Governance News

22 May 2019

Mark Standen
Partner

T +61 2 9921 4902 | **M** +61 412 104 902

Siobhan Doherty
Partner

T +61 2 9921 4339 | **M** +61 413 187 544

Kate Hilder
Consultant

T +61 2 9921 8785 |

For queries or to subscribe/unsubscribe to Governance News updates, please contact: kate.hilder@minterellison.com

Contents

Boards and Directors 4

Best path to an ASX200 board seat? Boards are primarily looking for deep executive experience with a significant profit and loss responsibility ... 4

United Kingdom | Worker directors appointed: Capita has appointed two employees (an accountant and a civil engineer) to its board to meet new UK Governance Code requirements ... 5

Diversity 6

United States | 6.6% of Fortune 500 companies will be led by women from 1 June (a record high) ... 6

Canada | Progress to be made? 56.8% of boards in Canada include zero women according to a report from Statistics Canada ... 7

Remuneration 8

Increased engagement with investors, including retail investors, on executive remuneration is now (reportedly) considered crucial according to certain prominent business leaders ... 8

United States | Mismatch between CEO performance and pay? ... 9

United Kingdom | 'We know this is slow but we are moving in the right direction': The Bank of England says it has reduced the gender pay gap 1% since last year ... 9

Shareholder Activism 9

Legg Mason has reportedly reached agreement with activist Trian on board change ... 9

In Brief | Myer has announced the appointment of former Just Group executive Jacquie Naylor as a non-executive director effective 27 May. The AFR comments that Ms Naylor's appointment follows criticism from activist Solomon Lew that the Myer board lacks retail expertise ... 9

Institutional Shareholders and Stewardship 10

In Brief | Push for (among other things) ESG integration in the investment process: Japan's Government Pension Investment Fund Stewardship Activities Report 2018 identifies integration of environmental, social and governance considerations into the investment process as a key priority in fulfilling stewardship responsibilities ... 10

In Brief | Will the distinction between ESG analysis and financial analysis continue to exist, in future? Fidelity International emerging markets portfolio manager Alex Duffy, has reportedly questioned the relevance of the

continued distinction between ESG (environmental, social, governance) analysis and financial analysis, arguing that 'you cannot separate the two'. 'I feel that the term ESG is going to be totally redundant in five years. Anyone that tells you they are an unsustainable investor which is the other side of the coin that doesn't make any sense' he is quoted as stating 10

Meetings and Proxy Advisers 10

United Kingdom | New transparency framework for proxy advisers: Proxy Advisers (Shareholders' Rights) Regulations 2019 to apply from 10 June 2019 10

United States | Is a 'draft review process' justified? The US National Investor Relations Institute has called on SEC to require proxy advisers to give companies opportunity to review (and correct) proxy reports before they are issued publicly 'to ensure that investors receive the most reliable proxy research' 11

Regulators 12

ASIC Annual Forum | ASIC Chair James Shipton has called on the financial sector to embrace the 'fairness imperative' 12

Casenote | High Court decision Frugtniet v Australian Securities and Investments Commission: The AAT is subject to the same constraints as ASIC when reviewing ASIC banning decisions 13

In Brief | A panel of ASIC representatives has reportedly told the ASIC Annual Forum that ASIC's monitoring and in particular, use of new penalties, is expected to drive a cultural shift in the superannuation sector, Investor Daily reports 14

Corporate Social Responsibility and Sustainability 14

Mixed scorecard? ISS' annual global analysis of sustainability practices found that companies are steadily improving their ESG rating but that there is also a growing misalignment between corporate practices and stakeholder expectations with respect to ESG issues 14

In Brief | Investment in the workforce is one of the best financial decisions companies can make? Freezing the salaries of 20 executives in order to raise worker pay, reportedly tripled the business of US home health care provider CareCentrix over five years. Citing this in support, CareCentrix CEO John Driscoll makes the case for companies acting to address pay inequality within their own workforce on the basis that it is: a) a sound financial decision; and b) it is part of 'the role and responsibility of the business community in contributing to the success of the American Dream' 16

Financial Services 16

Top Story | ASIC is consulting on lifting standards/transparency of complaints handling 16

ABA CEO Anna Bligh has reportedly cautioned the ASIC Annual Forum that higher standards of professionalism/cultural shift in financial institutions will necessarily result in lower growth in the short term 19

APRA has granted Societe Generale a licence to operate as a foreign authorised ADI 20

Update on new BEAR registration form for smaller ADIs: APRA has left the BEAR registration form (for small and medium ADIs) unchanged, but has clarified parts of the instruction guide in response to submissions 20

Not 'intended to signify any lessening' in the importance the regulator places on 'sound lending standards? APRA is consulting on proposed amendments to its guidance on residential mortgage lending 21

In Brief | Is APRA downplaying competition risk? A new report commissioned by the Customer Owned Banking Association (COBA) and compiled by Pegasus Economics entitled Reconciling Prudential Regulation with Competition, has found (among other things) that changes to the regulatory capital framework have undermined competition in the mortgage market 22

Accounting and Audit 22

United Kingdom | KPMG UK will reportedly change its executive governance structure to separate audit from the rest of the business 22

Risk Management 22

Culture 22

Top Story | Lessons from the Financial Services Royal Commission about how to use technology 22

Ethical lapses the primary reason behind forced CEO resignations in 2018? New global study into CEO turnover has found a sharp rise in the number of CEOs forced to resign due to ethical lapses 23

Climate Risk 25

Top Story | Heightened expectations of climate-related disclosure and assurance 25

62 climate experts have signed an Australian Institute petition urging the next parliament to make climate action a top priority 25

Boards and Directors

Best path to an ASX200 board seat? Boards are primarily looking for deep executive experience with a significant profit and loss responsibility

Report Overview | Joint Ernst and Young and 30% Club report, The Next Generation: Pathways to ASX 200 Board Roles of the 2018 Appointees

Ernst and Young (EY) and the 30% Club have jointly released a report analysing the experience and pathways to appointment to an ASX 200 board. The report identifies 'clear steps' for Chairs, business leaders can take to improve gender diversity, and also steps women seeking ASX 200 board roles can take to assist them in reaching their goal.

