Governance News

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Diversity

'Disappointing' result: Rather than meeting the 30% board diversity target (as hoped), gender diversity on the boards of Australia's largest companies has gone backwards since the start of the year according the latest AICD statistics

The Australian Institute of Company Directors (AICD) has released the latest gender diversity statistics of Australia's ASX 200 companies.

Some Key Points

- Female directors account for 29.5% of all ASX200 board positions as at 31 March 2019
- The year to date appointment rate of women is 23%
- There are four companies in the ASX 200 with zero women on their boards
- 50 ASX 200 companies have only one female board member

Observing that the 30% female board representation target has not been met, and that the overall percentage of women has decreased since the start of the year, AICD Managing Director and CEO Angus Armour, said the results are 'disappointing'. 'Diverse boards help prevent group-think, leading to better outcomes for shareholders, consumers, employees and the community. They promote greater innovation and improved bottom lines' Mr Armour said.

Mr Armour called on boards to take action to address the issue, directors he said should 'look around their boardroom and ask if there is sufficient diversity of skills, experience and gender to effectively meet the demands of a challenging governance landscape.'

Diversity is an issue that requires ongoing board attention: The Australian quotes Australian Shareholders Association (ASA) CEO Judith Fox as attributing the results to 'the same old issues'. Ms Fox reportedly said: 'It would be to do with board renewal and who comes to the attention of the board, whether their target pool is broad enough or whether its target pool of candidates is fairly narrow'. Ms Fox also reportedly said the issue requires ongoing board attention, 'One of the ideas that does concern us is this idea of "we've done that, it's over and done with, move on" … for us it's an ongoing matter requiring broad attention'.

[Sources: AICD media release 23/04/2019; Accountants Daily 23/04/2019; [registration required] The Australian 24/04/2019]

United Kingdom | The last listed company in the FTSE 250 with an all-male board, Daejan holdings, has reportedly resisted pressure to change

Daejan Holdings, a FTSE 250 property group, is reportedly the only remaining business among Britain's 350 largest listed companies with an all-male board. The company has reportedly refused to take steps to alter this, despite pressure from the UK government's Hampton Alexander review body (which is aiming to achieve 33% female board representation in the FTSE 350 by 2020). Reportedly the Daejan board has said that it is not inclined to appoint a female director 'just for the sake of it' and that the Orthodox Jewish beliefs of its founding family, should also be considered in this context.

[Sources: DailyMail UK 28/04/2019; [registration required] The Times 29/04/2019]

In Brief | Nikkei Asian Review reports that large Japanese companies will work to increase the number of female executives to 30% from single digits by the end of 2030, as the government seeks to promote women in the workforce

[Source: [registration required] Nikkei Asian Review 24/04/2019]

Remuneration

Engaging a pay consultant leads to larger pay packets for executives? (As yet unpublished) UTS/Auckland University of Technology research has found ASX listed companies that used

compensation consultants paid their CEO more than those that did not across salary, bonus and equity components

The University of Technology has issued a media release announcing that into use of compensation consultants by Australian companies has found that:

- around 30% of companies examined used a compensation consultant to provide a formal recommendation on CEO remuneration
- the top 500 ASX listed companies that used a pay consultant paid their CEOs more than those that did not
- it is unclear (without further research) whether higher pay associated with consultant use is due to consultants' recommendations or because a company hires a consultant to legitimise higher pay
- the more a consultant is paid, the more the CEO is paid, which is consistent with research from the US and UK that also shows CEOs are paid more when consultants are involved
- where a company that did not previously use a compensation consultant decided to engage one, the researchers found that the CEO subsequently received a larger increase in their pay package
- companies that retained a compensation consultant for more than a single year had even higher CEO pay than those who first engage a consultant

The study took into account the size of the company, profitability, risk, debt levels and corporate and governance structures. Even after controlling for all these factors the researchers still observed higher pay on average with consultant use.

Lead researcher Dr Nelson Ma from UTS Business School said that 'There has been a lot of controversy around CEO pay, and anger over multimillion-dollar remuneration packages, particularly in light of findings from the banking royal commission' and added that shareholders want assurance that pay is awarded based on value creation, the achievement of targets and increasing returns.

'The more we know about CEO pay, the better decisions shareholders and regulators can make' Mr Ma said.

About the research: The details of the research will be published in the upcoming edition of the *Australian Journal of Management.* The research was conducted jointly by the University of Technology Sydney (UTS) and Auckland University of Technology,

[Sources: UTS media release 23/04/2019; The SMH 23/04/2019]

Federal Labor has outlined a number of measures to address the gender pay gap including the introduction of pay gap reporting for large companies

The Federal Labor Party has issued a statement outlining its plans (if elected) to address the gender pay gap. Proposed actions include (among others):

- introducing a new requirement for large companies with more than 1,000 employees to publicly report their gender pay gaps
- banning pay secrecy clauses and giving employees the right to disclose (or not disclose) their pay
- setting up an expert Pay Equity Panel led by a new Presidential member and supported by a specialist Pay Equity Unit
- requiring companies bidding for government contracts to explain the difference between average rates of pay for men and women and how any gap is being closed
- requiring all Australian government departments and agencies to conduct gender pay audits within the first year of being elected to government

[Sources: [registration required] The AFR 26/04/2019; Federal Labor Party media release: Labor's Plan to help close the Gender Pay Gap]

United States | ISS Remuneration trends report has found CEO pay has continued to increase across all market segments and industries

Institutional Shareholder Services (ISS) has released the findings of its analysis of executive compensation trends in the US based on executive pay disclosures received to date.

Some Key Findings

- **Pay disclosures suggest that CEO pay has continued to increase** across all market segments and industries
- **CEO pay appears to be increasing at a faster rate than worker's pay:** According to ISS, CEO pay has increased at a relatively fast pace over the past 10 years. For example, S&P 500 CEOs median pay has increased 50% since 2009 to $12.2 million. By comparison, median worker earnings increased approximately 20% over the same period.
- **Increases in CEO compensation are primarily driven, according to ISS, by greater portions of pay paid in stock:** ISS found that stock-based compensation has increased, while other pay components remain relatively stable. In 2018 the average stock grant to S&P 500 CEOs was $7.2 million, compared to $3 million in pay fiscal year 2009.
- **Increasingly performance based:** Equity-based compensation has become increasingly performance-based in the past decade according to ISS. As a percentage of total equity compensation, performance-based equity almost doubled between 2009 and 2018. Cash performance-based compensation has remained relatively unchanged. Overall, cash and equity performance-based compensation now make up approximately 58% of total pay, compared to 34% in 2019. ISS observes that the increase in performance-based pay has continued, despite concerns that recent tax reform (which removed tax deductions on performance-based pay previously allowed under provisions of Section 162(m) of the Internal Revenue Code) would result in companies increasing the non-performance portion of executive payouts.
- **Performance metrics:** Long-term incentive plans were observed to use a wide variety of performance metrics at different weights, with Total Shareholder Returns (TSR), earnings, and returns being the most popular performance measure categories. For short-term incentives, companies tend to use earnings, revenue, and 'other' company-specific criteria.
- **No change in pay ratios?** The 2010 Dodd-Frank Act mandated disclosures of CEO compensation relative to the pay of the median employee. The rule was adopted in 2015 and was implemented in last year's proxy disclosure filings for the first time. Companies maintain a level of discretion on the definition of median employee. According to ISS, though there are some fluctuations in the definition of median employee disclosures, on aggregate the data indicates no changes in CEO pay ratios compared to last year and median employee compensation levels remain similar to last year.

[Note: The introduction of a requirement for companies to disclose the ratio of their CEO pay to that of their Australian workers' median 25th and 75th percentile pay is among the reforms recently proposed by the Australian Council of Superannuation Investors (ASCI) as a way of enhancing corporate accountability. The Australian Federal Labor Party has also indicated that if elected, it plans to implement a CEO pay ratio disclosure requirement. ASCI's proposed reforms, and Labor's response are covered in separate posts in this issue of Governance News.]

