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Remuneration

On track for a third year of record CEO pay? The WSJ reports that many S&P 500 CEOs received pay rises in 2018 that lifted their pay to $1m per month

The WSJ reports that:

- median compensation for 132 chief executives of S&P 500 companies reached $12.4 million in 2018, up from $11.7 million for the same group in 2017
- most of these CEOs received substantial raises (the median was 6.4%) despite most companies finished the year posting sluggish shareholder returns)
- Wages have also risen slightly for ordinary workers: average hourly earnings for nonsupervisory workers were up 3.5% in February from a year earlier, but employers added far fewer jobs than expected, according to the latest government data

The WSJ attributes the rise in executive pay to robust corporate profits and strong stock market returns for much of the year and also to concern that a slowdown could be on the horizon. If the pay trends continue for the rest of the companies in the S&P 500 index, 2018 could mark a third straight year for record CEO pay The WSJ suggests.

[Source: [registration required] The WSJ 17/03/2019]

Meetings and Proxy Advisers

Top Story | ISS report on themes to emerge from the Australian 2018 AGM season: The record level of shareholder dissent against remuneration reports and the reasons behind it is the key focus of much of the report

Institutional Shareholder Services (ISS) has released a report identifying the key themes to emerge from the 2018 AGM seasons in Australia (at ASX 300 companies) and New Zealand. With respect to Australia, much of the report is focused on the 'record' level of dissent against remuneration reports and the possible reasons behind it.

Australia: Some key points

Remuneration

- **There was a record 26 'strikes'** (votes of 25% or more against a remuneration report) in the ASX300.
  - ISS comments that the 'standout feature' of the 2018 AGM season was the extent of shareholder dissent against larger companies. In the ASX 100, 16% of companies received either a 'strike' or a 'near miss' (votes between 20-25% against a remuneration report). This group included four of Australia's top ten companies by market capitalisation.
  - The sum of strikes and 'near misses' equated to a record high 39 companies in the ASX300 with a material level of shareholder dissent.
- **What caused it?** ISS attributes the high level of shareholder dissent to a number of causes including the following.
  - **misalignment of executive remuneration with financial results and/or governance failures**
  - **inadequate disclosure** by companies which made it difficult for shareholders to understand what the bonuses represented, combined with excessive remuneration increases
  - **concerns over the structure of 'combined incentive plans'** ie plans that 'amalgamated short term and long term incentive plans'. ISS attributes the high levels of shareholder dissent to the lack of long term performance hurdles in many plans which ISS suggests may have given rise to

concerns that equity bonuses would be given without first being earned through achievement of performance hurdles aligned with shareholder interests.

- **sign of increased pressure on boards to be accountable for governance issues** (eg issues identified by the Financial Services Royal Commission).

- **Second strikes:** Four companies in the ASX300 received second 'strikes'. ISS asserts that spill resolutions at two companies appear to have been driven by a single activist shareholder in each case respectively and that this contributed to the elevated' levels of support for the resolutions in each case.
- **Votes against director election — shareholders appear to be increasingly willing to hold directors accountable for governance failures?** There were 700 management proposals in the ASX300 to elect or re-elect directors in 2018. ISS observed an increase in the number of directors incurring a high percentage of votes against their election with shareholders increasingly willing, ISS suggests, to hold directors accountable for governance failures. In addition, ISS suggests that some shareholders appear willing to vote against directors based on their performance or governance failures at other organisation(s) where that director may have held an executive/non-executive director position.
- **Shareholder pressure leading to change outside the meeting process?** The report suggests that there is evidence that pressure from shareholders is impacting boards (outside of the meeting process). For example: there were a number of instances in which director nominations seeking reelection were withdrawn ahead of the AGM, there were a number of resignations of high profile chairs and directors, and a number of directors undertook to step down from boards at the end of the year/end of their term and/or retire.

The number of resolutions is consistent with previous years

- **1,899 resolutions were put to shareholders at ASX300 companies** (which is consistent with 1,833 resolutions in Fiscal 2017 and 1,867 resolutions in Fiscal 2016). ISS recommended voting against management in approximately 11% of cases.

[Source: [registration required] ISS 2018 AU NZ Proxy Season Review]

United States | As You Sow Proxy Preview 2019 released: Climate change remains a key concern for investors

As You Sow has released its annual proxy preview: *Proxy Preview 2019*, which examines environmental, social and sustainable governance (ESG) resolutions filed at US companies this year.

Some of the report's key findings include the following.

- **386 ESG shareholder resolutions have been filed this year** as of 15 February.
- **Fewer exclusions:** Securities and Exchange Commission (SEC) staff have allowed the omission of six proposals so far (as compared with 27 last year) in the face of company challenges. This is attributed in the report to the fact that SEC was included in the recent six week government shutdown. The report observes that companies have lodged objections to at least 54 more proposals that have yet to be decided.
- **Successful engagement?** More proposals have been withdrawn than at the same time last year — 71 up from 62 in mid-February 2018. This usually indicates, the report observes, that shareholders and companies have reached an agreement.
- **Climate change, corporate political activity and sustainability account for just under 50% of resolutions this year.** Political activity (25%) and environment (21%) represent the majority of proposals. The remaining proposals concern: board diversity and oversight (12%), sustainability (11%), human rights (11%) and decent work (eg pay equity proposals) (10%), workplace diversity (4%).
- **Recent developments**:

- The trend towards large mutual funds supporting ESG resolutions looks to continue. Their support is credited in the report with pushing the average level of support for ESG resolutions to more than 25% last year and the report suggests that votes in 2019 are likely to be high as well.
- Possible changes to the proxy voting process? The report notes that there may be changes to the proxy voting process on the horizon. For example, business groups and trade organisations are applying pressure to the SEC to tighten its Shareholder Proposal Rule (which allows companies to exclude shareholder proposals in certain circumstances).

New proposals and questions for 2019

- **Climate change:**
  - The number of proposals specifically concerned with climate change has dropped to 60, down from 83 last year, although as in the past climate change also is raised in other proposals about sustainability disclosure and in a few on lobbying.
  - Most proposals seek information about how companies are managing greenhouse gas (GHG) emissions and carbon asset risks, and seek information about how companies plan to adapt their business models to be Paris-compliant.
  - Uncertainty over proposals seeking GHG emissions targets/disclosure? The report notes that in 2018, SEC agreed to allow EOG Resources to exclude a shareholder resolution asking the company to set GHG goals on the basis that the resolution concerned ordinary business, by seeking to 'micromanage' the company (ie under the exclusion allowed for proposals judged to raise mundane ordinary business issues not suitable for shareholder involvement). The impact of the SEC's decision was limited last year as it came after many similar proposals had already been lodged, but the report suggests that it may encourage companies to challenge similar proposals this year. The report notes that shareholders have reformulated some of their GHG goals requests this year, but 11 companies have received the 'basic, longstanding request' to set quantitative, time-bound reduction goals.
- **Sustainability disclosure and management:** This year a number of proposals ask for reporting using the metrics defined as material by the Sustainability Accounting Standards Board (SASB) – which the report identifies as a new development. Resolutions about tying executive pay to a wide range of issues continue.
- **Corporate influence spending:** 57 resolutions this year call for increased corporate oversight and disclosure of election spending. This is double the number filed last year, although lobbying proposal numbers are down.
- **Decent work:** The upswing in gender pay equality proposals is continuing. A new resolution asks companies not to require mandatory arbitration and non-disclosure agreements, which proponents say is particularly harmful for victims of sexual misconduct.
- **Diversity at work:** The number of proposals seeking data on gender, race and ethnicity is 50% down on 2018 but a new proposal is specifically targeting diversity in management.
- **Other issues:**
  - **Board diversity and oversight:** Alongside continued requests to diversify board nominees is a request to include sexual orientation and gender identity in the definition of diversity for directors. New proposals also raise questions about a wide range of 'hot button issues' including (among others) racism, immigrant detention, drug pricing.
  - **The Investors for Opioid Accountability coalition** was successful (60.5% vote favour) of its resolution seeking risk management disclosures at Walgreens Boots Alliance in January. Its campaign at opioid makers, distributors and treatment makers continues, after two majority votes last year.