Some Key Findings

Skills and Experience

- **Executive experience with P&L responsibility is the key priority:** The most important and desirable experience for ASX 200 boards is senior executive experience, in particular roles with significant profit and loss (P&L) responsibility.
- **Prior board experience is viewed as less important than executive experience:** According to the report, prior 'boardroom experience might help to tip the scales in your direction but only in conjunction with strong executive skills'. As such, prior board experience is not (of itself) a stepping stone to an ASX board role. Some of the reasons identified in support of this view include: a) that sufficient executive experience enables directors to 'command the respect of the rest of the board, the executive team and particularly the CEO'; b) prior non-executive director (NED) experience is not considered necessary to 'understand governance'; and c) many executives have significant boardroom experience (though from the perspective of reporting to the board/crafting board papers) which is considered sufficient to give them a strong understanding of how boards work.
- **The top three skills** survey respondents believed they brought to their board appointment were leadership, strategy and digital transformation. According to the report, 'boards are proactively looking for individuals who can provide insights into future technologies and the way companies are adapting to disruption caused by these new technologies and the influence of social media' the report states.
- **All respondents appointed possessed the required skills and executive experience irrespective of gender**

Insights into the search process: Boards appear to be casting the net outside their personal networks

- **Men and women that participated in the research had very similar journeys to ASX 200 boards** and gender balanced shortlists are the norm
- **No good hoping for a 'tap on the shoulder'?** The report found that there is active competition for every seat on the board and a 'a well-defined and highly-professional procedure for defining skills gaps and then identifying the person best-qualified for the role'
- **Search consultants are increasingly involved** in the process by providing 'unbiased' lists of diverse candidates
- **The majority of survey respondents were approached by a search firm** for the role and none said they had been approached via their networks. The report notes that this was not the case for all of those interviewed.
- **Approximately 50% of both male and female appointees had been actively targeting the board** they joined through conversations with search consultants and other directors
- **Some female interviewees emphasised that women need to be intentional in their networking and building a board profile** as considerably more men are in the CEO and senior P&L roles which afford higher visibility.

Simultaneous executive and boardroom careers?

The report identifies a trend towards board members holding executive roles and non-executive board roles simultaneously (though the majority of appointees were full time NEDs). Of those who were not full time NEDs, 75% of females and 25% of males were in a full-time executive role.

Barriers to appointing women persist (despite advances)?

According to the report, 'there are still times when chairs feel there is no alternative to an all-male short list or a male appointee'. The report argues that this 'underscores the need to ensure that a strong pipeline of female candidates is visible to chairs'. The report observes that is also demonstrates that 'when chairs are searching for a candidate with non-negotiable skills, they are not making concessions to recruit on the basis of diversity'.

Suggested way forward?

- **Three things female candidates should do:** The report suggests that female candidates seeking an ASX200 board position can optimise their chances of success by: a) gaining as much senior executive experience as possible; b) being aware that experience on smaller boards is secondary to senior executive experience; c) developing networks with senior board members so chairs can contact someone they know for a reference.
- **Three things business leaders should do**: To help drive progress on (gender) diversity, business leaders are advised to: a) mentor aspiring ASX 200 directors to give them an insight into the responsibilities, pressures, skills, experience and personal qualities required so they can make informed decisions on their career path; b) share their own networks/make appropriate introductions; c) make a commitment to bring women into leadership roles.
- **Three things Chairs should do:** To increase (gender) diversity, Chairs are advised to: a) be prepared to extend the net beyond prior CEO experience where there are already former-CEOs on the board; b) work with search firms to identify high calibre female candidates outside their own networks; c) consider the benefits of appointing a director who is still a full time executive.
- **About the report:** The report is based on an online survey completed by men/women appointed to their first ASX 200 board in 2018 and on interviews conducted with a number of those directors. It was sent to a total of 88 non-executive directors (NEDs) (52 males and 36 females), who had been appointed to their first ASX 200 board in 2018. Of the 33% who responded, 59% were female, 41% male. Interviews were also conducted with Chairs who had appointed at least one new director to the ASX 200 in the last year and search consultants who had worked with ASX 200 companies.

[Source: Ernst and Young media release 15/05/2019; Report: The Next Generation: Pathways to AX200 board roles of the 2018 appointees; [registration required] The AFR 15/05/2019; Financial Standard 15/05/2019]

United Kingdom | Worker directors appointed: Capita has appointed two employees (an accountant and a civil engineer) to its board to meet new UK Governance Code requirements

FTSE 250 company Capita has announced the appointment of two employees to its board as non-executive directors (NEDs). The Capita board currently comprises eight directors – the chairman, chief executive officer, chief financial officer and five independent non-executive directors.

[Note: The UK Local Authority Pension Fund Forum (LAPFF) recently issued a statement outlining the results of a survey into how companies plan to meet a new requirement under Provision 5 of the UK Corporate Governance Code (Code) to give employees a voice on boards. According to the LAPFF, of the 66% of companies that have reached a decision about how they will meet the new requirement, the majority (73%) are planning to appoint a non-executive director; 27% plan to establish a workforce advisory panel; and small proportion — 5% (2 companies) — plan to appoint a director from the workforce. See: Governance News 08/05/2019.]

Details

- All employees with two years' continuous service were eligible to apply for the NED roles and there were almost 400 applications received from Capita's staff of more than 63,000 employees.

- The two directors appointed to the board are: Lyndsay Browne (chartered accountant and Capita employee since 2003) and Joseph Murphy (chartered civil engineer and Capita employee since 2015).
- Both appointees will continue in their current day-to-day roles, with time allowances made for them to be able to fulfil their employee director responsibilities.
- Both will receive the same remuneration as other non-executive directors, and provided with a full program of training to equip them for their new roles.
- The appointment take effect from 1 July 2019, with an initial appointment period of three years (Ms Browne) and two years (Mr Murphy), respectively.
- Capita states that the worker directors will 'provide an employee's perspective and expertise, and input into strategic decision-making with the same level of authority as other directors'.

In a statement announcing the appointments Capita Chair Sir Ian Powell said 'I am delighted to welcome Lyndsay and Joseph to the board and proud that Capita is the first FTSE 250 company in many years to make such appointments. We are determined that the employee's perspective and increased diversity of thought are represented at board level. Lyndsay and Joseph bring very different skills, experience and insights. I have no doubt they will prove strong members of the board.'

