit quality, including: internal inspection findings restatement rates and adjustments to financial statements, and the firm's individual Australian Securities and Investments Commission (ASIC) audit inspection results.

More particularly, PwC's audit quality balanced scorecard includes the following information.

- **PwC's individual ASIC audit inspection findings**: Based on ASIC's most recent report (for the 18 months ended 30 June 2018, ASIC Report 607 Audit Inspection Program Report for 2017-2018) in 12% of the key audit areas that ASIC reviewed across PwC files, ASIC considered PwC did not obtain reasonable assurance that the financial report was free from material misstatement. PwC notes that this compares to 24% across the whole industry and 20% at the six largest firms in Australia.

- **PwC's global audit inspections**: In the period between 2016-2018, no PwC Australia audits of publicly listed companies were rated as non-compliant with PwC's guidelines and auditing standards. In 2018, global inspections identified that five sample files of smaller, private companies were not compliant with PwC standards. In no instance did this involve an inappropriate opinion being issued, but instead a need for improvement in how the audit work was performed and documented. These findings have formed a key part of our Quality Improvement Plan.
- **Restatements:** In cases where audit findings were identified by ASIC or PwC internal inspections for public companies, between 2016 and 2018, there were no instances where the relevant financial statements needed to be restated to the market. PwC writes this compares to an industry average of 4% (based on ASIC's financial reporting surveillance program of public companies).
- **Adjustments:** Before a company publishes its financial statements, it may make adjustments, or clarify or enhance it disclosures, as a result of an audit. In 2018 PwC identified on average six adjustments to the financial statements of listed companies - and ensured their appropriate treatment - before they were finalised and published.
- **Non-audit services and independence:** The *Corporations Act 2001 (Cth)* prohibits several types of services from being performed for a client by its external auditor and PwC has comprehensive internal policies in place to ensure our independence is not impaired. The level of non-audit work at PwC audit clients in the ASX200 represents, on average, approximately 26% of audit fees over the past three years. This equates to less than 3% of total PwC Australia revenue in 2018.

Greater accountability: PwC supports calls for publication of individual audit inspection results

PwC Assurance Managing Partner, Matt Graham said that there have been increasing calls for ASIC to disclose individual firm's audit inspection results in recent months (rather than just industry averages) and that PwC supports these calls. 'We are proud today to become the first firm in the country to publish a balanced scorecard which not only puts our ASIC audit inspection results on the public record, but also discloses how we're performing against a range of other quality measures' Mr Graham said.

Mr Graham added that PwC is aware that 'by committing to this level of transparency there may be times in the future when the results we publish don't meet' expectations and that ASIC's latest audit report identities areas for improvement for PwC which the firm is taking steps to address. 'Our ultimate goal is that ASIC considers that we have obtained reasonable assurance in all audit areas. We believe greater transparency will drive accountability, lead to better conversations across the market about audit quality and, ultimately, build trust' Mr Graham said.

The AFR quotes Mr Graham as stating that the release of the scorecard is also a question of rebuilding trust 'While it is a little daunting to put our results under the microscope for all to see and pick apart, we know the only way we can build and maintain trust in what we do is by being more transparent'.

The release of the balanced scorecard paints 'a more detailed picture' of audit quality: Mr Graham said that though ASIC's findings are a 'critical component of audit quality, and one we take very seriously' the findings only represent a 'small percentage' of the audits carried out annually. The release of the scorecard is intended, he said, to provide 'a broader overview of what's involved in an audit and how we're performing against the appropriately high expectations set by the market, the regulator, our clients and our firm.'

Time for a broader discussion about the role of audit?

Mr Graham also suggested that the release of the scorecard could 'kickstart a broader discussion in the market on what makes a good quality audit', and how audit could be improved to better serve the interests of investors and the community. For example, whether audit should look beyond historical financial information, and/or include new levels of coverage such as fraud, and/or whether it could provide assurance over non-financial measures in a company's annual report such as culture, controls and cybersecurity.

Should ASIC name firms?

According to The AFR:

- Deloitte has said it would support ASIC releasing more detailed audit quality results (ie naming individual firms), where results fall below 'an acceptable threshold' of audit quality over consecutive years.
- EY reportedly opposes identifying specific firms in the audit quality inspection results.
- Reportedly KPMG is considering its position on naming firms.

[Sources: PwC media release 29/05/2019; Accountants Daily 29/05/2019; [registration required] The AFR 28/05/2019]

Risk Management

Top Story | Australian risk managers consider their organisations to be well prepared (overall) to face key risks facing their organisations in the short and longer term

Report Overview | The Governance Institute of Australia, 2019 Risk Management Survey

The report identifies the key challenges/priorities (as nominated by risk managers/governance leaders) facing Australian businesses in the immediate and longer term. Overall, the report found that Australian risk managers consider their organisations to be well prepared (overall) to manage key risks facing their organisations in the short and longer term.