- **Human rights:** New proposals ask about immigrant rights and detention, and online child sexual exploitation. New proposals at travel companies Booking and TripAdvisor ask how they avoid complicity in conflict zones.
- **Media:** Alphabet, Facebook and Twitter continue to face questions about how they manage content and address risks posed by those who use their platforms to secretly influence elections and disseminate hate speech. Amazon.com is being asked about facial recognition software used by US Immigration and Customs Enforcement (ICE) in a new proposal.

[Source: [registration required] As You Sow Proxy Preview 2019]

Shareholder Activism

Reporting on customers' emissions a step too far? Rio Tinto has recommended shareholders vote against a shareholder climate resolution at the upcoming AGM

The Australasian Centre for Corporate Responsibility (ACCR) has lodged two shareholder resolutions at Rio Tinto Ltd to be considered at the 9 May AGM.

The resolutions are as follows:

1. **Constitutional Amendment (special resolution to amend the company's constitution):** A binding resolution to amend the constitution to allow for the submission of non-binding advisory shareholder resolutions. (Contingent on the constitutional amendment, one further advisory resolution was also submitted).
2. **Transition Planning disclosure (emissions reduction targets/disclosure):** Ordinary resolution seeking that the company disclose transition plans to limit global warming to 1.5C (as opposed to 2C) and that the transition plans include short, medium and long term targets to reduce scope 1, 2 emissions (mitigation of greenhouse gas emissions (GHG) that Rio Tinto controls) and scope 3 greenhouse gas emissions (customer emissions).

[Note: The full text of the resolutions is here]

Neither resolution is supported by the Rio Tinto board

The Rio Tinto board has recommended shareholders vote against both resolutions.

The board opposes the proposed constitutional amendment on the basis that it would:

- **Undermine the authority and accountability of the board:** The proposed constitutional amendment allowing shareholders to 'express an opinion' about how directors should exercise their powers would 'undermine both the authority and accountability of the board and consequently is not conducive towards effective administration and governance'.
- **Shareholders already have a means to voice their views an opinions**, including the right to ask questions or make comments at an annual general meeting and through regular and 'extensive' engagement activities between Rio Tinto and institutional investors.
- **The Rio board considers that any introduction of a framework to permit non-binding advisory resolutions should be by legislative change** in order to 'provide clarity of the consequences and implications of such resolutions for companies and their directors' and to ensure that any changes apply consistently across all companies.
- **Allowing non-binding advisory resolutions is 'likely to create uncertainty'** and to give rise to a 'number of practical difficulties including in relation to the authority and accountability of the directors.'

The board opposes the proposed increased climate disclosure/request to disclose scope 3 targets on the basis that:

- **To do so would be premature** given work on detailed 'engineering, economic and policy analysis on an asset by asset basis to inform the development of new Scope 1 and 2 emissions reduction targets' to be released in 2020 has not yet been completed. 'To agree to this resolution in the form it is proposed without having completed the required analysis would be premature' Rio writes.

- **Rio Tinto's current modelling is based on the 2C scenario:** Rio is currently analysing and testing the resilience of its portfolio against the 2C scenario and shifting to a 1.5C scenario will take time. The company has said that it will continue to 'evolve' its scenarios and analysis over time.

- **The company cannot practically provide the information requested:** Rio Tinto cannot commit to provide Scope 3 emissions reduction targets as 'these are targets ultimately for our customers' (mainly steel makers in China) over which the company has limited control. Currently technological developments which may reduce emissions in future are also outside the company's control. As such, Rio writes that it cannot support the resolution. 'It is this point…that prevents your directors from supporting the resolution' Rio writes.

[Sources: Rio Tinto ASX Announcements 2019 Rio Tinto Ltd Proxy For; Addendum to 2019 Notice of annual general meeting 18/03/2019; [registration required] The AFR 18/02/2019; 18/03/2019]

Regulators

ASIC has published its tenth report on the regulation of corporate finance issues: The report outlines ASIC's key concerns and expectations regarding financial information presented in prospectuses, on-market buy-backs and expert valuations as well as providing an update on the work of ASIC's corporate governance taskforce

Overview: ASIC Report 612: ASIC Regulation of Corporate Finance: July to December 2018

The Australian Securities and Investments Commission (ASIC) has published its tenth report on the regulation of corporate finance issues: *ASIC Report 612 ASIC Regulation of corporate finance: July to December 2018* (REP 612). The report covers ASIC's regulation of fundraising transactions, mergers and acquisitions, experts and corporate governance issues over the period July to December 2018. It outlines ASIC's key concerns and expectations regarding financial information presented in prospectuses, on-market buy-backs and expert valuations.

Some Key Points

Fundraising

- **296 original disclosure documents were lodged in the period, seeking to raise approximately $7.6 billion**. This compares with 229 original disclosure documents in the period 1 January 2018 to 30 June 2018 (previous period), seeking to raise $8.6 billion.

- **There was a significant decrease in the magnitude of the largest fundraising offers**, with total amounts actually raised in the top 10 fundraisings decreasing from $9.4 billion in the previous period to $5 billion in this period.

- **There were significantly fewer interim stop orders** this period (11 compared with 24 during the previous period).

- **Inadequate disclosure of business models:** The most common disclosure issue was the inadequate disclosure of business models. The most common result of ASIC intervention in these matters was new or amended disclosure, often after ASIC had extended the exposure period due to concerns with the quality of the disclosure. Misleading or deceptive disclosure followed as the second most common issue.

- **Use of ICOs (Initial Coin Offerings):** ASIC's review of ICOs in the past 12 months indicates that businesses and individuals are using ICOs for public capital raising and investments. ASIC reminds 'potential ICO issuers and their advisers that it is the legal substance of the offer — not what it is called — that will determine whether Australian laws apply'. ASIC flags that it intends to update Information Sheet 225 Initial coin offerings and crypto-currency (INFO 225) to provide further guidance on when an ICO may involve the issue of a financial product and on the relevant disclosure requirements that may apply, and to urge further caution around promotional statements to ensure they are not misleading or deceptive.