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 16/04/2019]

The case for retaining (and strengthening) the 'two strikes' rule: Allan Fels has reportedly said the existing rule is working as intended and has made boards more accountable to shareholders

The Age reports that Allan Fels has cautioned against revising or abolishing the 'two strikes' rule on the basis that 'it is clearly having the desired effect'. Mr Fels reportedly argued that the rule has:

- produced some restraint around pay and increased engagement between investors and boards
- not meant boards are overly 'preoccupied with pay' (at the expense of other issues). Rather, he argues the fact that boards are spending more time on remuneration is a measure of the scheme's success.

- it is not being 'misused' or co-opted by investors to push broader agendas. 'It is simply making boards more accountable to shareholders than they otherwise would be and allows shareholders to voice their anger about other aspects of board performance' Mr Fels reportedly said.

Reportedly Australian Council of Superannuation Investors CEO Louise Davidson is of a similar view.

No plans to revise the existing rule? The Age reports that neither the Morrison government, nor the Federal Opposition have any plans to amend the existing two strikes rule.

- Reportedly, a Labor spokesman said the Federal Labor party has no plans to alter the rule but, if elected, will require all ASX listed companies with more than 250 employees to report how much their CEO earned compared with an average employee.
- A spokesperson for the Morrison government has reportedly said that the government is 'closely' watching the operation of the rule as it does all governance arrangements for companies.

[Source: [registration required] The Age 23/04/2019]

Institutional Shareholders and Stewardship

Australian Superannuation fund, HESTA is reportedly part of a global coalition to pressure social media companies to take steps to prevent the uploading and spread of harmful content in the wake of the NZ Christchurch terrorist attacks

The AFR reports that a global coalition of 44 investors are targeting Facebook, YouTube (owned by Google) and Twitter to come up with technical solutions to prevent the uploading and spread of harmful content in the wake of the NZ Christchurch terrorist attacks. The coalition reportedly includes Australian superannuation fund HESTA, the Church of England Pensions Board, West Yorkshire Pensions Fund and the Swedish national pensions fund API-4 (among others).

HESTA CEO Debby Blakey is quoted as stating that taking action on the issue is a question of safeguarding long term value. Ms Blakey also reportedly said there is a consensus in the community for these issues to be dealt with and that as an investor HESTA has a responsibility to call for change. 'We are at the table as a long-term investor ... By remaining invested we retain a seat at the table. We would rather engage on the issue of community expectations and make sure that the high standards of safety are met rather than divest and walk away.

The AFR comments that any investor-led campaign involving Facebook comes up against an immediate challenge given founder Mark Zuckerberg controls approximately 60% of the company's voting stock. However Ms Blakey has reportedly said that though HESTA has no plans to divest stock, the weight of money behind the coalition and the weight of community opinion should have an impact. 'The community backlash, if they're [the social media platforms] not prepared to engage with such a large number of the institutional owners, that would be very significant,' she reportedly said.

[Source: [registration required] The AFR 23/04/2019]

No plans to change strategy in response to the 'noisiest' shareholders? BHP CEO Andrew Mackenzie has reportedly said that despite pressure from superannuation funds, BHP has no immediate plans to change its climate strategy

The Australian reports that BHP CEO Andrew Mackenzie has said that BHP has no immediate plans to change strategy on climate risk, despite calls from 'noisy' superannuation funds.

Speaking at a retailer shareholder briefing, Mr Mackenzie reportedly said BHP's management and board considered the views of superannuation funds and activist investors looking for BHP to divest from fossil fuels from an 'appropriate perspective' but considered that these views need to be balanced against those of other shareholders. 'It's the job of myself and the team and the board to balance all of these claims, because a lot of people have a stake in us, to come up with what I think is the best possible outcome — led by our desire to create long-term shareholder value in line with our purpose in society…we can't just listen to the noisiest shareholder — we have to do the right thing for all shareholders and also, I think, for shareholders yet to come, which forces us to take a longer-term view' he is quoted as stating.

Mr Mackenzie also reportedly said that he considered BHP's retail shareholders to be central to the company's future strategy, noting that they do not necessarily share superannuation funds' views on climate strategy.

Mr Mackenzie reportedly told retail shareholders that BHP, like Glencore, had put a hold on further -investment in its thermal coal business, noting it made up only 3% of the company's revenue. However, he confirmed that the company had no near-term intention of following in Rio Tint's footsteps and divesting the business. 'Of course we don't expect the demand for coal for raising power to grow like the demand for other products, like gas and renewables, going forward. But it is a significant part, right now, of the energy mix and likely to remain so for several decades to come' he said.

[Source: [registration required] The Australian 22/04/2019]

In Brief | The AFR reports that the outgoing Chair of Australian Super has resisted Australian Council of Trade Union (ACTU) demands for the fund to support their industrial relations campaigns. Reportedly Ms Ridout said that trustees make decisions in the best interests of members, not those of 'special interests' and as such, 'I would never allow industrial issues to intercede in investment decision-making'

[Source: [registration required] The AFR 29/04/2019]

Other Shareholder News

Top Story | ACSI calls for targeted corporate governance reforms: ACSI has released a policy paper outlining four targeted measures to improve corporate accountability

The Australian Council of Superannuation Investors (ACSI) has released a policy paper outlining four proposals to update Australia's corporate governance framework and improve corporate accountability. ACSI states that if implemented in full, the proposed changes 'would encourage boards to ensure that they are adequately informed about business issues, properly equipped to oversee management, and prepared to take appropriate remedial action when things go wrong'.

Key Takeaways

1. **ACSI proposes four measures to enhance corporate accountability:** a) requiring a binding shareholder vote on remuneration policy every 3 years; b) requiring disclosure of CEO pay ratios to shareholders; c) introducing annual director elections; and d) permitting non-binding (advisory) shareholder resolutions
2. **Time for regulators and parliamentarians to act:** In the wake of the Financial Services Royal Commission, and given Australia lags its peers in implementing accountability measures of the kind proposed, ACSI argues that it's vital that momentum is not lost and has called on regulators and parliamentarians to implement the changes
3. **Shadow Treasurer has welcomed the proposed CEO pay disclosure measure,** as an endorsement of Federal Labor's stated policy

Proposed Reforms

1. **Introduce a binding vote on remuneration policy every three years** to supplement the existing two strikes rule.

2. **Disclose CEO pay ratios to shareholders**, along with an explanation of how the ratio supports the company's values, strategy and culture. More particularly, ACSI is calling for the introduction of a requirement for companies to disclose the ratio of their CEO pay to that of their Australian workers' median 25th and 75th percentile pay. Companies should also be required to explain any changes over time, along with how those ratios are consistent with the company's values, strategy and culture. ACSI comments that in combination, the two measures (the binding vote on remuneration policy every three years, and the disclosure of CEO pay ratios) will ensure investors have greater influence to prevent pay outcomes that are inconsistent with their expectations.

3. **Introduce annual director elections** (for directors of listed companies on a 'comply or explain' basis). Asking companies to put directors forward for re-election annually in Australia will ensure: a) 'boards are the frontline in demonstrating accountability for their companies'; b) 'responsive and timely' feedback on director performance by investors; and c) careful consideration by boards and shareholders of each individual director's contribution to the board and their effectiveness.

4. **Give shareholders the right to propose non-binding resolutions to company meetings** (without the need to seek an amendment to a company's constitution), subject to 'appropriate support' ie the existing 5% or 100 member rule). The proposed reform would benefit boards by giving them the benefit of investor views on a range of matters (on an advisory basis) without 'disrupting the board's role in governing the company'.

[Note: ACSI has previously recommended shareholder resolution reform of this kind in the context of diving progress on ESG issues. See: Governance News 03/11/2017]

'Targeted' and 'proportionate' response to the issues identified over the course of the Hayne Commission

Commenting on the proposals in the media, ACSI CEO Louise Davidson reportedly observed that the measures have already been introduced in other developed markets such as the UK and the US and that consequently, Australia has some 'catching up to do' to bring its corporate governance framework into line with best practice. Ms Davidson also said that considers the proposals to be a 'proportionate and targeted response' to the issues highlighted by the recent Financial Services Royal Commission.