[Source: Capita media release 14/05/25019]

Diversity

United States | 6.6% of Fortune 500 companies will be led by women from 1 June (a record high)

According to the latest Fortune 500 list, as at 1 June, a record number (33 companies or 6.6%) will be led by a female CEO. This represents a significant increase on last year (24 companies or 4.8%).

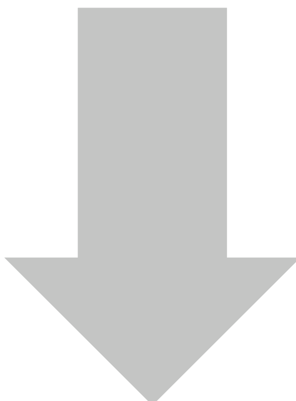
Some Key Points

A 'record' 6.6% of Fortune 500 companies will be led by women as at 1 June

Women hold 22.5% of Fortune 500 board seats

Some boards have achieved 50/50 (or better) gender diversity but they make up a small proportion: 10 out of 500 companies

Increased board diversity overall may result in increased female CEO tenure



Very few female CEOs will be non-white

Minority women held only 4.6% of Fortune 500 board seats (as compared with 66% held by white men)

The same pool of women is being tapped to take on multiple director roles at different companies (rather than more women beging appointed)

Pressure from institutional investors: Fortune attributes the increase to pressure from institutional investors to improve board diversity which resulted in an uptick in the number of female CEOs appointed over the last twelve months. Institutional investors (and now boards) are reportedly increasingly convinced, Fortune argues, of the value of diverse leadership of the value of diverse leadership.

Increased board diversity may result in increased female CEO tenure? Christy Glass, a professor at Utah State University, is quoted as commenting that the more diverse boards are overall, the more likely female CEOs will stay in

their roles. This is significant, she suggests because women CEOs in the Fortune 500 overall have shorter stints than their male counterparts (42 months versus 60).

Very few CEOs are non-white women: Fortune comments that though the number of female CEOs is at a record high, very few are non-white women (especially given the departures of PepsiCo's Indra Nooyi (who is Indian-American), and PG&E CEO Geisha Williams (who is Latina)). In addition, Bed Bath & Beyond's Mary Winston, though the first Black woman to serve as a Fortune 500 CEO since Xerox's Ursula Burns stepped down two-and-a-half years ago, is in an interim post.

Fortune quotes Professor Glass as suggesting that the lack of broader diversity may be addressed, over time through a push for increased diversity overall, 'when women lead companies at the board rank and as CEOs, [there's] more attention [paid] to equality policies and practices. So one added bonus of the growth of women directors is that CEOs place more emphasis on recruiting, retaining, and advancing people of color' Professor Glass is quoted as stating.

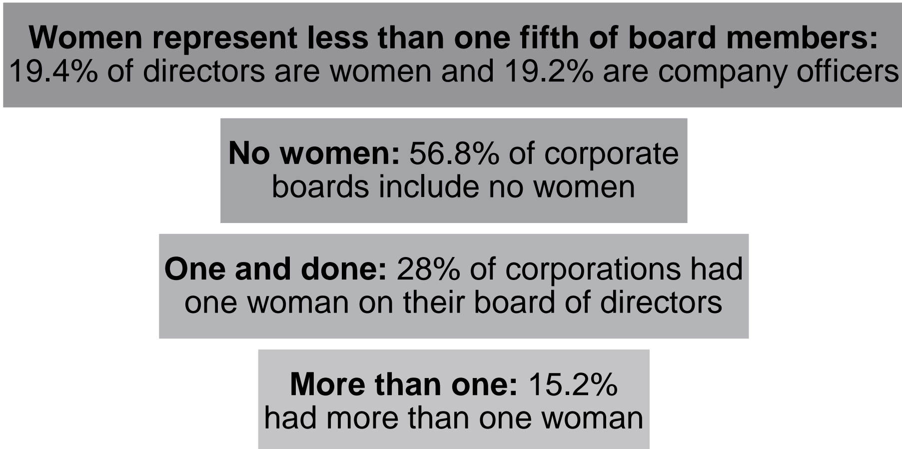
[Sources: Fortune 500 2019; Fortune 16/05/2019; 21/05/2019]

Canada | Progress to be made? 56.8% of boards in Canada include zero women according to a report from Statistics Canada

Snapshot | Statistics Canada study: Representation of Women on Boards of Directors, 2016

Statistics Canada has released a study analysing the gender composition of corporate boards (including private corporations, government business enterprises and public corporations) in Canada. The study is reportedly more comprehensive than previous studies because it includes analysis of the gender composition of boards beyond publicly traded corporations.

High level picture of female board representation on Canadian boards



Progress to be made? Most Canadian boards are all-male and of those boards that do include women, only 15.2% include more than one.

The report cites US and European studies as showing that corporate boards with a 'critical mass' (ie three or more women) were more likely to perform differently from those with fewer or no women.

Some Key Points

Higher levels of female board representation?

- boards of government enterprises are the most likely to include women: women hold 28.8% board seats
- women are most likely to be included on boards with three or more directors (55.2%) compared with 31.4% for corporations with two board directors and 14.6% of corporations with one director
- boards of the smallest or largest companies are more likely to include women

Lower levels of female board representation?

- women are least likely to be represented in boards with only one director
- women are less represented in medium sized entities than they are in the smallest or the very largest entities
- women are least represented at board level in private corporations holding 17.4% of seats (this increases slightly (20.5%) for public corporations)

Higher levels of female board representation?	**Lower levels of female board representation?**
▪ the finance sector has the highest level of female board representation (22.5%), followed by utilities (21.4%) and management of companies and enterprises (20.1%) ▪ Canadian-controlled entities had the highest share (21.3%) of women on boards, followed by those controlled by entities from France (17.5%) and the United Kingdom (17.1%)	▪ corporations are more likely to have just one woman on their board. For example, 28.1% of public corporations had one woman on their board, 10.5% of them had two women and 5.5% had three or more women as members of their board of directors. Among private corporations, 27.6% had one woman on their board, 9.8% had two women and 4.2% had three or more women ▪ the construction (12.8%) and manufacturing (14.4%) sectors have the lowest proportions of female directors ▪ Japanese-controlled entities had the lowest share (9.6%) of women on boards

CBC quotes the president and CEO of Women in Capital Markets (a not-for-profit organisation that aims to accelerate diversity in Canada's financial sector) as commenting that awareness of the problem is not being matched by action with companies slow to implement concrete measures eg quotas or director term limits to force progress. 'We have a long, long way to go before we really see not only the level of diversity across all boards that we would like to see, but also the level of diversity that we know drives real business results' she said.