Mergers and acquisitions

- **The number of independent control transactions commenced increased** to 44 (as compared with 29 in the previous period).
- **The number of restructure transactions also increased** to 10 (as compared with two in the previous period).
- **Consistent with the previous period, voluntary escrow relief remained the most common relief sought** from ASIC in relation to the takeovers provisions of the Corporations Act. Relief relating to relevant interests, item 7 transactions and variation of offer terms or bid class were the next most commonly sought relief types.
- **Most of ASIC's regulatory interventions in control transactions this period related to schemes of arrangement.** ASIC raised issues with offer terms, 'truth in takeovers' statements, shareholder classes and bid structures.
- **ASIC states that 'novel or complex consideration in schemes that raise issues of class composition fairness of public policy concerns' is likely to attract ASIC's scrutiny**. Examples where ASIC intervened (during the period) include: a) offering shares in a proprietary company to a large number of target security holders including retail investors; b) consideration that is different (in form or substance) between certain security holders; and c) consideration structures that allow for share splitting and the use of other devices that detract from equality of treatment and an efficient competitive and informed market.

Market and procedural integrity

- ASIC states that it 'continued to intervene' in a number of schemes and bids during the period where there were concerns about voting intention and other public statements. ASIC continues to seek to ensure bidders and scheme acquirers properly 'recognise the limits of agreements, arrangements and understandings they may reach with target holders'.

Climate risk disclosure

The report contains high-level recommendations for listed companies with respect to disclosure of risks associated with climate change and the potential effects on business. This includes the recommendation that companies 'comply with the law'. Among other things, ASIC states that s299A(1)(c) of the *Corporations Act 2001 (Cth)* requires disclosure of material business risks affecting future prospects in an OFR, which may include climate change. ASIC also encourages companies to consider voluntarily reporting under the Task Force on Climate Related Financial Disclosures (TCFD recommendations).

Corporate governance practices

The report includes an update on the work of the Corporate Governance Taskforce to improve corporate governance practices in large listed entities

- **The taskforce is reviewing two issues** (work streams): a) director and officer oversight of non-financial risk; and b) board and officer decisions regarding the granting and vesting of variable remuneration to key management personnel.
- **Information requests have been made of a number of entities:** So far, ASIC has selected an unspecified number of large financial services entities that are subject to both work streams and a further group of listed entities has been selected for the remuneration review only (including entities from non-financial services sectors). ASIC states that some of these entities may be the subject of the director and officer oversight work stream in a later period.
- **Entities' approach to engagement with ASIC is also a focus for the regulator:** ASIC observes that in addition to the responses received from the entities, it is interested in 'the manner in which the entities are responding to these requests [ie requests for information] and their engagement with the corporate regulator'.
- **The next step will be 'arranging discussions** with the relevant entities to

further understand their corporate governance practices'. An organisational psychologist to undertake behavioural analysis of the entities.

- **Timeline:** ASIC aims to publish reports on the corporate governance practices observed as part of the review in August 2019. The reports will include observations on the practices observed across the various cohorts in the work streams and will highlight actual practices, deficiencies as well as good practices, and ASIC's recommendations regarding practices requiring improvement.

[Sources: ASIC media release15/03/2019; REP 612 ASIC regulation of corporate finance: July to December 2018]

APRA capability review update | Terms of reference announced

Treasury has released the terms of reference for the Australian Prudential Regulation Authority (APRA) capability review for consultation. The Review will be led by the Chair Graeme Samuel AC, Diane Smith-Gander and Grant Spence and provide a forward-looking assessment of APRA's ability to respond to an environment of growing complexity and emerging risks for APRA's regulated sectors.

Review objectives:

1. Assess APRA's capability to deliver upon its statutory mandate under the APRA Act and relevant industry Acts.
2. Undertake a forward-looking assessment of APRA's ability to respond to an environment of growing complexity and emerging risks for APRA's regulated sectors.
3. Identify recommendations to enhance APRA's future capability, having regard to the changing operating environment and any relevant organisational initiatives which are already underway.

The Panel should evaluate the extent to which the factors listed below support the regulator in delivering its statutory mandate with particular focus on those areas considered to be of greatest relevance to the review objectives.

- well-considered and clear strategy that takes into account the future operating environment, effectively cascaded throughout the organisation
- decision-making that balances financial safety and financial stability, and considerations of efficiency, competition, contestability and competitive neutrality
- culture that supports supervisory and enforcement actions in support of strategic objectives
- robust internal governance arrangements, supported by fit-for-purpose internal reporting, performance monitoring and audit and assurance activities
- appropriate resource allocation, responsive to emerging issues, and efficient utilisation
- staff with necessary expertise (eg industry, technical and data analytics) supported by appropriate tools
- sound process and outcomes realised across APRA's core supervision, policy and resolution functions (including appropriate utilisation of enforcement tools)
- appropriate engagement with Australian financial sector regulators, including suitable information sharing arrangements
- fit-for-purpose statutory powers.

The Panel should take into account relevant recent reviews and reports as they relate to APRA, including: a) the recently completed Financial Services Royal Commission Final and interim reports; b) the Productivity Commission's final report Superannuation: Assessing Efficiency and Competitiveness; c) the Productivity Commission's final report Competition in the Australian Financial System; d) the IMF's Financial System Stability Assessment of Australia (scheduled for release in early 2019); and e) APRA's own internal Enforcement Review (scheduled for completion in March 2019).

The Panel should also consider benchmarking APRA against the practices of comparable international prudential regulators.

Outside scope: The Panel 'should take as given' APRA's legislative framework, except as outlined above in relation to APRA's statutory powers.

Timeline: The deadline for submissions is 10 April 2019. The Review itself is to commence in March 2019 for report by 30 June 2019.

[Sources: APRA media release 13/03/2019; APRA Capability Review – Terms of Reference]

APRA is considering 'naming and shaming' underperforming superannuation funds?

Overview of APRA Deputy Chair Helen Rowell's speech: Opening the door to greater transparency in superannuation

The Australian Prudential Regulation Authority (APRA) Deputy Chair, Helen Rowell delivered a speech entitled *Opening the Door to Greater Transparency in Superannuation*, in which she outlined the regulator's plans for a 'new era of superannuation transparency'.

'As part of our ongoing strategy to weed out underperforming funds, products and options, APRA plans to usher in a new era of superannuation transparency: providing better information on trustee and product performance, and increased visibility of APRA's actions to address underperformance. Trustees that fail to live up to their obligations will have very few places to hide' she said.