ACSI also called on parliamentarians and regulators to implement the proposals

'ACSI's proposals for annual director elections, votes and disclosure on pay, and greater shareholder power are important steps…Similar measures have had a positive effect in other markets, making companies more accountable to their end investors. We encourage Australian regulators and policymakers to adopt these constructive proposals.'

More to come?

ACSI has said that the proposed reforms are part of a broader policy agenda which it intends to ahead of its annual conference on 8 May.

[Sources: ACSI media release 29/04/2019; ACSI policy paper: Towards better corporate accountability 29/04/2019; [registration required] The AFR 29/04/2019; Investment Magazine 29/04/2019]

Superannuation investors back Labor's pay transparency policy?

In a statement, Shadow Assistant Treasurer Andrew Leigh welcomed ACSI's call for CEO pay ratio disclosure noting that the CEO pay proposal is in line with Federal Labor's stated policy position. Mr Leigh said that in October 2018, the Federal Labor Party announced that (if elected) it plans to require all listed firms with more than 250 employees to report the ratio of their CEO pay to the pay of the median employee. In addition, firms would be encouraged to provide an explanation of their remuneration strategy. The measure would apply from the 2021 financial year to allow the Australian Securities and Investments Commission (ASIC) time to issue appropriate guidance and sufficient time for firms to comply with the new requirements.

[Source: [accessed via LexisNexis Capital Monitor – registration required] Andrew Leigh MP media release 29/04/2019]

Pakistan | The Securities and Exchange Commission of Pakistan (SECP) has released a draft of a new corporate governance code for public listed companies for discussion

The Securities and Exchange Commission of Pakistan (SECP) has released for discussion, a draft of a new corporate governance code for public listed companies for discussion: *[Draft] Listed Companies (Code of Corporate Governance) Regulations, 2019*.

The proposed effective date is 1 July 2019. The timeline for the consultation is not specified.

Some Key Points

- **Overboarding:** Limits the maximum number of directorships a director can hold to seven.

- **Director independence:** Mandates that boards must have a minimum of two independent directors (or one third of the board) whichever is higher. The draft Code also mandates that executive directors (including the CEO) do not constitute more than one third of the board.

- **Gender diversity:** Mandates that at boards must have at least one female director. The draft Code also 'encourages' companies to arrange director training for at least one female executive every year from July 2020, and for at least one heard of department every year from July 2021.

- **Minimum education requirements for directors**: The draft Code 'encourages that' by 30 June 2022, all directors have acquired prescribed certification under any director training program approved by the SECP. Directors with a minimum of 14 years of education and 15 years of experience on the board of a listed company are exempt from the requirement. The Code also requires that companies make arrangements to carry out director orientation programs to 'acquaint' directors with applicable regulations and laws.

- **Board responsibilities:** The draft Code sets out the responsibilities of the board, including (among others) responsibilities to: ensure a formal code of conduct that 'promotes ethical culture in the company' is in place, that there are adequate systems and controls in place for identification and 'redressal of grievances arising from unethical practices'; and that there are formal mechanisms in place to annually assess board and board committee performance.

- **Records of 'significant policies':** The draft Code specifies that boards should maintain formal records of 'significant policies' including when they were last approved and updated and includes a list of 'significant policies'. These include (among others): ESG policies, whistleblowing policies, and 'governance and risk internal control measures'.

- **Issues to be put before the board:** The draft Code sets out a list of 'significant issues' CEOs are expected to put before the board. These include in addition to various financial risks, reports on 'governance, risk management and compliance issues'. The draft Code states that risks to be considered 'shall include reputational risk and shall address risk analysis, risk management and risk communication'. In addition, whistleblowing and environmental, social and governance are among the issues included.

- **Audit:** Among other things, the draft Code specifies mandates that all listed companies in the financial sector change their external auditors every five years. The draft Code also specifies that the Chair of the audit committee will be an independent director and cannot be the Chair of the board, that the CEO and CFO will not attend any meeting of the audit committee except by invitation, and that at least one member of the audit committee is 'financially literate'.

[Source: Securities and Exchange Commission of Pakistan: Draft Listed Companies (Code of Corporate Governance) Regulations 2019]

South Korea | A recipe for better AGMs? The Financial Services Commission and the Ministry of Justice have jointly announced plans to improve shareholder engagement and participation in annual general meetings

The South Korean Financial Services Commission (FSC) and the Ministry of Justice (MoJ) have jointly announced plans to improve shareholder engagement and participation in annual general meetings.

Proposed measures include:

- enabling companies to notify shareholders about upcoming AGMs via email

- clarifying that companies are able to offer incentives — 'at a level that does not breach social norms' — for the purpose of increasing voting turnouts/securing quorums at AGMs

- making electronic voting more convenient for shareholders by enabling them to prove their identity by using their smart phones or credit cards, or using shareholder ID and password issued by companies as proof of identity

- requiring companies to provide shareholders with more detailed information about executive candidates eg a record of his/her entire career, a work plan by candidates for non-executive directors, and reasons for recommendation of candidates by the board of directors

- requiring companies to disclose the actual amount of remuneration paid to directors in the previous year

- extending the period for notification of convocation, from two weeks to four weeks

- prior to the AGM (which will give shareholders more time to review items on the AGM agenda)
- to address the concentration of AGMs being held on the same day, the FSC will introduce a new clause in the Capital Markets Act that limits the number of companies to hold an AGM over a certain period of time. Dates will be allocated upon their application for potential dates on a first-come, first-serve basis

[Source: Financial Services Commission media release [English] 24/04/2019]

Markets and Exchanges

In Brief | ASX reportedly launches blockchain test: The AFR reports that 11 early adopters of the ASX's planned equities blockchain are set to commence accessing the test site. The test of ASX distributed ledger technology (DLT) is reportedly a significant milestone for the project which is reputed to be the world's largest deployment of a private blockchain in financial markets

[Source: [registration required] The AFR 29/04/2019]

Financial Services

Room to improve: APRA has released its review of the 2013 reforms of the superannuation prudential framework and flagged areas in need of 'strengthening'

The Australian Prudential Regulation Authority (APRA) has released its review of 2013 reforms of the superannuation prudential framework.

Findings: Overall APRA found that the superannuation prudential framework has met its original objectives but that it 'must keep evolving to ensure members' interests are protected'. More particularly the review found that the framework has been effective in materially lifting industry practices in key areas such as governance, risk management and outsourcing but that prudential requirements in other areas including board appointment processes, management of conflicts of interest and life insurance in superannuation, could be strengthened.

As such, the review identified a number of areas where APRA will consider enhancements to the existing framework and/or to its supervisory practices. These include 'proposed enhancements' to the following.

Summary of proposed changes

[Note: The proposed changes detailed in Table 2 — Potential enhancements at p 8 of APRA's review document. The full text can be accessed via the link at the end of this post, or here.]

Prudential Standard	Proposed changes
SPS 510 Governance	Strengthening the nomination, appointment and removal process of RSE licensees 'particularly in relation to' the following. ▪ board skills/experience: requiring RSE licensees to have a skills matrix in place with additional guidance to be provided on the formulation of this matrix and its key elements. ▪ board composition: limiting board tenure to a specified period and other enhancements to board renewal processes. ▪ board performance assessment process: 'board performance assessment processes could be more robust and address the board's performance in a range of areas' eg , delivery of member outcomes and strategy execution. 'APRA could provide feedback on industry best practice in relation to board performance assessment processes'.
SPS 520 Fit and Proper	▪ 'Detailing more explicitly' the factors to determine the fitness and propriety of responsible persons, including their skills and experience.