About the report: The statistics are based on 2016 data collected through the Corporations Returns Act.

[Source: Statistics Canada media release 07/05/2019; Study: Representation of Women on Boards of Directors, 2016, 07/05/2019; Egon Zehnder 2018 Global Diversity Tracker; CBC news 14/05/2019]

Remuneration

Increased engagement with investors, including retail investors, on executive remuneration is now (reportedly) considered crucial according to certain prominent business leaders

The AFR reports that Telstra Chair John Mullen and BHP CFO Peter Beaven have separately told the Australian Shareholders Association annual conference that boards need to increase engagement with shareholders (including retail shareholders) on the executive remuneration.

The AFR quotes Mr Mullen as saying that:

- **More transparency required:** The push by retail investors to see clearer links between performance and rewards requires boards to be even more transparent about objectives, structure and performance measures. 'Retail investors wants plain English and a clear link between effort and reward' Mr Mullen is quoted as stating.
- **Outcomes not structure is the key concern:** In his view, investors are primarily concerned with pay outcomes rather than with pay structure, and that this underscores the need for the board to both use discretion on the amount of pay awarded, and also the need for boards to improve communication about what the executive remuneration scheme is trying to achieve.
- **Include retail investors in engagement efforts:** Mr Mullen said that large Australian companies, including Telstra should 'bend over backwards' to engage with smaller shareholders whose interests, he said, are likely to align more closely with those of management/boards than institutional investors. 'The small investor is there almost invariably because they are looking for long-term appreciation' he reportedly said. Given the growing influence of larger institutional investors, retail investors he said, could feel short changed/left out of the process.

Mr Mullen reportedly said that following the Telstra AGM result last year (see: Governance News 22/10/2019) the Telstra board has significantly stepped up shareholder engagement efforts, and has already held three rounds of meetings to discuss changes to pay structure ahead of this year's AGM.

BHP CFO Peter Beaven reportedly holds similar views to those expressed by Mr Mullen with respect to the need for companies to increase engagement. Mr Beaven is quoted as stating that 'It's incumbent on us to communicate with these people [retail investors], because that's what we should do. But also because we need to be aligned with our shareholders to prosecute our strategy'.

The AFR reports that like Telstra, BHP has been active in engaging with retail investors through a variety of forums including through online investor forums and briefings by BHP CEO and Chair for retail investors, including a session held before BHP's AGM.

[Source: [registration required] The AFR 20/05/2019]

United States | Mismatch between CEO performance and pay?

The WSJ's analysis of CEO pay at S&P 500 companies has found that for the fourth consecutive year, CEO pay reached record highs (median CEO compensation rose to $12.4 million, up 6.6% from 2017 and the highest point since the 2008 recession), despite the fact that median shareholder return for the companies in question was minus 5.8%. Reportedly, the growing complexity of CEO compensation packages combined with the performance mismatches has led some investors to call for a radical simplification of CEO pay: pay CEOs in cash and give them shares they must hold for a minimum period

[Source: [registration required] The WSJ 17/05/2019]

United Kingdom | 'We know this is slow but we are moving in the right direction': The Bank of England says it has reduced the gender pay gap 1% since last year

In her speech on the value and importance of diversity and inclusion at the Bank of England, Deputy Governor and COO Joanna Place said that the BoE is making (slow) progress on narrowing the gender pay gap. She said that as at 30 March 2019, the mean gender pay gap was 20.2% and the median gender pay gap was 23.0% which is the lowest since the bank started reporting in 2017 and a 1% improvement on last year. Ms Place said that the primary reason is the lack of women in senior roles, which the bank is working to address through various initiatives.

[Source: Bank of England, Gender diversity is good for wider diversity and greater inclusion - speech by Joanna Place 15/05/2019]

Shareholder Activism

Legg Mason has reportedly reached agreement with activist Trian on board change

The WSJ reports that Legg Mason Inc has said it has reached an agreement with activist Trian Fund Management (which reportedly holds a 4.5% stake in Legg Mason) on the composition of its board. Legg Mason has reportedly named two Trian appointees — Nelson Peltz (Trian's CEO) and Ed Garden — as directors. In addition Legg Mason said Trian will also identify a third independent director candidate who, following board approval, will be included as a Legg Mason nominee. Two further independent directors will also be nominated to the board.

Trian has reportedly said that its priority is to assist Legg Mason to reduce costs, boost revenue and increase profitts. The WSJ suggests that the fact that Trian has added more than one director is an indication that it plans to be deeply involved in the company's operations.

[Source: [registration required] The WSJ 20/05/2019]

In Brief | Myer has announced the appointment of former Just Group executive Jacquie Naylor as a non-executive director effective 27 May. The AFR comments that Ms Naylor's appointment follows criticism from activist Solomon Lew that the Myer board lacks retail expertise

[Sources: Myer ASX Announcement: 21/05/2019; [registration required] The AFR 21/05/2019]

Institutional Shareholders and Stewardship

In Brief | Push for (among other things) ESG integration in the investment process: Japan's Government Pension Investment Fund Stewardship Activities Report 2018 identifies integration of environmental, social and governance considerations into the investment process as a key priority in fulfilling stewardship responsibilities

[Source: Government Pension Investment Fund Stewardship Activities Report 2018 [English translation]

In Brief | Will the distinction between ESG analysis and financial analysis continue to exist, in future? Fidelity International emerging markets portfolio manager Alex Duffy, has reportedly questioned the relevance of the continued distinction between ESG (environmental, social, governance) analysis and financial analysis, arguing that 'you cannot separate the two'. 'I feel that the term ESG is going to be totally redundant in five years. Anyone that tells you they are an unsustainable investor which is the other side of the coin that doesn't make any sense' he is quoted as stating

[Source: InvestorDaily 16/05/2019]

[Note: As part of its broader policy response to the Financial Services Royal Commission, the Australian Council of Superannuation Investors (ACSI) recently proposed that ESG considerations should be built into APRA standards and guidance (ie integrated into investment decision making). See: Governance News 08/05/2019]

Meetings and Proxy Advisers

United Kingdom | New transparency framework for proxy advisers: Proxy Advisers (Shareholders' Rights) Regulations 2019 to apply from 10 June 2019

The UK *Proxy Advisors (Shareholders' Rights) Regulations 2019* transpose Article 3j of the revised EU shareholder Rights Directive (SRD II) into UK law, in line with the UK's obligations as a member of the EU.