Some Key Points

APRA will be a more 'assertive regulator' with a new focus on member outcomes

- **Australia's superannuation system is sound and stable, though there is room for improvement:** Ms Rowell said that 'the fact that APRA's primary concern is underperforming funds – rather than the risk of a fund collapsing and wiping out members' savings – is something we shouldn't take for granted' and despite the issues raised by the Financial Services Royal Commission and the Productivity Commission, the superannuation system remains 'sound and stable.'
- **Member outcomes are a key area of focus for APRA:** Ms Rowell said that trustee boards should not wait for legislative changes or for other recommendations of the Royal Commission to be implemented to review and improve their practices but should be proactive, in taking steps to ensure they are delivering strong outcomes for members (eg by implementing the member outcomes and strategic planning prudential standards that APRA released last year). Ms Rowell added that boards will shortly receive a letter from APRA highlighting particular areas where funds can improve including: lifting board capability, developing a stronger fiduciary culture and adequately addressing conflicts of interest.
- **APRA will be a 'more assertive' and 'less patient' regulator:** In response to the findings of the Hayne Royal Commission, Ms Rowell cautioned industry to 'expect to see a more assertive APRA that pushes harder for trustees to fix problems more quickly, is less patient with inadequate responses or inaction, and more willing to make an example of uncooperative trustees and directors'. Ms Rowell added that the regulator is disappointed that parliament is yet to pass legislation that would give APRA a broader directions power for superannuation, and the power to pursue civil penalties against trustees and directors for breaching their obligations to members. But, that the regulator expects that the legislation will soon be passed, and that when it is passed, APRA 'is ready to make use of its new powers'.

[Note: Ms Rowell appears to be referring Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2019 which passed the senate with amendments on 14 February and is currently before the House of Representatives. See: Governance News 20/02/2019]

Greater transparency is a priority for APRA

- **Greater transparency about enforcement action:** In addition to taking a more assertive supervisory stance, Ms Rowell said that APRA will deliver greater transparency on the industry's operations, performance and delivery of outcomes, and also on the actions it is taking to lift behaviour and practices across the industry and within individual trustees. 'It's not enough for us to only act behind the scenes; the public needs to have greater confidence that action is being taken…We will therefore start providing, to the extent feasible, more information on the steps we are taking to ensure trustees address weaknesses and rectify breaches, including instances of formal enforcement action'.

- **'Enhanced data collection':** Ms Rowell said that the enhancement of superannuation data collection is central to delivering greater transparency. She said that APRA will use this additional data to create an outlier list' or 'worst in show' list and that the trustees of these funds will be targeted with intensified supervision. 'If trustees are unable or unwilling to respond appropriately, we will be urging them to seriously consider whether restructuring or exiting the industry is in their members' best interests' she said. Ms Rowell acknowledged that sourcing and delivering additional data may present a regulatory burden for funds but said that this is unavoidable given it is 'essential to restore confidence in the industry and for APRA to do its job'. She added that she expects industry to assist in finding solutions, rather than 'just telling us that something can't be done'.

- **'Worst in show' list will not be disclosed publicly 'for now':** Ms Rowell acknowledged that being labelled among the 'worst-in-show' is 'likely to hurt the financial interests of members' and on this basis, the information will not be made public. She added that this may change in future. 'I do stress "for now" – we are actively developing ways to provide greater transparency around the outcomes individual funds and products are delivering their members, thereby making performance clearer to all' she said.

- **Outsourcing arrangements will be an 'early target':** APRA will continue conducting 'deep dive' reviews into areas of prudential concern and consider how it can publish more about the findings including details of specific superannuation entities and the assessment of their practices. Ms Rowell said and outsourcing — in particular to related parties — will be an 'early target'. She said that 'this marks a step change in APRA's approach, consistent with our commitment to enhanced transparency'.

- **Public disclosure of 'heat maps':** From the start of 2020, trustees will be start undertaking their member outcomes assessments and in parallel, APRA expects to begin making public its APRA's 'heat maps' (ie APRA's view of fund performance at a more granular level). This will include a set of performance metrics at an individual fund and product level (where reliable data is available) across four key quantitative areas: a) investment performance; b) fees and costs; c) insurance; and d) scale and sustainability. Initially this will just be for MySuper products, but will be broadened to include choice products.

[Source: Opening the door to greater transparency in superannuation: speech by APRA Deputy Chair Helen Rowell, to the Australian Institute of Superannuation Trustees' Conference of Major Superannuation Funds 13/03/2019]

APRA has cautioned against superannuation funds engaging in social activism (where it is contrary to the interests of members)?

According to media reports, Australian Prudential Regulation Authority (APRA) Chair Wayne Byres has reportedly responded to the Treasurer's recent request to confirm whether the regulator has the necessary powers to ensure superannuation trustees (and more particularly union appointed trustees) do not pursue political objectives at the expense of member interests, by confirming super trustees are legally required to act in line with the best interest duty and sole purpose test.

In addition, Mr Byres also reportedly called on parliament to pass legislation that would enable APRA to intervene (where trustees are not acting the best interests of members).

[Note: The legislation referred to appears to be *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2019* which passed the senate with amendments on 14 February and is currently before the House of Representatives. See: Governance News 20/02/2019]

The AFR quotes Mr Byres as stating that 'any evidence of trustees potentially giving priority to anything other than members' interests and the provision of retirement incomes would be of concern' to the regulator. The AFR interprets Mr Byres' response as a caution to superannuation trustees against engaging in 'activism' on social issues.

[Sources: [registration required] The AFR 19/03/2019; 19/03/2019; [registration required] The Age 19/03/2019]

APRA has provided an update on its approach to risk-based capital requirements, loss-absorbing capacity (LAC) and non-financial risk projects

Overview of APRA Executive General Manager, Policy and Advice Division Pat Brennan's speech: *Bank capital — behind the headlines*

In a speech entitled, *Bank capital — behind the headlines*, Australian Prudential Regulation Authority (APRA) Executive General Manager, Policy and Advice Division Pat Brennan provided an update on the regulator's' approach to risk-based capital requirements, loss-absorbing capacity (LAC) and non-financial risk projects. Mr Brennan said that APRA considers the banking system is well capitalised and that the regulator is supplementing this financial strength by 'ensuring strong risk management and sound governance practices are in place across the full spectrum of risks that banks face'.

Some Key Points

Risk-based capital (no changes to quantum of capital required)

- Mr Brennan said that while the overall amount of capital that needs to be held by Australian banks has already been set in the 'unquestionably strong benchmarks' announced in July 2017, the allocation of the precise amount of capital attributable to each source of risk is still 'being worked through as part of the revisions to the capital framework'.
- APRA expects to soon release its response to revised capital requirements for credit risk and operational risk (following consultation). In relation to credit risk, Mr Brennan said that the next phase of consultation will focus on the treatment of residential mortgages for all banks, and other amendments to the standardised approach to credit risk.
- 'Later this year', APRA plans to release its full response to the revised credit risk requirements for the IRB approach and its response to improving transparency, comparability and flexibility. Mr Byres said that the outcome of this could lead to 'significant presentational and calculation changes to a number of prudential standards, although these would not affect the quantum of capital required'.
- Mr Brennan said that this work will be a multi-year process and is likely to involve further rounds of consultation and quantitative impact studies to enable APRA to assess the impact and better calibrate the proposed changes. He said that given the need for extensive consultation, the revised prudential standards are likely to be finalised in late 2020, and are intended to commence in early 2022, consistent with the international timetable agreed at the Basel Committee.