Prudential Standard	Proposed changes
	▪ Reviewing notification requirements for individuals that are assessed by RSE licensees as not having satisfied fitness and propriety requirements.
SPS 521 Conflicts of Interest	Strengthening the requirements for managing conflicts of interest, including: ▪ improving processes relating to the disclosure of conflicts. ▪ requiring RSE licensees to explicitly assess the impact of conflicts of interest on member outcomes. ▪ introducing a two-stage process for the consideration of conflicts of interest (establish interests held, then establish whether those interests give rise to a conflict). ▪ 'other enhancements' to the standard and/or guidance that strengthen or clarify expectations for the avoidance, management and/or mitigation of conflicts.
SPS 220 Risk Management	▪ Harmonising SPS 220 with the equivalent standard that applies to other industries (CPS 220) eg by aligning requirements on risk culture and the requirement to have an independent risk function and Chief Risk Officer. ▪ Strengthening requirements for RSE licensees to consider risks and risk appetite in their strategic planning.
SPS 114 Operational Risk Financial Requirement	Reviewing the objectives and operation of the Operational Risk Financial Requirement (ORFR) including: ▪ refining the percentage of funds under management (FUM) to be held for operational risk events to reflect the size and complexity of RSE licensees' business operations. ▪ refining the data collection for operational risk loss events or 'near-misses' to allow analysis of baseline operational risk in the sector. ▪ strengthening the way RSE licensees assess operational risk events to encourage consideration of risk events other than catastrophic events. APRA will also consider developing a broader reserving standard and guide that reflect prudent practices around the management of all reserves, including those established for operational risk events.
SPS 231 Outsourcing	▪ Strengthening the standard to ensure considerations relating to outsourcing are appropriately reflected in the strategic planning of RSE licensees. ▪ Strengthening the requirements for outsourcing to related party and intra-group entities to ensure conflicts of interest are more effectively avoided, managed or minimised
SPS 232 Business Continuity Management	▪ Expanding the scope of business continuity management to ensure RSE licensees consider the impact of events that are not directly connected to the business operations of the RSE licensee and the business operations of its outsourced service providers, such as material downstream vendors.
SPS 530 Investment Governance	▪ Clarifying or strengthening the factors that RSE licensees are required to consider for member directed (choice) investment options. ▪ Considering additional guidance or requirements to enhance the application of investment strategy stress testing. ▪ Reviewing and updating the guidance on consideration of environmental, social and governance (ESG) factors in formulating investment strategy.

Prudential Standard	Proposed changes
SPS 250 Insurance in Superannuation	▪ Strengthening requirements for the development of appropriately targeted insurance arrangements that reflect an RSE licensee's membership base. ▪ Strengthening the requirements for selecting an insurer, including consideration of any conflicts.
Superannuation Reporting Standards	▪ Reviewing the reporting standards to ensure that the current definitions are both suitable and can be interpreted more consistently, the level of materiality reflects the purpose for which the data is being collected, and there is appropriate coverage of both MySuper and choice products. ▪ When new reporting requirements are being considered or are required, ensuring there more effective engagement/communication with industry during their development and that appropriate consideration is given to the different business models that exist across the superannuation industry.

Work has already commenced: APRA Deputy Chair Helen Rowell said in a statement that APRA is 'already taking steps to strengthen the prudential framework in many of the areas highlighted by the review, and we will look to make further changes to incorporate its findings as we progress our superannuation policy priorities. This will include consideration of measures to address relevant recommendations in the financial services Royal Commission report and the report on the Productivity Commission's superannuation review.'

[Source: APRA media release 30/04/2019; Information paper: Review of APRA's 2013 superannuation prudential framework 30/04/2019; Investor Daily 30/04/2019]

APRA has announced a four week consultation on revised prudential standard SPS 515 Strategic Planning and Member Outcomes following the passage of legislation

The Australian Prudential Regulation Authority (APRA) has released for consultation proposed revisions to Prudential Standard *SPS 515 Strategic Planning and Member Outcomes* (SPS 515) following the passage of the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No.1 Bill 2019)* (the Act). Among other things, the Act introduces a legislated 'outcomes assessment'.

[Note: Prudential Standard SPS 515 was released as part of its Strengthening Member Outcomes package in December 2018. For an overview of the reforms, including SPS 515 see: Governance News 17/12/2018]

'Substance' of the requirements in SPS 515 is unchanged: APRA is proposing revisions to SPS 515 to clarify how the legislated outcomes assessment interacts with APRA's requirements, and to specify additional factors to be addressed in the assessment as provided for in the legislation. APRA states that 'the overall substance of the requirements for RSE licensees in revised SPS 515 are unchanged, however they are expressed differently to more clearly delineate APRA's requirements from those imposed by the Bill'.

Proposed changes to SPS 515

The revised SPS 515 requires a Business Performance Review (BPR) to be undertaken as part of an RSE licensee's strategic and business planning process. APRA states that the BPR reflects the same underlying objective as the requirements set out in the version of SPS 515 released in December 2018.

The BPR requires an RSE licensee to analyse its performance in achieving its strategic objectives having regard to: a) its monitoring of its business plan; b) the outcomes achieved for different cohorts of members; and c) the results from the legislated outcomes assessment.

SPS 515 is also being amended to include requirements for the purposes of the legislated outcomes assessment, as provided for under the Act. RSE licensees will be required to: a) document the methodology applied in undertaking the legislated outcomes assessment, including how the RSE licensee has determined 'comparable choice products'; and b) to separately consider the impact of scale and the operating costs of its business operations on the financial interests of members that hold the product.

Timeline unchanged: The deadline for submissions is 29 May 2019. The new standard is still scheduled to commence from 1 January 2020 (which means that the first business performance review is required to be undertaken by 31 December 2020).

[Sources: APRA media release 30/04/2019; Proposed revisions to Prudential Standard SPS 515 Strategic Planning and Member Outcomes; Draft Prudential Standard SPS 515 Strategic Planning and Member Outcomes]

Enabling underperforming superannuation funds to be stripped of their default status is reportedly among the proposed reforms the Federal Labor Party plans to implement (if elected)

The Australian reports that the Federal Labor party has said that if elected it will consider a number of superannuation reforms including:

- reforms to enable underperforming superannuation funds — regardless of whether they are industry funds or retail funds — to be stripped of their default status;
- options to implement the Financial Services Royal Commission Final Report recommendation that superannuation savings be 'stapled' to a worker (rather than a superannuation fund), rather than adopt the Productivity Commission's proposed 'best in show' list option;

[Note: The recommendation referenced appears to be Financial Services Royal Commission recommendation 3.5: One default account which recommends that a person should have only one default account and that to that end, 'machinery should be developed for 'stapling' a person to a single default account'. See: Financial Services Royal Commission Final Report Volume 1 Recommendation 3.5. This was also among the 31 recommendations made by the Productivity Commission in its final report into superannuation released in January 2019. See: Governance News 16/01/2019. The 'best in show' recommendation referenced above, was also one of the recommendations included in the Productivity Commission's Final Report. The recommendation is that a single 'best in show' shortlist of up to ten superannuation products should be developed and presented to all members who are new to the workforce (or do not have a superannuation account), from which they can choose a product. The Productivity Commission recommended that the first 'best in show' shortlist should be in place by no later than the end of June 2021. See: Governance News 16/01/2019]

- after the 'worst performers' are removed, Labor will also reportedly consider options to 'weed out middling performers' ie 'funds that could be serving their members better but are giving them a somewhat acceptable level of advice and service'

The Australian reports that the commitments were made by Labor financial services spokeswoman Clare O'Neil in a private presentation to industry leaders.

[Source: [registration required] The Australian 24/04/2019]

ASIC has cautioned superfunds that communication concerning the 'protecting your super' reforms should be 'helpful and balanced'

Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019 received royal assent on 12 March and associated regulations commenced on 6 April 2019. The legislation includes a number of reforms which are intended to protect against the erosion of superannuation savings through: a) making insurance opt-in (rather than opt-out) for members whose accounts have been inactive for 16 months; b) enabling the Australian Tax Office (ATO) to take proactive steps to consolidate inactive superannuation accounts; c) impose fee caps on certain fees for low balance accounts (account balances under $6000); and ban exit fees.