New transparency requirements for proxy advisors: Article 3j of SRD II places requirements on proxy advisors, which primarily offer voting services and/or advice to shareholders in publicly listed companies, to make certain disclosures about the way in which they conduct their business.

The explanatory memorandum accompanying the regulations states that: 'The disclosure requirements are intended ensure that proxy advisors' clients will be able to better understand what standards of conduct the proxy advisor adheres to, how the proxy advisor ensures an adequate standard of quality in its advice and how it manages conflicts of interest, in order to help the market for proxy advisor services to function effectively'.

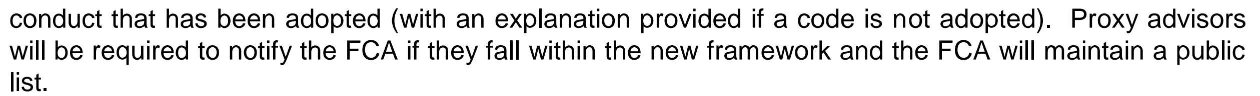
New requirements for proxy advisors

Under the new framework, proxy advisors will be required to:

1. **disclose which code of conduct which they apply, and report on the application of the code.** If proxy advisors apply a code of conduct but depart from its recommendations, they are required to declare the parts of the code from which they depart, why they depart from it and indicate any alternative measures adopted. Where proxy advisors do not apply a code of conduct at all, they must explain why this is the case.
2. **disclose information on their research capabilities and how they produce their advice and voting recommendations** (eg models, methodologies, information sources and resources).
3. **identify and disclose any actual or potential conflicts of interests or business** relationships that may influence the preparation of their research.

Role of the Financial Conduct Authority (FCA)?

- **Enforce compliance:** The UK Financial Conduct Authority (FCA) will become responsible for enforcing the new requirements placed on proxy advisors, including the obligation to disclose publicly the code of



conduct that has been adopted (with an explanation provided if a code is not adopted). Proxy advisors will be required to notify the FCA if they fall within the new framework and the FCA will maintain a public list.

- **Ongoing monitoring and supervision are not implied:** It is expected that instances of noncompliance with the disclosure requirements will be brought to the FCA's attention via market participants, 'meaning that ongoing monitoring and supervision are not necessary or implied by this instrument' the explanatory memorandum states. As such, 'the new regulations do not establish a conduct regime for proxy advisors, or does it directly set expectations in respect of controls and the quality of proxy advisers' service provision. Rather, by improving transparency of proxy advisers' conduct and service provision, the instrument aims to raise standards through the exercise of market discipline'.

Timeline: The new regulations will come into force on 10 June.

[Source: The Proxy Advisors (Shareholders' Rights) Regulations 2019; Explanatory Memorandum]

United States | Is a 'draft review process' justified? The US National Investor Relations Institute has called on SEC to require proxy advisers to give companies opportunity to review (and correct) proxy reports before they are issued publicly 'to ensure that investors receive the most reliable proxy research'

In a recent post on Harvard Law School Forum, the US National Investor Relations Institute (NIRI) has argued the case for the US Securities and Investments Commission (SEC) imposing a requirement for a 'draft review process' to enable US public companies a chance to verify the accuracy of proxy adviser reports before investors start voting. The post is based on a letter sent by NIRI to the SEC.

Why the measure is needed: NIRI argues that a the opportunity for companies to review a draft of proxy reports would be the 'most efficient way to reduce the number of factual errors or misunderstandings in proxy advisor reports'. In addition, NIRI argues that the inclusion of a hyperlink to a 'company rebuttal' in cases where there is no factual error but where the company disagrees with the way in which a voting policy has been applied, should also be considered on the basis that it would help ensure investors are fully informed before they vote.

More particularly, NIRI argues that current arrangements are inadequate in a number of respects including the following.

- **'Most' US companies don't have an opportunity to review draft reports for accuracy before investors start voting:** Glass Lewis does not allow any companies to see draft reports before publication and charges companies a fee to obtain their final reports. Institutional Shareholder Services (ISS) provides draft reports to S&P 500 firms that request drafts.

- **The need for greater SEC oversight has increased in recent years as ISS and Glass Lewis institutional clients have started using automated proxy voting systems** whereby votes are cast based on preset voting policies without investment managers having to take any further action. NIRI writes that public companies reported that almost 20% of their shares were voted within three days of the issuance of an adverse proxy advisor recommendation during the 2016 and 2017 proxy seasons, suggesting some asset managers follow proxy advisory firms without conducting their own assessment.

- **SEC's 2014 Staff Legal Bulletin 20, which placed a greater onus on institutional investment managers to oversee the work of the proxy advisors they hire, though a helpful 'first step,' has had limited success** in reducing the number of errors in proxy reports or improving the responsiveness of proxy advisers to concerns,

What is NIRI asking for? NIRI states that it is supportive of recommendations aimed at improving report accuracy, put forward by the Shareholder Communications Coalition.

- SEC should require proxy advisory firms to provide each public company (that requests such a review) with an advance copy (at least five business days before issuance) of any report that includes a proxy voting recommendation about such company.

- Proxy advisory firms should be required to promptly correct any factual or other error in a report that is identified by a public company. In addition, the firms should disclose when comments have been received

by a public company on the front page of a report about that company, with a hyperlink provided for investors to access such comments. This process would ensure that investors don't vote based on inaccurate information or a flawed assumption by the proxy advisor.

According to NIRI some institutional investors, including BlackRock, are supportive of a draft review process. BlackRock has reportedly suggested a similar measures.