Loss-absorbing capacity (LAC) and recapitalisation

- APRA has not yet reached a decision on the proposals put forward in last year's discussion paper regarding this issue.
- Mr Brennan said that so far responses have been 'somewhat mixed' with some submissions supporting the proposed approach and others questioning whether it will sustainable over the longer term/whether it is the best way forward.
- Mr Brennan observed that the proposed approach is consistent with the 2014 Financial System Inquiry recommendation that stated recapitalisation capacity should be 'sufficient to facilitate the orderly resolution of Australian authorised deposit-taking institutions and minimise taxpayer support' and does not go so far (as is the case in other jurisdictions) as aiming to eliminate the possibility of tax payer funded bailouts. He added that APRA is considering feedback received but 'would still prefer a solution that is on the side of simplicity'.
- Timeline: Mr Brennan said that APRA is 'now motivated to work through the considerations as swiftly as possible'. Following finalisation of the LAC framework APRA will build out other aspects of the prudential framework for recovery and resolution.

APRA's work on non-financial risk

- Mr Brennan said that capital standards not (of themselves) the only indicator of how well banks are run. Rather capital standards (including unquestionably strong benchmarks), are set on the basis that 'sound risk management and governance' practices are in place and that APRA is complementing and adding to its existing focus on sound financial risk management by strengthening the prudential framework for non-financial risks eg cyber-risk, remuneration, accountability, governance, risk management, recovery and resolution.

- **What banks can expect:** Mr Brennan outlined a number of examples of what banks can expect from APRA with respect to its increased supervisory focus on non-financial risk issues going forward.

  1. **Cyber-risk — new detailed practice guide:** APRA released the final version of Prudential Standard CPS 234 Information security, 'which provides a clear set of requirements and expectations covering information security, including cyber risk' (See: Governance News 12/11/2018). Mr Brennan said that APRA will very shortly be supplementing this with a detailed practice guide.

  2. **Remuneration — new prudential standard:** In 'the next quarter' APRA plans to consult on an updated prudential standard on remuneration. Mr Brennan said that the new standard 'will be stronger and be primarily focused on outcomes'. It will include: a) requirements for performance assessment to reflect consideration of all relevant contributions to performance (eg risk management); b) transparency requirements (banks will need to be transparent with APRA on how remuneration decisions are made); and c) requirements for variable remuneration to 'be truly variable in practice'.

  3. **Governance and accountability (revised fit and proper standards/governance standards):** In line with the extension of BEAR (as recommended by the Financial Services Royal Commission recommendations 6.8, 6.6), APRA will refresh its Governance and Fit and Proper standards to not only more closely complement the accountability regime, but to strengthen standards more generally. This will be informed by learnings from supervisory activity, the CBA Prudential Inquiry and the findings of the Royal Commission.

  4. **Risk management:**

     - **In the near future APRA will release for consultation a materially updated Prudential Standard APS 220 Credit Quality** that we will also rename to Credit Risk Management. Given credit is the most material risk of the Australian banking sector we expect this will get plenty of attention.

     - **APRA is also developing an overarching operational risk standard** and will consider changes to Prudential Standards CPS 220 Risk Management as our work of non-financial risk progresses.

[Source: Speech APRA Executive General Manager, Policy and Advice Division Pat Brennan: Bank capital – behind the headlines 19/03/2019]

Financial Services

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

Implementation of Financial Services Royal Commission recommendation 1.15 (Enforceability of industry codes): Treasury has released a consultation paper seeking feedback on a range of questions in relation to how to implement Commissioner Hayne's recommendation to make industry codes more enforceable

Treasurer Josh Frydenberg has announced the release of a consultation paper seeking feedback on relevant considerations in amending the law to implement Recommendation 1.15 (enforceable code provisions) of the Financial Services Royal Commission's Final Report.

Timeline: The closing date for submissions is 12 April 2019.

Context

Recommendation 1.15 states that the law should be amended to provide that:

- the Australian Securities and Investment Commission's (ASIC's) power to approve codes of conduct extend to codes relating to all APRA-regulated institutions and Australian Credit Licence (ACL) holders
- industry codes of conduct approved by ASIC may include 'enforceable code provisions', which are provisions in respect of which a contravention will constitute a breach of the law
- ASIC may take into consideration whether particular provisions of an industry code of conduct have been designated as 'enforceable code provisions' in determining whether to approve a code
- for remedies, modelled on those now set out in Part VI of the Competition and Consumer Act, for breach of an 'enforceable code provision'
- for the establishment and imposition of mandatory financial services industry code.

The Treasurer says that the government plans to amend the law to allow:

- **ASIC to approve codes for a wider range of entities than currently possible.** The consultation paper notes that ASIC can currently only approve industry codes that relate to the activities of Australian Financial Services licensees (AFS licensees); authorised representatives of AFS licensees or issuers of financial products. Under the recommended changes, ASIC would be able to approve codes that relate to ACL holders activities, and the activities of all APRA-regulated institutions where those entities do not have an AFSL.
- **ASIC-approved codes to include 'enforceable code provisions', contravention of which constitutes a breach of the law and with remedies modelled on those in the *Competition and Consumer Act 2010 (Cth) (CCA).*** The consultation paper notes that the Commissioner suggested that the enforcement provisions and remedies under Part VI of the CCA could be used as a model for the enforceable code regime. These include for example: pecuniary penalties, injunctions, damages, non-punitive orders, punitive orders, disqualification from managing a corporation. The consultation paper suggests that rather than providing for individual enforceable code provisions to be subject to a civil penalty, as is the case in the CCA model, it may instead be preferable that there be a general civil penalty 'where there are systemic or egregious breaches of a code', and that this penalty would be consistent with the amount currently set out in the *Corporations Act 2001 (Cth)*.
- **ASIC to take into account whether particular provisions of an industry code have been designated as enforceable code provisions in determining whether to approve a code.** The consultation paper suggests that Commissioner Hayne's recommendation raises the issue of whether ASIC should consider adopting additional criteria when considering whether to approve a code. These additional criteria include considering whether the code contains: a comprehensive body of rules developed in consultation with stakeholders; adequate provisions for dispute resolution, remedies and sanctions; and effective and independent administration (including compliance monitoring).
- **Enforceable provisions:** The Treasurer said that 'it will also be made clear' that certain promises made in codes are enforceable against financial services firms by consumers. In addition, he said that where an industry does not put forward its proposed enforceable code provisions in a timely manner, mandatory financial services industry codes will be able to be imposed by the government.

The Treasurer also observed that the proposed changes would enable industry and ASIC to complete their implementation of recommendations 1.16 and 4.9.

[Note: Recommendation 1.16 provides that the Australian Banking Association (ABA) and ASIC should take all necessary steps to have the provisions that govern the terms of the contract made or to be made between the bank and the customer or guarantor designated as 'enforceable code provision' in the Australian Banking Code). Recommendation 4.9 provides that the Financial Services Council, the Insurance Council of Australia and ASIC should take all necessary steps by 30 June 2021 in respect of the Life Insurance Code of Practice, the Insurance in Superannuation Voluntary Code and the General Insurance Code of Practice. See: Financial Services Royal Commission Final Report]

Further detail: consultation Paper

The consultation paper poses 17 questions to stakeholders that it says will inform the development of legislation to implement recommendation 1.15.

The Consultation Paper also sets out further information on the current code framework and government-mandated codes, and 'deals with' the recommendations of the ASIC Enforcement Review Taskforce (ASIC ERT) and the other Royal Commission recommendations.