The Australian Securities and Investments Commission (ASIC) has issued a statement calling on superannuation trustees to provide 'helpful and balanced' communications to their members regarding the reforms.

ASIC Commissioner Danielle Press said that ASIC expects said, 'superannuation trustees to implement the changes in a timely manner and communicate responsibly – their communications need to help their members. It is not appropriate for trustees to encourage all members to maintain insurance – many members with inactive accounts will be better off allowing the insurance to lapse. Similarly, trustees should not be urging all members with low-balance accounts to keep their account within the fund as this may not be in the best interests of members'.

Ms Press said that ASIC may take action in relation to trustees' communications regarding the reforms, where trustees break the law through misleading communications.

ASIC has also released consumer information on the reforms on its MoneySmart website.

The statement from ASIC follows a letter sent to superannuation fund trustees, which 'reinforced' among other things, 'that any information provided to members in implementing the changes is balanced and factual, not misleading'.

[Source: ASIC media release 17/04/2019]

Update on proposed measures to implement Hayne Recommendation 2.4 (grandfathered commissions): Reportedly submissions to Treasury on proposed legislation and regulations to act on recommendation 2.4 have raised concerns

The AFR reports that Australian Super's submission to Treasury on draft legislation and regulations to action Financial Services Royal Commission Recommendation 2.4 (grandfathered commissions), has raised concerns that the proposed reforms would in fact 'entrench' the payments.

[Note: Consultation on draft legislation to implement Financial Services Royal Commission recommendation 2.4, *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019* closed on 22 March 2018 (see: Governance News 27/02/2019). Consultation on draft regulations, supporting the implementation of the proposed Bill, closed on 25 April. See: Governance News 05/04/2019]

More particularly, Australian Super reportedly objects to the establishment of a scheme under which 'benefits that would otherwise have been paid as conflicted remuneration are rebated to affected clients' rather than banning the payments, is problematic. 'Allowing conflicted remuneration to continue in regulations supporting a Bill designed to end grandfathered conflicted remuneration is disingenuous and arguably misleading to Parliament and its constituents' Australian Super reportedly argues. In addition, the submission reportedly says that the 'scheme arrangements are legally imprecise, not at all transparent for affected consumers and potentially work against consumers' best interests'. As such, the submission reportedly concludes that 'they are completely at odds with the recommendations of the Hayne royal commission'.

Chartered Accountants Australia and New Zealand reportedly raised concerns regarding the proposed start date (1 January 2021), arguing that industry is unlikely to be ready by then.

[Sources: [registration required] The AFR 29/04/2019; [registration required] The Australian 29/04/2019]

Further consultation required? The FPA has raised concerns about the impact of AFCA legacy complaints rule changes on the cost of professional indemnity insurance for financial planners and has suggested that further consideration/investigation is warranted

The Financial Planning Association of Australia (FPA) has issued a statement raising concerns about the Australian Financial Complaints Authority's (AFCA) proposed legacy complaints rule changes and the potential impact they will have on professional indemnity (PI) costs for financial planners. The FPA also has concerns about whether PI policies will cover potential legacy complaints reaching back more than ten years.

In its submission to AFCA on the proposed rule changes the FPA recommends these issues warrant urgent consideration and further investigation by AFCA with the professional indemnity insurance industry.

[Note: On 19 February 2019, the responsible Minister changed the authorisation conditions for AFCA Limited to operate the AFCA scheme. The new conditions require AFCA to deal with complaints about conduct by financial firms (who are current members of AFCA) dating back to 1 January 2008. The expanded jurisdiction will operate for a period of 12 months from 1 July 2019. AFCA consulted on proposed changes to the rules and operational guidelines and this consultation closed on 12 April. AFCA has said that it anticipates that the revised rules/guidelines will be released in June 2019. See: AFCA Scheme Amendment Consultation 19/02/2019]

FPA CEO, Dante De Gori explained the FPA's concerns regarding the proposed changes as follows: 'The FPA has concerns regarding the rules change as proposed in the consultation paper. It is unclear whether the consideration of the AFCA Ombudsmen will be based on the law, codes, guidance and good industry practice available at the time the conduct occurred, rather than the current standards. We are concerned about whether professional indemnity policies will cover potential legacy complaints. If PI cover does not extend to legacy complaints under the conditions set in the proposed rules change – particularly in relation to the application of the 30 June 2019 rules, jurisdiction and monetary limits to legacy complaints – this will have a significant impact on the ability of licensees to pay any determinations made by AFCA in relation to legacy complaints.'

The AFR comments that the FPA's statement follows news that the Association of Independently Owned Financial Professionals is looking to raise $1 million from its members to challenge the legality of The Financial Services Royal Commission Final Report recommendation to end grandfathered commissions (recommendation 2.4).

[Sources: FPA media release 23/04/2019; [registration required] The AFR 24/04/2019]

Fingerprints to replace PINs?

Reportedly bank cards that enable customers to verify payments using their fingerprint rather than their PIN are now being trialled by NatWest with 200 customers in Scotland.

Some Key Points

- It's suggested that eliminating the need for customers to remember a PIN may assist vulnerable customers, be simpler for customers.
- The fingerprint is only held on the card and not centrally by the bank, with each transaction verified using data which is encrypted and stored locally on the card.
- Reportedly, the cards work with existing contactless and Chip and PIN terminals, meaning vendors do not need to update their technology.
- Dependent on customer feedback, the technology may be rolled out more broadly.

[Sources: Australian FinTech 30/04/2019; MetroNews 25/04/2019]

In Brief | Open Banking (possibly) delayed? InnovationAus suggests that the government's failure to pass the Consumer Data Right legislation before the Federal election could potentially lead to further delays to the rollout of the open banking scheme given that the Federal Labor party has reportedly said it intends to amend the legislation

[Source: InnovationAus 18/04/2019]

In Brief | Increased competition? APRA has announced it has granted Judo Bank Pty Ltd a licence to operate as an authorised deposit-taking institution (ADI) without restrictions under the Banking Act 1959

[Source: APRA media release 24/04/2019]

In Brief | ANZ has released a set of dispute resolution principles to ensure customer complaints and legal matters are handled fairly and in line with community expectations. ANZ states that the principles represent a 'small, but important part of ANZ's response to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry'

[Source: ANZ media release 15/04/2019]

In Brief | APRA has released a letter to private health insurers providing reporting guidance on travel and accommodation benefits and age-based discounts. The guidance is in response to aspects of the reforms announced by the Federal Government in October 2017 that came into effect from 1 April 2019

[Source: APRA letter to Private Health Insurers 29/04/2019]

In Brief | Reuters reports that Japanese financial regulator, The Financial Services Agency (FSA) has conducted investigations at two cryptocurrency exchanges — Huobi Japan and Fisco Cryptocurrency Exchange — following management changes at both companies, to assess whether appropriate

measures have been implemented for customer protection and legal compliance (including compliance with anti-money laundering requirements)

[Source: Reuters 23/04/2019]

Accounting and Audit

United Kingdom | No structural split recommendation: The CMA's Final Report into competition in the UK Audit Market makes four recommendations to address the lack of competition in the sector, including the 'operational split' of the big four accounting firms' audit work

The UK Competition and Markets Authority has released its final report following the completion of its market study into the audit sector (see: Governance News 15/10/2019). The review includes four recommendations to address lack of competition in the audit market.

The recommendations are intended to:

1. increase the effectiveness of audit committees across the FTSE350, ensuring that the selection and oversight of auditors is focused on quality (scepticism and challenge) as well as technical expertise
2. increase 'long-run resilience and choice in the market' to achieve a position where more than the Big Four firms can and do audit the UK's biggest companies
3. address issues caused by the Big Four firms' combined audit/non audit service structures

Four Recommendations

The recommendations are as follows.