Not a 'corporate veto'? NIRI rejects the argument that the proposed changes would amount a 'corporate veto' or interfere with proxy advisors' relationships with their clients. NIRI observes that the requirement (or at least a recommendation by the AMF (Autorité des marchés financiers) that proxy firms provide draft reports) has been in place in France since 2011.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 18/05/2019]

Regulators

ASIC Annual Forum | ASIC Chair James Shipton has called on the financial sector to embrace the 'fairness imperative'

In his opening and closing statements at the Australian Securities and Investments Commission (ASIC) Annual Forum, ASIC Chair James Shipton's spoke largely on the theme of 'putting people and fairness first in financial services.' Mr Shipton also reiterated the steps ASIC is taking to promote these objectives and called on the financial sector to 'rise to the challenge' of discharging its core function, 'to serve people and its obligation to act efficiently, honestly and fairly'.

Some Key Points

Steps ASIC is implementing

- **ASIC's new 'why not litigate?' enforcement strategy**: Mr Shipton said that ASIC is 'significantly increasing and accelerating court-based enforcement responses driven by our new enforcement strategy. At the same time, we are looking to use the full extent of our new penalties and powers through the prism of "Why Not Litigate?"'. Mr Shipton emphasised that the approach does not mean that ASIC will take a 'litigate first' or 'litigate everything' approach. He said that the aim of the approach is to 'deter future misconduct and address community expectations that wrongdoing be punished and publicly denounced through the courts'. In practice, he said that this means that once ASIC is satisfied breaches of the law are more likely than not and that the facts of the case show pursuing the matter would be in the public interest, then ASIC will 'activity ask ourselves: why not litigate this matter?'

[Note: ASIC's February update on implementation of the Financial Services Royal Commission Final Report recommendations provides further detail about ASIC's new approach to enforcement and the principles that underpin it. See: Governance News 20/02/2019.]

- **ASIC's 'enhanced' supervisory approach:** Mr Shipton said that ASIC is focused on embedding and expanding new supervisory approaches and promoting best practice and innovation in regulation, particularly through its Close and Continuous Monitoring (CCM) program. Speaking more generally, Mr Shipton said ASIC's enhanced supervisory approach is aimed at 'promoting permanent cultural and behavioural changes in institutions individually and across the financial services industry more broadly'. The new approach focuses 'beyond current known non-compliance to look at things that create significant risk of future breaches'. Mr Shipton added that ASIC is 'increasingly using advanced data and market analytics in this work to detect misconduct early'. With respect to the CCM program, Mr Shipton said that ASIC will provide public commentary on the CCM program's findings towards the end of this year and publish findings on the corporate governance review in the second half of 2019. These reports, he said would inform ASIC's regulatory work going forward.

In addition, Mr Shipton said that ASIC is focused on working towards implementing new obligations and responsibilities in response to the Financial Services Royal Commission, including an expanded role for ASIC to become the primary conduct regulator in superannuation.

Mr Shipton emphasised that the regulator does 'not want to see resistance and reluctance' towards ASIC's new approach.

The 'Fairness imperative'

Mr Shipton called on the financial sector to embrace the 'fairness imperative' saying that in order for there to be 'meaningful improvement of the financial markets, I think financial institutions must embrace and embed fairness into everything they do. They must build systems and processes in their businesses that both embed the legal and community expectations of fairness as well as to act fairly and professionally'.

Mr Shipton said everyone in the finance sector must have the procedural discipline to ask, ‘Is this practice or product going to cause harm, be detrimental or have a negative consequence?’ He added that he is unconvinced that this 'level of questioning and procedural discipline has been applied by the financial industry when developing, and reviewing, business practices and financial products'.

The concept of 'do no harm' must be embraced by the finance sector, Mr Shipton said.

Inclusion

Mr Shipton also said that in addition to being fairer, financial systems need to be more inclusive. 'The sobering reality is that, just as we need to make the financial system a fairer one, we also need to work harder to include every segment of our community into that system. This is a core challenge for all of us. Ultimately, we need a financial system that not only serves every segment of the community but also is one where those who work in it feel proud of being a part of it' he said.

Global challenges

Mr Shipton noted that the forum, coincided with the 44th Annual Meeting of the International Organisation of Securities Commissions (IOSCO), hosted by ASIC in Sydney and that a number of IOSCO delegates also attended the ASIC forum. He observed that 'many countries’ financial regulators said they faced the same opportunities and challenges as ASIC, as global financial markets become more integrated'.

[Sources: ASIC media release 20/05/2019; ASIC Annual Forum 2019 - ASIC Chair's introductory comments 16/05/2019; ASIC Annual Forum 2019 - ASIC Chair's closing remarks 17/05/2019; [registration required] The AFR 16/05/2019; 16/05/2019]

Related News: Without enhanced consumer protections in place, 'do no harm' is not enough?

Writing in the Conversation, Professor of Finance at the University of Melbourne, Kevin Davis argues that the recently completed Financial Services Royal Commission is unlikely to drive lasting improvements in the banking and financial sectors because it failed to address, in his estimation, a number of key issues.

Among these issues is the failure to sufficiently 'concentrate' on enhancing consumer protection, as opposed to deterring and/or penalising misconduct. 'Until consumer financial literacy catches up with financial product innovation and complexity, there will continue to be a big "market for financial misconduct"' Professor David argues and 'exhorting institutions to do no harm won’t take it away'.

[Source: The Conversation 21/05/2019]

Casenote | High Court decision Frugtniet v Australian Securities and Investments Commission: The AAT is subject to the same constraints as ASIC when reviewing ASIC banning decisions

On 15 May 2019, the High Court handed down its judgment in *Frugtniet v Australian Securities and Investments Commission*.

The High Court held that the Administrative Appeals Tribunal, when reviewing an ASIC decision to impose a banning order on Mr Frugtniet, was prohibited from considering Mr Frugtniet's spent convictions because ASIC was prohibited from considering them under Part VIIC of the Crimes Act 1914 (Cth). This was despite the fact that Part VIIC excluded a court or tribunal from the relevant prohibition.

Facts

In 2014, ASIC found Mr Frugtniet was not a fit and proper person to engage in credit activities and imposed a banning order on him under section 80 of the *National Consumer Credit Protection Act 2009 Cth.* Mr Frugtniet applied to the Administrative Appeals Tribunal for a review of the decision.