ASIC ERT Recommendations: Treasury notes that while the Commissioner was 'generally positive' about the ASIC ERT recommendations he recommended going further by making a breach of a code a breach of the law and by making codes mandatory. Treasury comments that a 'mandatory codes approach would, in effect, subsume the other recommendations of the ASIC ERT'.

Questions for stakeholders

1. What are the benefits of subscribing to an approved industry code?
2. What issues need to be considered for financial services industry codes to contain 'enforceable code provisions'?
3. What criteria should ASIC consider when approving voluntary codes?
4. Should the Government be able to prescribe a voluntary financial services industry code?
5. Should subscribing to certain approved codes be a condition of certain licences?
6. When should the Government prescribe a mandatory financial services industry code?
7. What are the appropriate factors to be considered in deciding whether a mandatory code ought to be imposed on a particular part of the financial sector by Government?
8. What level of supervision and compliance monitoring for codes should there be?
9. Should code provisions be monitored to ensure they remain relevant, adequate and appropriate? If so, how should this be done and what entity should be responsible?
10. Should there be regular reviews of codes? How often should these reviews be conducted?
11. Aside from those proposed by the Commissioner, are there other remedies that should be available in relation to breaches of enforceable code provisions in financial service codes?
12. Should ASIC have similar enforcement powers to the Australian Competition and Consumer Commission (ACCC) in Part IVB of the Competition and Consumer Act in relation to financial services industry codes?
13. How should the available statutory remedies for an enforceable code provision interact with consumers' contractual rights?
14. Should only egregious, ongoing or systemic breaches of the enforceable provisions of an industry code attract a civil penalty?
15. In what circumstances should the result of an external dispute resolution (EDR) process preclude further court proceedings?
16. To what matters should courts give consideration in determining whether they can hear a dispute following an Australian Financial Complaint Authority (AFCA) EDR process?
17. What issues may arise if consumers are not able to pursue matters through a court following a determination from AFCA.

The Australian Banking Association has released a statement welcoming the consultation. ABA CEO Anna Bligh is quoted as commenting that 'While the new Code is already enforceable as relevant clauses form part of a customer's contract, the industry will work with the government to identify what more can be done regarding enforceability following the recommendation of the Royal Commission'.

The AFR suggests that the recommendation has 'confused the government, regulators and finance lobby groups' over how it should be implemented.

[Sources: Treasury media release 18/03/2019; Consultation Paper: Enforceability of financial services industry codes Taking action on recommendation 1.15 of the Banking, Superannuation and Financial Services Royal Commission 18/03/2019; [registration required] The AFR 17/03/2019; Australian Banking Association media release 18/03/2019; Treasurer Josh Frydenberg media release 18/03/2019]

ASIC's superannuation priorities: ASIC Commissioner Sean Hughes has outlined ASIC's priorities in implementing the recommendations of the Financial Services Royal Commission as they apply to the superannuation sector

Australian Securities and Investments (ASIC) Commissioner Sean Hughes delivered a regulator update at the annual 2019 Superannuation Law Conference. The focus of Mr Hughes' comments was on the implications of the recommendations of the Financial Services Royal Commission for the superannuation industry.

Some Key Points

The issues identified over the course of the hearings were caused by 'poor consumer experience' Mr Hughes said. These issues included: a) poor governance and the management of conflicts of interest; b) failing to act in the best interests of members eg in fees charged, grandfathered commissions or in the delays to the transitioning of members to MySuper; c) issues around fees for no service; d) poor practices to gain and retain members eg use of inducements; and e) consumer harm arising from the complexity and misunderstanding about insurance and claims handling. Mr Hughes added that the issues identified are widespread. 'To those critics who would say the case studies presented an unrepresentative vista of consumers' and members' experiences, we would point out that there were (and are) many, many other stories which went untold in the time the Royal Commission had available to it' he said.

ASIC's work on superannuation

Mr Hughes said that ASIC's work in superannuation is focussed on consumers, and on promoting good consumer outcomes and that this should also be the focus of trustee's work. Mr Hughes outlined some examples of recent work undertaken by ASIC in relation to superannuation.

1. **Insurance in superannuation:** ASIC's recent work includes actions arising from ASIC's review (Report 591) into insurance in superannuation to improve industry practices (see: Governance News 10/09/2018). Additionally, Mr Hughes said that the passage of the *Protecting Your Super* package provisions, which make insurance opt out for accounts inactive for 16 months means there are immediate issues for trustees to consider. He encouraged, trustees to message consumers as consistently as possible regarding the changes and to take care to ensure that consumers are provided with accurate not misleading information about their inactive account.

[Note: *Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018* passed both Houses, having been amended in the Senate on 18 February and received assent on 12 March 2019. See: Governance News 20/02/2019]

2. **Changes to internal dispute resolution arrangements:** ASIC plans to consult with stakeholders about internal dispute resolution policy settings contained in ASIC regulatory guide 165 (RG 165 Licensing: Internal and external dispute resolution). Mr Hughes said that a key focus of this consultation will be on the maximum internal dispute resolution timeframes, and how and when the current 90-day resolution deadline should be reduced. ASIC will also focus on strengthening obligations regarding providing written reasons.
3. **Advice fees in superannuation:** Mr Hughes said that ASIC will continue to focus on fee for no service issues and that the regulator is undertaking a project looking at the different models for delivering advice to superannuation members. Mr Hughes said that as part of this project, ASIC is surveying 25 superannuation trustees and will also look at some examples of personal advice. He said that ASIC is particularly interested in whether conflicts affect the quality of advice. Noting the recommendations of the Hayne Royal Commission concerning fees, Mr Hughes added that ASIC considers that 'there is scope for trustees to improve their oversight practices in this area, including having regard to the sole purpose and best interest requirements in the law.'
4. **Employer decision making:** Mr Hughes said that ASIC is continuing to look at the role of employer choice of fund, as this affects outcomes for many consumers particularly those who are disengaged. He added that currently there is no regulatory requirement for employers to make a good choice but that if the proposed changes to s68A of the *Superannuation Industry (Supervision) Act 1993* about employer inducements are made, there may be more scope for active work by ASIC in this area.

[Note: The reference to changing s68A appears to be a reference to Recommendation 3.6 (no treating of employers) in the Financial Services Royal Commission's Final Report. Recommendation 3.6 recommends that: Section 68A of the SIS Act should be amended to prohibit trustees of a regulated superannuation fund, and associates of a trustee, doing any of the acts specified in section 68A(1)(a), (b) or (c) where the act may reasonably be understood by the recipient to have a substantial purpose of having the recipient nominate the fund as a default fund or having one or more employees of the recipient apply or agree to become members of the fund. The provision should be a civil penalty provision enforceable by ASIC. The government has said that it agrees to amend the SIS act to facilitate enforcement of the provision.]

5. **Proposed changes to fees and costs disclosure (RG 97):** Mr Hughes noted that ASIC is currently consulting on changes to the fees and costs disclosure regime for managed investment schemes and superannuation and that that in light of potential changes to the requirements, ASIC's oversight of fees and costs disclosure will continue to focus on ensuring that issuers are not misleading consumers about fees and costs.