1. **Increased audit committee scrutiny**
   - Audit committees should come under greater scrutiny by the new regulator, ie that Audit, Reporting and Governance Authority (ARGA) which will replace the Financial Reporting Council (FRC). This may include ensuring that committees report their decisions as they hire and supervise auditors, and that the regulator issues public reprimands to companies whose committees fall short of adequate scrutiny of their auditors.
2. **Operational split of the big four's audit work**
   - The report found that 'auditors should focus exclusively on producing the most challenging and objective audits'.
   - However, given the difficulties with implementing an immediate global structural split, the CMA recommends an operational split of the Big Four's (Ernst and Young, Deloitte, KPMG and PricewaterhouseCoopers) UK audit work.
   - If this does not deliver the anticipated benefits, the case for a structural split should be revisited.
3. **More choice to increase resilience: mandatory joint audit**
   - To drive up audit quality (by increasing the capacity of 'challenger firms') and increase choice in the market, the CMA recommends mandatory joint audit
   - Challenger firms should work alongside the Big four in these joint audits and should be jointly liable for the results
   - The joint audit requirement should remain in place until the regulator determines that choice and competition have improved enough to address the vulnerability of the market to the loss of one of the Big Four
4. **A five year review of progress by the new regulator**
   - The new regulator, the ARGA, should review the effects of these changes periodically, in the first instance 5 years from full implementation. This should consider in particular: a) the merits of moving to independent appointment for auditors; b) whether to go beyond the operational split already proposed; and c) how to fine-tune the joint audit remedy to adapt to market developments.

Next steps: The government has committed to responding to CMA market study recommendations within 90 days. The CMA normally publishes such responses on its website.

Context: The CMA states that it has taken account of the other reviews of the audit market, including Sir John Kingman's report on the sector regulator, the UK government's consultation on his work and Sir Donald Brydon's review of the quality and effectiveness of audit. It has also taken into account the recommendations made by the BEIS Select Committee in its review of the audit market.

Institute of Chartered Accountants in England and Wales' (ICAEW's) response

ICAEW CEO Michael Izza, said though supportive of the CMA's focus on reinforcing the independence of auditors, the ICAEW is concerned that some of the proposed measures could prove 'counterproductive, pushing up costs for businesses and consumers while doing little to improve quality or increase choice'.

In particular, Mr Izza questioned whether mandatory joint audit (with joint liability) will have the anticipated benefits, suggesting instead that the measure 'looks like a very complex intervention, and there is a high risk that it could both drive out incumbents and discourage new entrants. We have long argued that a segmented market share cap would be a better and faster way of extending competition'.

Mr Izza added that the report 'does contain a number of other ideas which are realistic and pragmatic, and do go to the heart of rebuilding trust in audit' but was not specific. He said that the ICAEW looks forward to working with all parties to 'produce effective recommendations for regulation and legislation which will ensure that audit meets the future needs of the British economy and wider society.'

Market response?

Reportedly there is general agreement that audit quality and competition in the marketplace do need to improve. However, the response to some recommendations has been mixed.

- **Joint audit recommendation:** Reportedly the proposed mandatory joint audit recommendation has been questioned by the sector. For example, Ernst and Young, KPMG and the Investment Association have reportedly questioned whether the proposal will deliver the intended benefits. However, Crown and Mazars (two challenger firms) have reportedly welcomed the proposal.
- **Operational split recommendation:** Reportedly EY is opposed to the proposal that the big four should have to separate their audit arms from the rest of their business. Ernst and Young is quoted in The WSJ as stating: 'We believe this would undermine audit quality by reducing our ability to draw on critical skills, capabilities and investment and diminish the resilience of the audit business.' Deloitte and PwC have reportedly said they will be taking time to read through the CMA's report before making comment.

The reforms don't go far enough/are unlikely to be effective?

The FT reports that the recommendations have been questioned by industry commentators. Professor Atul Shah argues that the proposed changes are inadequate to address the issue identified because they avoid 'tackling directly the monopoly power of the Big Four and the urgent need to break them up to preserve competition and independence'. Among other things, Professor Shah argues that the operational split is unlikely to deliver benefits given 'Chinese walls' in banking have proven ineffective, 'why would we still believe they can and will work here'? Similarly, The Guardian characterises the proposals as 'timid' and unlikely to be effective in achieving their stated objectives.

[Sources: Statutory audit services market study: Final Report 18/04/2019; Final Summary Report 18/04/2019; Competition and Markets Authority media release 18/04/2019; [registration required] The WSJ 18/04/2019; [registration required] The FT 19/04/2019; The Guardian 21/04/2019; ICAEW 18/04/2019; 18/04/2019; Accountancy Age 18/04/2019; [registration required] The AFR 23/04/2019]

Risk Management

Climate Risk

Top Story | AICD H1 2019 Director Sentiment Index released: Climate change is a key concern for Australian directors

The Australian Institute of Company Directors (AICD) has released its first bi-annual Director Sentiment Index for 2019: *Director Sentiment Index H1 2019*. The report is a survey of AICD member opinions and future intentions on a range of issues including the economy, government policy and governance regulations.

A high level overview of some of the key findings is below.

[Note: For a summary of the H2 2018 survey results see: Governance News 26/10/2019]

Key Takeaways

1. **Overall, director confidence has fallen to its lowest level in over two years**, with overall director sentiment falling 21 points to minus 16.9 over the last six months. The AICD attributes this primarily to a fall in confidence about the health of the Australian, Asian, US and European economies over the next 12 months
2. **Climate risk and energy policy emerged as key director concerns** with directors nominating climate change as the number one long-term and number two short-term issue for the incoming federal government to address
3. **Cultural Change us a focus for the majority of Australian boards:** 91% of directors said their board is trying to effect cultural change within their organisation (as compared with 89% of directors in H2 2018).

Some Key Points

Climate change has emerged as a key a priority for directors

- **'Awake at night' issues?** Consistent with previous surveys (H1 2018 and H2 2018), sustainability and long term growth prospects continue to be the main issue that keeps directors 'awake at night'. Other concerns include: changing business models, legal and regulatory compliance, corporate culture and data security.
- **Climate change ranks is the third main economic challenge** currently facing Australian business behind, global economic uncertainty and China's outlook.
- **(Suggested) top priorities for the government?**
  - **Climate Change**, energy policy and taxation reform are the top priorities for the Federal government to address in the short term. The importance of climate change has increased significantly since the last survey (12 points on H2 2018).
  - **Climate Change** was ranked as the top long term priority for the federal government to address in the long term, consistent with H2 2018. This was followed by infrastructure, an aging population, energy policy and taxation reform.

Community expectation that the incoming Federal government will articulate a clear response to climate risk? The SMH quotes AICD CEO Angus Armour as commenting that the findings demonstrate there is a 'great deal of convergence' around climate risk across all sectors and called for the incoming Federal government to deliver certainty on the issue. Mr Armour reportedly said, 'We've reached a point where a second-best option that was agreed on a bipartisan basis, that would carry forward the next five or 10 years, would still be better than no policy certainty at all.'

Regulation

- **'Red tape' is expected to increase:** Directors continue to feel pessimistic regarding the level of 'red-tape' in the next 12 months, with 59% expecting it to increase (as compared with 51% in H2 2018 and 42% in H1 2018). 78% of directors identify corporate reporting requirements as the aspect of their business most affected by 'red tape' (as compared with 77% of directors in H2 2018 and 78% in H1 2018). This was followed by workplace health/safety and preparing/paying taxes.
- **Directors are even less willing (as compared with H2 2018) to continue on boards/accept new board appointments**: According to the survey, directors continue to feel pessimistic about the impact of legislation on director liability in H1 2019.
  - 35% of directors feel that it has negatively affected their business decision making (as compared with 33% in H2 2018)
  - 43% feel it has negatively affected their willingness to continue on a board (as compared with 40% in H2 2018)

- 52% feel it has negative affected their willingness to accept new board appointments (as compared with 51% in H2 2018).