The AAT affirmed ASIC's decision. The AAT took into account that, in 1978, Mr Frugtniet had served two years in prison for theft and fraud and that, in 1997, he had been found guilty of obtaining property by deception (with no conviction recorded). Both matters were 'spent convictions' within Part VIIC of the Crimes Act.

ASIC did not take the spent convictions into account when making their decision, because s85ZW of the Crimes Act prohibited it from doing so. The AAT considered that it could take the convictions into account, because s85ZW was subject to an exclusion that allowed a court or tribunal to take spent convictions into account for the purpose of making a decision (section 85ZZH(c))

Federal Court's view

Both Bromberg J and the full Federal Court agreed with the AAT's argument that it could take the spent convictions into account.

High Court's view

The High Court disagreed. It said that the role of the AAT was to stand in the shoes of the original decision-maker and address the same question the decision-maker addressed. This meant the reviewer must take into account the same considerations the original decision-maker was required to take into account, and conversely must not take into account any considerations the original decision-maker could not take into account. The exclusion in section 85ZZH(c) had to be read subject to this principle.

Take out points

In a statement, ASIC said that 'The judgment makes clear that the AAT is subject to the same constraints as ASIC when reviewing ASIC banning decisions, and must not take into account considerations which ASIC is forbidden from taking into account'

The case demonstrates that express statutory provisions must be read subject to overriding legal principles. It also serves as a useful reminder that companies and regulators making 'fit and proper' assessments need to be aware that in certain circumstances they cannot take into account the fact that the person being assessed has been charged with, or convicted of, an offence.

Next steps: The AAT is now required to hear the matter again, taking into account the High Court's decision. ASIC's decision to permanently ban Mr Frugtniet from engaging in credit activities remains on foot pending redetermination by the AAT of Mr Frugtniet's application for review.

[Sources: ASIC media release 15/05/2019; Frugtniet v Australian Securities and Investments Commission *[2019] HCA 16]*

In Brief | A panel of ASIC representatives has reportedly told the ASIC Annual Forum that ASIC's monitoring and in particular, use of new penalties, is expected to drive a cultural shift in the superannuation sector, Investor Daily reports

[Source: InvestorDaily 20/05/2019]

Corporate Social Responsibility and Sustainability

Mixed scorecard? ISS' annual global analysis of sustainability practices found that companies are steadily improving their ESG rating but that there is also a growing misalignment between corporate practices and stakeholder expectations with respect to ESG issues

ESG Review 2019: The State of Play of Corporate Responsibility

Institutional Shareholder Services (ISS) has released its annual analysis of the sustainability performance of major international companies in developed countries. According to ISS, the findings demonstrate positive trends in corporate sustainability performance, which ISS attributes to a number of factors including: a) the impact of voluntary initiatives such as the Task Force on Climate-related Financial Disclosures (TCFD) and the SASB reporting standards; b) regulatory developments including tighter reporting requirements in a number of jurisdictions (eg The European Union Action Plan on Sustainable Finance; and c) increased awareness at company level of the materiality of ESG factors.

The report also found the number of reported controversies across all ESG topics continues to rise. ISS interprets this as evidence of a growing misalignment between corporate practices and stakeholder expectations.

Some Key Points

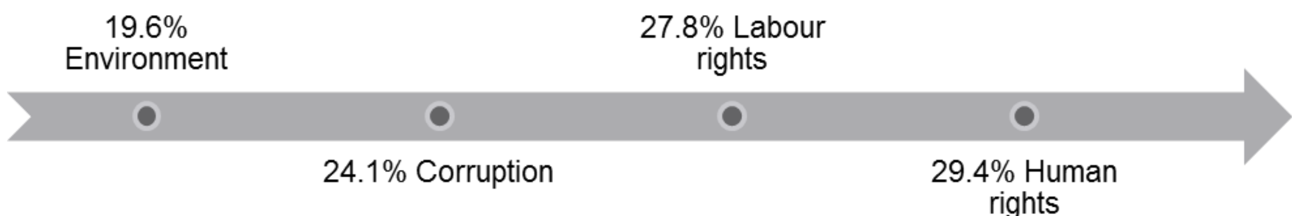
Positive trends in corporate sustainability performance:

- According to the report, the proportion of companies covered by ISS' Corporate Rating and assessed as 'good' or 'excellent' (both assessments lead to Prime status) increased from 17% last year to 20.4%.
- The number of companies rated 'poor' has steadily decreased since 2013 from 53% (2013) to 39% (2017) to 32% last year — the lowest level recorded.
- ISS found 41% of the assessed companies contribute 'positively' to the UN Sustainable Development goals (SDGs) through their products and services, of which 8% contribute to a 'significant' extent. Conversely, the products of 27% of assessed companies were assess as obstructing the achievement of the SDGs.
- There was a 5% increase on last year on the number of companies reporting their Scope 1 and 2 greenhouse gas emissions and ISS also found evidence that the quality of reporting is improving (ISS Trust Metric shows an average improvement from 76/100 in 2016 to 81/100 in 2018).
- According to ISS, TCFD alignment also increased slightly. Of all companies reporting to the CDP, 106 also produced TCFD-aligned climate reporting in 2018. Of those, more than 30% of those companies are within the financial sector.

Evidence of a growing misalignment between stakeholder practices and corporate ESG practices?

- Norm-Based Research, which identifies significant allegations against companies linked to the breach of established standards for responsible business conduct, saw a more than 40% rise in the number of reported controversies across all ESG topics. By far the largest number of ESG controversies were observed in the US (19%) followed by Brazil, India and Indonesia (each with 4%).

Significant ESG controversies



- Failures to respect human rights (failure to respect indigenous rights, community rights or consumer rights, failure pay a 'fair share' of taxes and poor stakeholder consultation) and labour rights (poor labour standards, failure to respect union rights, child labour/forced labour and discrimination) together accounted for the majority (56%) of significant controversies assessed under Norm-Based Research in 2018. This is attributed in the report to a growing awareness of standards, improved monitoring mechanisms and a 'maturing' debate around human rights due diligence as well as to the expanding influence of social media.
- Controversies over corruption (anti-competitive behaviour, bribery, money laundering) accounted for 24.1% and environment (pollution, loss of biodiversity, opposition to climate regulation and failure to mitigate climate change) accounted for 19.6%.
- Most exposed industries? Materials companies are the most exposed group to both environmental and social related controversies. Banks are most at risk of governance controversies.
- **Emerging trends?** Going forward, ISS expects: 1) climate change; 2) responsible consumption and resource use; 3) data security and data privacy; and 4) #MeToo and discrimination to receive greater focus.