Key Takeouts

- **Regulatory reform/legislative change was nominated as the key risk facing organisations:** Regardless of industry sector, organisation size or job title, regulatory reform/legislative change was nominated as the top risk facing organisations over the next 12 months and over the next three to five years. In the financial sector, this was particularly pronounced with 57% of respondents ranking it as the key issue facing their organisations.
- **Organisations across all sectors believe their level of preparedness is high:** The survey found that organisations consider that they are well prepared (overall) to 'face down' risk challenges over the next 12 months and 3-5 years. Respondents in the finance sector assessed themselves to be better prepared than the overall average.
- **Organisations believe they are already addressing many of the risks identified at the Financial Services Royal Commission?** The survey found that respondents across all sectors consider that they are well placed to manage the risks associated with damage to brand/reputation and risks associated with staff conduct, and professional liability (issues that were raised at the Financial Services Royal Commission). The Governance Institute concludes from this that organisations believe that are addressing these risks successfully already.

Introduction

The Governance Institute of Australia (GIA) has released its 2019 Risk Management Survey, which identifies the key challenges/priorities (as nominated by risk managers/governance leaders) facing Australian businesses in the immediate and longer term. A high level overview of some of the key findings is below.

- **Top five risks over the next 12 months?** Risk managers and governance leaders across all sectors ranked regulatory reform and legislative changes as the top risks to manage over the next 12 months. Followed by: damage to brand/reputation (2); increased competition (3); talent attraction/retention (4); and cybercrime (5). In the financial sector, regulatory risk was also ranked as the top risk, but cybercrime was ranked at 2, competition at 3, brand/reputation at 4 and disruption at 5.
- **Top five risks to manage over the next three to five years?** Over the longer term, regulatory or legislative change was again identified the key issue across all sectors followed by: disruption/failure to innovate (2); increased competition (3); cybercrime (4); and damage to brand/reputation (5). In the financial sector, the priorities were a little different. After regulatory/legislative change, respondents identified: cybercrime (2); competition (3); disruption (4); and economic shock (5) as the next most important issues.
- **Organisations across all sectors believe their level of preparedness is high:** Asked how effective their organisations are in proactively identifying and managing risks overall, respondents ranked

themselves on average at 6.69/10. This increased to 7.27/10 for regulatory risk (ranked the top risk over the next year/over the next 5 years).

- **Level of (overall) preparedness in the finance sector?** Respondents in the finance sector assessed themselves to be better prepared than the overall average (7.24/10). Consistent with the average across all sectors, they were most confident in their preparedness to manage regulatory risk (7.85/10 vs the average across all industries 7.27/10) and least confident in the preparedness to identify and manage talent risk (6.33/10 vs 5.78/10 across all sectors)

[Note: Among the issues the Australian Prudential Regulation (APRA) flagged in its recent information paper presenting its analysis of self-assessments conducted by 36 financial institutions was whether boards/leadership had been sufficiently self-critical in their assessments. APRA noted that boards/senior leadership teams tended to have generally positive assessments of their own performance, even when they had identified serious weaknesses in their institutions APRA has said that one area of focus in engaging with institutions on the self-assessments will be whether boards and senior leadership have been sufficiently self-critical given the wide range of weaknesses identified. See: Governance News 28/05/2019]

- **Organisations believe they are already addressing many of the risks identified at the Financial Services Royal Commission?** Respondents across all sectors consider that they are well placed to manage the risks associated with damage to brand/reputation (7.07/10). Likewise, they assessed their level of preparedness to manage risks associated with staff conduct, and professional liability (issues that were raised at the Financial Services Royal Commission) similarly highly (7+/10). The Governance Institute concludes from this that organisations believe that are addressing these risks successfully already.

- **Respondents said that they were least well prepared to manage disruption (6.01/10) and talent (5.78/10).** The GIA suggests that this is an indication of the competitive pressures local companies are feeling from multi-nationals (eg Amazon, Apple, Google and Facebook). The GIA also suggests that the findings indicate that though respondents are aware of the risks posed by talent/retention, cyber crime and disruption/failure to innovate in the longer term, they are as yet unsure about how best to address/manage these risks and also that they believe that these issues will continue to be an ongoing concern.

- **Environmental risk?** Overall, environmental risk was ranked third to last in terms of preparedness (6.314/10) which the Governance Institute says is an indication that organisations are aware they are lacking in this area and also that they are less concerned about it (than they are about other risks).

- **Highly valued but under-resourced?** While respondents felt that the risk management function was highly valued by their organisations (70% agreed/strongly agreed), the need for 'better tools and resources' (29%) to manage risk and 'clarity of purpose and strategy' (23%) from senior leadership were identified as key areas of concern

Conclusions?