Culture

- **Cultural change is a focus for the majority of boards:** 91% of directors believe their board is trying to effect cultural change within their organisation (as compared with 89% of directors in H2 2018). 36% said that their board was making a 'substantial effort' to effect cultural change within their organisation.
- **Australian boards have a risk-adverse decision making culture**: 70% of directors perceive there to be a risk averse decision making culture on Australian boards (as compared with 69% of directors in H2 2018). 30% of directors attribute this to excessive focus on compliance over performance, followed by pressure from shareholders for short terms returns (21%) and lack of genuine diversity in the board room (13%).
- **The top three steps for boards to take to rebuild/regain trust** were identified as: demonstrating respect for customers/clients/communities (53%, up from 52% in H2 2018), trustworthiness of leadership (44% slightly down from 48% in H2 2018) and improving corporate culture (42% slightly down from 43% in H2 2018). Increased 'genuine' stakeholder engagement (33%), and greater accountability in cases of misconduct (35%) were also identified as important steps.

Board diversity

- **Consistent with the results of the H1 2018 and H2 2018 surveys, skills diversity remains a priority for boards:** The effort made to increase the diversity of skills in board membership was more or less stable in H1 2019 with 72% of directors stating that their business is actively seeking to improve skills diversity (as compared with 74% of directors in H2 2018). 52% of directors said that their board is actively trying to increase gender diversity (as compared with 53% in H2 2018).

Economic outlook

- **Director confidence levels:** Overall, director confidence has fallen to its lowest level in over two years, with overall director sentiment falling 21 points to minus 16.9 over the last six months. The AICD attributes this in the main to a fall in confidence about the health of the Australian, Asian, US and European economies over the next 12 months.
- **Outlook for the Australian economy:** Directors are pessimistic about the Australian economy as compared with the second half of 2018:
  - 23% perceive the economy to be strong and 31% perceive it to be weak at present (as compared with 39% perceiving the economy to be strong in H2 2018).
  - The outlook for the next 12 months is also negative. 50% of directors expect the economy to be weak over the next 12 months (an increase on H2 2018 where 30% expected it to be strong over the next 12 month period).
- **Outlook at state level:** NSW, VIC and ACT directors are the most optimistic about the health of their state economy at present. NSW directors were the most optimistic with 50% viewing the NSW economy as either very strong (7%) or strong (43%). QLD directors were the most pessimistic with 53% viewing the health of the QLD economy as very weak (14%) or weak (39%). Directors across all states and territory are less optimistic than they were in H2 2018.
- **Global outlook:** Directors are less optimistic about the health of major global economies over the next 12 months as compared with the second half of 2018. The European economy is viewed the least favourably with 62% viewing it to be weak/very weak. The Asian economy is viewed the most favourably with 36% viewing it as strong/very strong.
- **The key economic challenge facing Australian business in H1 2019** was identified as global economic uncertainty followed by China's outlook and climate change. Energy policy was ranked fourth and low productivity growth ranked fifth. By comparison, in H2 2018 rising global protectionism was ranked the primary challenge (this slipped to 11th place in H1 2019).

- **Business growth:** Directors' optimism regarding past and future business growth has decreased since last year. Less than half (44%) of directors now expect their business to grow in the coming year as compared with 53% in H2 2018.

About the survey: The survey was conducted with 927 AICD members over the period 28 February to 14 March 2019.

[Sources: AICD media release 18/04/2019; Summary report; Full report: AICD Directors sentiment index: research findings first half 2019; The SMH 18/04/2019]

A global coalition of central banks, the Network for Greening the Financial System, has called on all financial actors (including central banks and supervisors) to take urgent action to implement measures to ensure a smooth transition to a low carbon economy

A group of the 34 central banks and supervisors — the Network for Greening the Financial System (NGFS) — recently released a report entitled: *'A call for action — climate change as a source of financial risk'.* The report aims to translate commitments to act on climate-related financial risks into concrete actions and includes four recommendations to assist central banks, supervisors and the financial community to make a smooth transition to a low-carbon economy.

The recommendations are:

1. **Integration of the monitoring of climate-related financial risks into day-to-day supervisory work,** financial stability monitoring and board risk management:
   - Supervisors are encouraged to set expectations to ensure financial firms are adequately addressing the financial risks from climate change, including by conducting scenario analysis to assess their strategic resilience to climate change policy.
   - Firms are encouraged to take a long-term, strategic approach to the consideration of these risks, and to embed them into their business-as-usual governance and risk-management frameworks.
2. **Lead by example**, specifically central banks are encouraged to integrate sustainability into their own portfolio management.
3. **Collaborate to bridge the data gaps to enhance the assessment of climate-related risks**. Public authorities should share and if possible make publicly available any climate-risk data.
4. **Build in-house capacity and share knowledge with other stakeholders on management of climate-related financial risks.** An important element to achieving effective consideration of climate risks across the financial system is to support internal and external collaboration.

The release of the report was accompanied by a joint letter from the Governor of the Bank of England Mark Carney, Governor of Banque de France François Villeroy de Galhau and NFGS Chair Frank Elderson calling on all actors in the financial system to take urgent action to implement the recommendations. 'We recognise that the challenges we face are unprecedented, urgent and analytically difficult. The stakes are undoubtedly high, but the commitment of all actors in the financial system to act on these recommendations will help avoid a climate-driven “Minsky moment” – the term we use to refer to a sudden collapse in asset prices. As long as temperatures and sea levels continue to rise and with them climate-related financial risks, central banks, supervisors and financial institutions will continue to raise the bar to address these climate-related risks and to “green” the financial system…climate change is a global problem, which requires global solutions, in which the whole financial sector has a crucial role to play' the letter states.

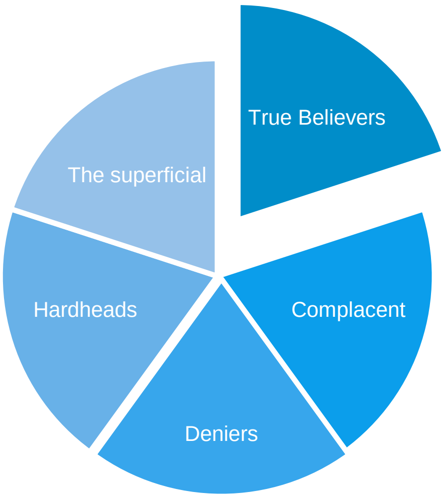
Separately, the Bank of England has released a statement committing to disclose how financial risks from climate change are managed across its entire operations in its 2019/2020 annual report, in line with the NFGS recommendation that central banks lead by example.

[Sources: Fortune 26/04/2019; Open Letter on Climate Related Financial Risks: Joint Letter from the Governance of the Bank of England Mark Carney, Governor of Banque de France Francois Villeroy de Galhau and Chair of NSGS Frank Elderson 17/04/2019; Network for Greening the Financial System media release 17/04/2019; NGFS First comprehensive report 17/04/2019; NGFS Executive Summary First Comprehensive Report 17/04/2019; Bank of England media release 17/04/2019]

How can the gap between stated intentions and concrete actions on sustainability issues best be addressed? Writing in Harvard Business Review, INSEAD researches outline suggested strategies to persuade directors to act

Writing in Harvard Business Review, INSEAD researchers outline the findings of their research into board attitudes towards sustainability issues. Based on interviews with European directors, they found that there are a wide range of and overall and that overall there is a 'gap between aspiration and action'. Given the rising importance of these issues in the eyes of the community they argue, this needs to change: 'it is 'only a matter of time before board directors find that bridging the gap between aspirations and action is a requirement of fiduciary duty, with all the attendant obligations and liabilities' they argue. Taking this as their starting point, they outline a range of strategies to engage directors on these issues.