[Note: Mr Hughes appears to be referring to *Consultation Paper 308 Review of RG 97 Disclosing fees and costs in PDSs and periodic statements* (CP 308) which sets out ASIC's response to recommendations from a review by external expert, Mr Darren McShane in *Report 581 Review of ASIC Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements* (REP 581) which made various recommendations as to how disclosure could be improved. ASIC proposes to take forward a number of recommendations from Report 581. The paper includes a proposed updated Regulatory Guide 97 Disclosing fees and costs in PDSs and periodic statements (draft updated RG 97) Regulatory Guide (RG 97), as well as draft amendments to Sch 10 of the Corporations Regulations. Consultation on the proposed changes closes on 2 April. See: Governance News 16/01/2019]

6. **Focus on advertisements:** ASIC regularly monitors disclosure, advertising and promotions in superannuation and 'takes a great interest in advertisements that do not meet our good practice guidance when considering the exercise of our regulatory powers' Mr Hughes said.
7. **Financial Services Royal Commission recommendations: focus areas for 2019**

- In 2019, ASIC will have a greater focus on court-based outcomes to provide strong public denunciation and punishment of wrongdoing. We will start by asking 'why not litigate?'
- In addition to the specific referrals from the Royal Commission, ASIC is also undertaking investigations into 12 matters that were case studies before the Royal Commission, with some of these relating to superannuation.
- ASIC will also establish a separate Office of Enforcement within ASIC in 2019 (see: Governance News 20/02/2019)
- ASIC is looking at how to deliver an enhanced supervisory approach for superannuation and has already strengthened and bolstered its team focused on this area. Mr Hughes said ASIC plans to use a range of supervisory techniques, including more frequent on-site visits; make better use of data currently available to both ASIC and APRA and make use of new data sources including internal dispute resolution data that must be reported to ASIC, as well as data on life insurance claims coming from joint ASIC and APRA work. 'You should be expect us to be more visible, in your office, and asking questions about conduct, challenging you on what you say is in your members' best interests'.
- Mr Hughes said that ASIC and APRA already have joint work underway to enhance cooperation arrangements in order to improve outcomes across the financial system, increase efficiency of regulation and promote a whole-of-system oversight.

[Source: Regulator update: Speech by ASIC Commissioner Sean Hughes delivered at the 2019 Annual Superannuation Law Conference, Law Council of Australia 08/03/2019]

NAB has released its response to Financial Services Royal Commission's Recommendations: NAB supports 72 (of 76) recommendations

In a statement to the market, NAB has said that it supports 72 (of 76) Financial Services Royal Commission recommendations and that it will work with the government and regulators with a view to taking positive action as quickly as possible on the 'remaining areas' which relate to mortgage broker arrangements, definition of small business and BEAR accountabilities.

Banking recommendations

The NAB states that it agrees with 13 of 17 recommendations that relate to banking.

- **Recommendations 1.3 (Mortgage broker remuneration) and Recommendation 1.5 (Mortgage brokers as financial advisers):** NAB states that it will work with the Treasury led working group to ensure that the broking industry remains viable, customers have choice and get the best possible outcomes.

[Note: The Financial Services Royal Commission's Final Report included a recommendation that mortgage broker remuneration change. More particularly, Recommendation 1.3 recommends that the 'borrower, not the lender, should pay the mortgage broker a fee for acting in connection with home lending'. The government has committed to 'address conflicted remuneration for mortgage brokers' but has stopped short of committing to implement a consumer pays model. See: FSRC Final Report: Mortgage broking implications 11/02/2019. The Labor Party have said that (if elected) they will implement 75 of 76 recommendations (with the exception of recommendation 1.3). Instead (if elected) Labor plans to implement other measures eg fixed rate commissions, to implement the intention of Commissioner Hayne's recommendation. See: Governance News 27 February.]

- **Recommendation 1.10 (definition of small business in the Australian Banking Association Code of Practice):** NAB states that it supports the intent to expand the definition of small business and will expand its definition from aggregate borrowings of less than $3m to aggregate borrowings of less than $5m.

[Note: Appearing before the Standing Committee on Economics Review of the Four Major Banks, CBA's Matt Comyn and Westpac's Brian Hartzer were both asked for their views on Recommendation 1.10 in the Financial Services Royal Commission's final report which recommended expanding the definition of small business in the Australian Banking Association (ABA) Code of Practice. Both Westpac and CBA expressed support for the recently revised definition in the ABA Code of practice to remain unchanged at $3m. Both Mr Hartzer and Mr Comyn separately expressed the view, that their position is consistent with the rest of industry. Mr Hartzer also suggested that industry is concerned that the proposed expansion of the definition would likely result in a 'tightening up of credit for customers' (see: Governance News 13/03/2019). Separately, the ABA committed to implementing recommendation 1.8,1.13 and 1.15 (which relate to amendments to the ABA Code of Banking Practice) but has said that it 'has not yet reached a view' on whether to implement recommendation 1.10. The reasons given in the ABA's statement, for the need to further consider their position, appear to be similar to/consistent with those provided by Mr Hartzer and Mr Comyn. See: Governance News 06/03/2019]

- **Recommendation 1.17 (BEAR product accountabilities):** NAB states that it has allocated responsibility to specific accountable persons for each step in the design, delivery and maintenance of all products offered to customers by NAB and any necessary remediation of customers in respect of any of those products. NAB adds that it 'will address this recommendation in consultation with APRA as part of any regulatory change'.

The statement adds that NAB has completed or in the process of implementing 26 of the recommendations including: announcing in July 2018 that NAB will not charge default interest to agricultural customers impacted by drought; announcing a board customer committee to better oversee NAB''s processes to ensure fair products and service outcomes and to evaluate customer feedback and complaints, and removing grandfathered commissions for NAB financial planning advisers.

[Sources: NAB ASX Announcement: NAB takes action on recommendations from the Royal Commission 15/03/2019; Independent Financial Adviser 15/01/2019]

No time to back-pedal on support for Commissioner Hayne's recommendations? ASIC Chair James Shipton has reportedly condemned anonymous suggestions by senior bankers in the press that tighter regulation will have negative impacts for business and for borrowers

The SMH reports that ASIC Chair James Shipton has condemned the attitude of some senior bankers who have cautioned (anonymously in the press) against the potential negative impacts of tighter regulation (eg tightening of credit to SMEs and home loan borrowers). Mr Shipton reportedly suggested that the comments are evidence that sector has not taken the Hayne royal commission seriously and that they regard ASIC's more assertive regulatory stance as a 'frolic'. Mr Shipton is quoted as stating that 'some of the anonymous comments by senior bankers in the press have been counterproductive and are not helping in the slightest trying to change the narrative. What they're doing is focusing on rogue regulators going off on a frolic…It's not a frolic.

According to The SMH, Australian Banking Association (ABA) CEO Anna Bligh responded by stating 'I don't doubt that there are people at those senior levels who are saying those type of things' but that many of the sources are 'middle managers' rather than senior leaders. Reportedly Ms Bligh went on to say 'This is disrupting their entire world. And this disruption has to happen, it's not going to be comfortable, it's not going to be easy, it's not going to be quick. If any CEOs were telling me that they thought that everyone in their organisation was on board, I would think they are delusional.'