Governance Institute CEO Megan Motto commented that the survey indicates that there is 'still a lot of confusion and nervousness in the market, especially about reporting requirements, roles, and engaging the newly strengthened regulators', which reflects what has been observed anecdotally in the market. Ms Motto added that there are also a number of 'positives' to emerge from the findings. 'I think it's safe to say that governance and risk professionals have never been so valuable. They are increasingly being relied on at board, and executive level to provide the right data and analysis, strengthening their trusted advisor status'. There is scope, she suggested for further education/training.

About the survey

- The online survey was conducted from 3 April to 3 May 2019 with 499 respondents

- 20% of respondents were drawn from the financial services sector; 17% from healthcare, 15% from education; 11% from professional/technical services and 11% from the public sector

- 38% of respondents were senior governance/risk managers; 21% were CEO/C-suite and 27% lead the risk management team within their organisation

- 39% of organisations surveyed had revenue over $100m, 45% had revenue between $1m-$100m. 31% operate in other countries as well as Australia

[Sources: Governance Institute of Australian media release 31/05/2019; Investor Daily 03/06/2019]

Net Promoter Scores and customer satisfaction levels are reportedly trending upwards for the big four banks following the Financial Services Royal Commission

According to Roy Morgan, satisfaction and net promoter score (NPS) levels of the big four banks declined following the Hayne Royal Commission, but there are signs of improvement over the past two months.

Some Key Points

- In April, satisfaction with the big four reached 75.9%, up by 0.6% points since February and NPS was 0.4, up from minus 1.6. Roy Morgan comments that both measures remain below the pre-Hayne Commission levels, but are showing positive signs of potential recovery.
- Smaller banks (ie banks outside the big four) have higher satisfaction ratings (83.8%) than the big four (75.9%). Roy Morgan suggests that the focus of the Hayne Commission on the big four may have had a bigger impact on their rating which is now down by 3.3% points from prior to the commission, compared to a decline of only 1.1% points for the banks outside of the big four.
- According to Roy Morgan, the CBA has the highest satisfaction among the big four at 78.1%, followed by Westpac (74.7%), ANZ (74.4%) and NAB (72.7%). Among the major smaller banks, Bendigo Bank has the highest rating with 90.1%, followed by ING (89.9%).

[Note: Among the issues APRA flagged in its recent information paper presenting its analysis of self-assessments conducted by 36 financial institutions was over-reliance on 'basic' metrics including reliance on the NPS (in the absence of other data such as customer complaints) as an issue in need of attention see: Governance News 28/05/2019]

[Sources: Roy Morgan media release 27/05/2019; Independent Financial Adviser 30/05/2019]

Westpac's real time payment platform PayID has reportedly been the target of a cyberattack, Westpac has reportedly said that no customer bank account numbers were compromised

The SMH reports that almost 100,000 Australians' private details may have been exposed in an attack on Westpac's real-time payments platform PayID.

Reportedly the system, which allows the instant transfer of money between banks using either a mobile number or email address, could reveal enough information to enable identity fraud.

The SMH reports that Westpac confirmed the incident but did not confirm how many people had been impacted. 'Westpac can confirm we had detected mis-use of the [New Payments Platform's] PayID functionality and we took additional preventative actions which did not include a system shutdown…No customer bank account numbers were compromised as a result' the SMH quotes Westpac as stating.

[Sources: [registration required] The SMH 03/06/2019]

United States | SEC has awarded a whistleblower $4.5m

The US Securities and Exchange Commission (SEC) has awarded more than $4.5 million to a whistleblower whose tip led the company to conduct an internal investigation and subsequently, to the company self-reporting the whistleblower's allegations to the SEC and another government agency. As a result of the self-report by the company, the SEC opened its own investigation into the alleged misconduct.

Chief of the SEC's Office of the Whistleblower Jane Norberg explained: 'In this case, the whistleblower was credited with the results of the company's internal investigation, which were reported to the SEC by the company and led to the Commission's resulting enforcement action and the related action…The whistleblower gets credit for the company's internal investigation because the allegations were reported to the Commission within 120 days of the report to the company."

SEC comments that the this is the first time a whistleblower is being awarded under a provision of the whistleblower rules, which were designed to incentivise internal reporting by whistleblowers who also report to the SEC within 120 days.

SEC does not name either the whistleblower or the company in the announcement (to protect the whistleblowers' anonymity). However, the WSJ suggests that that the allegations concern an alleged kickback scheme operated by a subsidiary medical device maker Zimmer Biomet Holdings Inc. Reportedly Zimmer Biomet settled investigations by the SEC and the US Department of Justice into alleged violations of the US Foreign Corrupt Practices Act in 2017.

[Sources: SEC media release 24/05/2019; FCPA blog 27/05/2019; [registration required] The WSJ 24/05/2019]