Generally directors fall into five behavioural archetypes



- Based on their interviews with European directors, the researchers found that board members hold a range of views on the importance of sustainability issues and a correspondingly wide range of views on whether their organisation is doing enough to address the associated risks/opportunities.
- In addition, the researchers found that though there is a tendency for directors with similar views to gravitate towards the same companies, many directors are on boards where a range of views are represented.
- Generally, directors' views into five categories or behavioural archetypes: 1) Deniers; 2) Hardheads; 3) The superficial; and 5) the complacent.

Suggested strategies to engage directors (and persuade them to act) on these issues

Behavioural Archetype	Characteristics	Suggested method of engagement
Deniers	▪ view sustainability as nothing more than a buzzword or a fad ▪ denial/hostility to sustainability issues may not be immediately apparent as it is 'largely unacceptable' today. Where deniers are a 'dominant force' on a board then sustainability issues will tend to given short shrift in annual reports/sustainability concerns will be notable for their absence ▪ Deniers may also be adept at using PR or corporate communications to 'greenwash' their message ie to overstate environmental benefits/understate environmental damage.	▪ frame sustainability conversations in terms of business risk/benefit ie through specific, concrete concepts such as cost reduction, business opportunity, consumer demand, risk exposure as opposed to broader concepts such as saving the planet, the good of future generations ▪ speaking to deniers one-on-one, rather than in the context of a bigger meeting where they may feel under attack/ambushed ▪ choosing an opportune moment — 'never raise the issue in times of crisis'
Hardheads	▪ consider sustainability to the extent that it is as a relevant factor affecting their business eg how can costs be minimised? ▪ may use complex ethical considerations to excuse/justify their lack of action eg who are we to say rainforests should be preserved	▪ advisable to frame conversations in their own terms ie a business risk (as is the case when engaging with deniers) ▪ consider encouraging them to drive their company to 'be the best in

Behavioural Archetype	Characteristics	Suggested method of engagement
	when the prosperity of the local people comes from palm oil?	class' or to choose a more ethically acceptable route that's not too far from existing practice eg appointing a dedicated sustainability director ▪ look for a quick win ie start with areas where the business case is strong and results are tangible
Superficial	▪ have a 'shallow' understanding of the need for sustainability, and are more concerned with being seen to do the right thing than with actually doing it ▪ tend to 'pass the buck' rather than take action themselves ▪ the researchers found that the 'worst' boards of this kind implicitly promote greenwashing. 'By talking the talk, they encourage executives to do the same and fail to give the strategic framework executives need to take real action'.	▪ 'play to their good intentions' by making specific, positive suggestions on how to translate intentions into action eg advocate for the creation of a dedicated sustainability committee which can talk through the issues and suggest concrete actions for the whole board to ratify
Complacent	▪ this group may have been early adopters of initiatives such as CSR reports or green product lines ▪ they have not kept up to date with developments ▪ directors in this category use past sustainability triumphs to shut down the conversation about sustainability. They consider that because they have 'good' processes/policies in place, there is no more work to be done	▪ acknowledge past successes while highlighting current shortfalls ▪ seek out like-minded directors and create coalitions ▪ try to move the debate forward by focusing on small actions, rather than a wholesale strategic review
True believer	▪ deep understanding of sustainability and its link with long-term growth ▪ their starting point is always: 'Are our products and business models future-proof?' ▪ consider the long-term economic viability of their organisation is closely linked and dependent on social and environmental responsibility ▪ consider sustainability issues to be closely linked to basic questions of company purpose, core product offerings, business models and innovation ▪ companies with true believer boards are likely to have: sustainable products; ethical supply chains; employment practices that exceed the regulatory minimum; a board 'expertise matrix' that includes corporate	▪ True believers need to consider not only how best to engage with other board members but also not to get too carried away in advancing attention to sustainability relative to the economic constraints, albeit from a long-term perspective.

Behavioural Archetype	Characteristics	Suggested method of engagement
	social responsibility (CSR); sustainability as a criterion for recruiting and remunerating senior executives; energy-neutral facilities and low-carbon operations; and a strong commitment to integrating sustainability into research and development and innovation.	

[Source: [registration required] Harvard Business Review 19/04/2019]

Westpac committed to 100% renewables by 2025

Westpac has announced it will become a member of RE100, a global initiative led by the Climate Group in partnership with CDP whose members commit to go 100% renewable. Westpac has committed to source the equivalent of 100% of its global electricity consumption through renewable sources by 2025.

[Note: RE100 launched in Australia at the end of 2018. See: RE100 media release 25/10/2018; Governance News 26/10/2018. For a list of RE100 signatories click here.]

[Source: Westpac media release 17/04/2019]

The majority of Australians support action on climate change according to an Australia Institute survey

The Australia Institute surveyed a nationally representative sample of 1,536 Australians about their attitudes to climate change. The survey found that here is support for a wide range of climate policies and broad agreement that climate change is serious and can and should be addressed. Support was present across Australia rather than being focussed on particular states.

Some Key Points

- **Almost six in 10 respondents agreed that Australia is facing a climate change emergency and should take emergency action (58%)**. Agreement was highest in Victoria (60% of respondents agreed this is the case).
- **Support for transition to renewables:** Two in three survey respondents (68%) supported a rapid transition to 100% renewable energy, including a majority of each major party's voters. Support was highest in WA (72%) followed by NSW (68%). Three in five survey respondents supported a national program to switch to an electrically charged transport system (62%)
- **Support for research:** Three in five survey respondents supported a large publicly funded research program into zero carbon industry and agriculture (63%)
- **Support for no new coal mines and no exploration of new coal, oil or gas deposits:** Half of Australians supported no new coal mines constructed (53%) and no new exploration for new deposits of coal, oil or gas (49%).
  - 50% of QLD respondents, 54% of WA respondents, and 55% of NSW respondents do not support new coal mines
  - Support for no new exploration for new deposits of coal, gas or oil is highest in NSW (52%), and somewhat lower in Western Australia (48%), Victoria (47%) and Queensland (45%)
- **Government action is required:** Seven in ten respondents (69%) agreed that strong government action is needed to rapidly reduce greenhouse gas emissions and transform Australia's economy to one that is zero-carbon. Only 16% of respondents disagreed. Two in three Western Australians agreed (65%) which is four times higher than the portion from WA who disagreed (14%)
- **Those against climate action are in the minority:**

- Three in 10 respondents (30%) agreed that strong action on climate change would leave us worse off. Half of respondents (50%) disagreed that strong action on climate change would leave us worse off. Disagreement was highest in Queensland (55%)
- Fewer than three in 10 respondents (28%) agreed that what Australia does on climate change will make no difference. Six in 10 respondents (59%) disagreed that what Australia does on climate change will make no difference. Disagreement was highest in Queensland (60%) and Victoria (59%)

[Source: [accessed via subscription service Capital Monitor] The Australia Institute media release April 2019]

In Brief | In the absence of government action, The AFR reports that some Australian companies are setting their own carbon price as a means of future-proofing their businesses against 'inevitable' policy change

[Source: [registration required] The AFR 30/04/2019]

In Brief | 'Irresponsible' on climate issues: The BBC reports that climate change activist Greta Thunberg met with UK members of parliament and described the UK's response to climate change as 'beyond absurd'. She reportedly criticised the country for supporting new exploitation of fossil fuels and said the cuts to carbon emissions have been exaggerated. 'You don't listen to the science because you are only interested in the answers that will allow you to carry on as if nothing has happened' Ms Thunberg is quoted as stating

[Source: The BBC 23/04/2019]

Other Developments

In Brief | The answer to the skills shortage? Harvard Business Review reports that a new study has found that though executives tend to be pessimistic about their employees' ability to acquire necessary new capabilities, employees are in fact keen to learn new skills. By creating a learning culture; engaging employees in the transition instead of shepherding them through it; developing an internal talent pipeline for the entire workforce; and collaborating with outside partners to build the right skills in the labour pools it hires from, companies can tap into this existing talent reserve

[Source: Harvard Business Review May-June 2019 Issue]