[Source: [registration required] The SMH 15/03/2019]

In Brief | CBA wealth management update: CBA has said it is prioritising the implementation of the Financial Services Royal Commission recommendations, refunding customers and remediating past issues and has accordingly suspended preparations for the demerger in order to support the focus on these priorities

[Sources: CBA ASX Announcement: Wealth management and mortgage broking business update 14/03/2019]

In Brief | Consultation on AFCA rules changes for legacy disputes: The Australian Financial Complaints Authority (AFCA) is consulting on proposed changes to its Rules to allow it to deal with eligible complaints about conduct dating back to 1 January 2008. This expanded jurisdiction would operate for a period of 12 months from 1 July 2019. It follows the recommendation by the Banking Royal Commission for AFCA to consider such legacy disputes. Submissions are due 12 April. It is anticipated that the amended Rules will be released in June 2019

[Source: AFCA media release 18/03/2019]

Other Developments

The FSC has called on the federal government to take steps to address barriers to the rationalisation of substandard legacy products in the financial services sector in the upcoming federal budget

In its pre-budget submission to the government, the Financial Services Council (FSC) has called (among other things) for the government to take steps to facilitate the rationalisation of old, substandard legacy products in the financial services sector.

Currently, the FSC said there are barriers to members transferring customers into newer products, eg significant tax liabilities triggered by shutting down legacy products, and a 'better off' test that is complex and expensive to apply.

The submission suggests a number of ways to address these issues including the that the consumer interest test be applied at a collective level (rather than an individual level), the rollover of all tax attributes to the new vehicle; and no tax implications of the rollover itself.

The FSC estimates there are at least 600 legacy structures, each of which may contain multiple products, disadvantaging an estimated 2.44 million consumers. In addition, the FSC notes that the Royal Commission, the Productivity Commission's inquiry into superannuation and the 2014 Financial Services Inquiry all flagged the issue and that the government has previously committed to addressing it (in agreeing to implement the FSI recommendation).

FSC CEO Sally Loane said: 'Consumers should not be worse off due to any transition to a newer product and will most likely be substantially better off in modern products with lower fees, better customer service, and improved accessibility. The FSC believes a rationalisation scheme should involve a test to ensure a rollover is in the interest of consumers as a whole, and removal of any taxes on the rollover.'

[Sources: Financial Services Council media release 11/03/2019; Financial Services Council submission to Treasury: 2019-2020 Federal Budget; [registration required] The Canberra Times 17/03/2019; Independent Financial Adviser 13/03/2019]

In Brief | Westpac wealth management update: Westpac has announced changes to its wealth strategy including exiting the provision of personal financial advice in favour of a referral model and changes to the executive leadership team. 'The changes we're announcing today are about focusing our investment where we have genuine competitive advantage and growth opportunities' Westpac Group CEO Brian Hartzer said

[Sources: Westpac ASX Announcements: Westpac resets wealth strategy 19/03/2019; Resetting Westpac's wealth strategy 19/03/2019; [registration required] The AFR 19/03/2019]

Corporate Misconduct and Liability

In Brief | The Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019 received Assent on 12 March and has now commenced

[Source: Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019]

Accounting and Audit

In Brief | Opposing views? The AFR reports that there are opposing views as to the likely impact of recent revisions to the ASX Corporate Governance Principles and Recommendations in improving culture, and more particularly in the context of audit, in driving quality improvements

[Source: [registration required] The AFR 19/03/2019]

Risk Management

Top Story | New developments impact climate change related risks

At a recent event hosted at MinterEllison's offices, the Reserve Bank of Australia made a significant statement on the relevance of climate change to its economic modelling processes. MinterEllison's Sarah Barker, has written an article providing insights into Mr Debelle's statement. Her article can be accessed on the MinterEllison website here: https://www.minterellison.com/articles/new-developments-impact-climate-change-related-risks

[Source: MinterEllison https://www.minterellison.com/articles/new-developments-impact-climate-change-related-risks]

Poor remuneration practices are a key indicator of poor culture?

Speaking at the 2019 Conference of Major Superannuation Funds (CMSF Conference), former Australian Competition and Consumer Commission (ACCC) Chair Graeme Samuel reportedly discussed the link between remuneration and culture and the role of remuneration structures in driving misconduct, which he said emerged as a key theme of the financial services royal commission.

Ms Samuel reportedly expressed the view that:

- **Link between remuneration and misconduct:** The Royal Commission identified a number of instances in which remuneration structures incentivised the wrong sort of behaviour or the wrong culture ie where employees were paid for behaviours that were labelled as misconduct by Commissioner Hayne and the community generally.
- **Culture starts at the top:** Culture starts at the top and there must be a very visible chair, a very visible board, a very visible chief executive and a very visible senior management. 'All of them must insist that the values of the organisation are subscribed to and those who don't belong in the organisation' Mr Samuel is quoted as stating.
- **Cultural change should be led from within organisations (not by external consultants):** Mr Samuel reportedly said that the push for cultural change is best done internally and with limited involvement from external consultants.

'You don't need to spend millions on hiring consultants – a chief executive who understands the company values doesn't need an outsider.'

- **Culture fails where those governing do not sincerely believe in the values they have set out in writing:** Mr Samuel reportedly said that executives 'talk about vision statements; they might talk about values but it's not part of their DNA…. and that message then starts to flow through the organisation.'

- **Absence of a link between culture (as it is expressed) and remuneration structures is problematic:** Mr Samuel reportedly said that a 'clear sign' of cultural breakdown is when remuneration structures don't reflect the correct values of the organisation. 'Those at the top will protest certain values such as the customer must always be put first but then they will endorse or sanction activities that clearly don't put the customer first or members of a superannuation fund as the case may be' he is quoted as saying.

- **Bonuses should not be automatic:** Executives and others within an organisation should be rewarded if their performance is beyond what is expected of them but that bonuses should not be part of the package/automatic.

[Source: Investment Magazine 14/03/2019]

More evidence that technological expertise at board level translates into value for shareholders? Citing an MIT study as evidence, the WSJ reports that companies with technology expertise on their boards outperform others

The WSJ reports that a recent study by Massachusetts Institute of Technology's Center for Information Systems Research (MIT) has found that companies with experienced technology experts on their board outperform others in areas such as revenue growth, return on assets and market capitalisation growth

Reportedly the study found that:

- 24% (of 1,233 publicly traded companies with revenues over $1 billion) had board members that were classified as technology experts. These board members included those with experience as a chief information officer or chief technology officer and expertise in software, digital platforms, big data and innovation, among other skills
- revenue growth over three years for boards with three or more such directors was 17.6% compared with 12.8% for boards without technology experts
- market capital growth over three years for boards with three or more technology expert directors was 31.3% compared with 23.3%
- boards with three or more technology experts also had a 34% higher return on assets, according to the study

The WSJ comments that there is a growing trend for companies to elect technology executives to boards in a bid to raise technology awareness/elevate technology awareness to board level.

[Source: [registration required] The WSJ 13/03/2019]