[Source: ISS media release 15/05/2019; [registration required] ISS Report: ESG Review 2019: The State of Play of Corporate Responsibility]

In Brief | Investment in the workforce is one of the best financial decisions companies can make? Freezing the salaries of 20 executives in order to raise worker pay, reportedly tripled the business of US home health care provider CareCentrix over five years. Citing this in support, CareCentrix CEO John Driscoll makes the case for companies acting to address pay inequality within their own workforce on the basis that it is: a) a sound financial decision; and b) it is part of 'the role and responsibility of the business community in contributing to the success of the American Dream'

[Sources: The Guardian 16/05/2019]

Financial Services

Top Story | ASIC is consulting on lifting standards/transparency of complaints handling

Overview | CP 311 Internal Dispute Resolution: update to RG 165

The Australian Securities and Investments Commission (ASIC) is consulting on proposed new Internal Dispute Resolution (IDR) standards and reporting requirements to improve the way in which financial firms including Australian Prudential Regulation Authority (APRA) regulated superannuation funds handle consumer and small business complaints.

Key Takeouts

- **Scope of the changes:** The consultation covers proposed updates to ASIC's IDR standards (currently set out in Regulatory Guide 165 Licensing: Internal and external dispute resolution) and the proposed framework for mandatory IDR data reporting by financial firms to ASIC.
- **Aim of the reforms:** The proposed reforms are intended to improve the way in which financial firms including Australian Prudential Regulation Authority (APRA) regulated superannuation funds, handle consumer and small business complaints.
- **Some key proposals:** Among other things, ASIC proposes to expand the definition of complaint to include expressions of dissatisfaction made 'to or about' an organisation including on a firm's own social media platform(s), to reduce the maximum timeframes for IDR processes and to set new requirements for tracking and responding to complaints.
- **Naming individual firms?** ASIC proposes to publish IDR data at both aggregate and firm level and is seeking stakeholder views on what principles should guide it's approach (ahead of further consultation).
- **Providing feedback:** The consultation states that 'If you disagree with the policy proposals set out in this consultation paper, particularly around reduction of IDR timeframes and collection and recording of IDR data, evidence of your own IDR performance and experience will be required to persuasively support any counter position'.

The Australian Securities and Investments Commission (ASIC) is consulting on proposed new Internal Dispute Resolution (IDR) standards and reporting requirements to improve the way in which financial firms including Australian Prudential Regulation Authority (APRA) regulated superannuation funds handle consumer and small business complaints.

Announcing the consultation, ASIC Deputy Chair Karen Chester said that the proposed reforms, which include new mandatory data reporting, are intended to improve the way that consumer complaints are dealt with across the financial system and to make firms' complaints handling performance transparent.

The deadline for submissions on the proposed changes is the 9 August.

Context

Evidence of the need for improvement

The proposed reforms follow the release last year of ASIC report 603 which identified a number of areas in which current complaints handling processes could be improved (see: Governance News 17/12/2018).

ASIC Deputy Chair Karen Chester commented that it is 'widely acknowledged there is room for much improvement when it comes to handling consumer complaints in our financial system'. This view is evidenced, Ms Chester said, by the findings of the Ramsay Panel Review, recent ASIC research, case studies before the Financial Services Royal Commission (FSRC) and ASIC's own supervisory work.

Ms Chester added that the absence of effective redress for consumers and the failure of firms to identify and investigate systemic complaints were also findings of the Financial Services Royal Commission and the Prudential Inquiry into the CBA.

Proposed Changes

The consultation covers proposed updates to ASIC's IDR standards (currently set out in Regulatory Guide 165 Licensing: Internal and external dispute resolution) and the proposed framework for mandatory IDR data reporting by financial firms to ASIC.

Proposed changes include the following.

- **Reducing maximum time frames for IDR responses:**
  - reduce the maximum IDR timeframe for superannuation complaints and complaints about trustees providing traditional services from 90 days to 45 days
  - reduce the maximum IDR timeframe for all other complaints (excluding credit complaints involving hardship notices and/or requests to postpone enforcement proceedings and default notices where the maximum timeframe is generally 21 days) from 45 days to 30 days
  - introduce a requirement that financial firms can issue IDR delay notifications in exceptional circumstances only.
- **Expanding the definition of** complaint to include expressions of dissatisfaction made 'to or about' an organisation including on a firm's own social media platform(s). This is in alignment with the definition in AS/NZS 10002:2014.
- **Introducing additional guidance to assist financial firms to accurately identify complaints** including: the factors firms should and should not consider when determining whether a matter is a complaint and the point at which a complaint must be dealt with under a firm's IDR process.
- **Modifying the definition of 'small business'** in the Corporations Act 2001 (Cth) to align it with the small business definition in the AFCA Rules which states: 'A Primary Producer or other business that had less than 100 employees at the time of the act or omission by the Financial Firm that gave rise to the complaint'.
- **Requiring financial firms to record all complaints**, including those that are resolved to a complainant's satisfaction at the first point of contact.
- **Requiring firms to provide clear reasons for rejecting/partially rejecting a complaint** including: identifying and addressing all the issues raised in the complaint; setting out the financial firms' finding on material questions of fact and referring to the information that supports those findings; and providing enough detail for the complainant to understand the basis of the decision and to be fully informed when deciding whether to escalate the matter to AFCA or another forum.
- **Setting clear standards about what should be in written reasons for decisions:** ASIC proposes to include the content of IDR responses as a core requirement for all financial firms, including superannuation trustees, in the legislative instrument making parts of RG 165 enforceable: see paragraph 22.
- **Requiring customer advocates to comply with RG 165** (including meeting the maximum IDR timeframes and minimum content requirements for IDR responses) if they: act as an escalation point for unresolved consumer complaints or have a formal role in making decisions on individual complaints.
- **Strengthening the requirement that firms take a systemic focus to complaints handling**: ASIC proposes to introduce new requirements on financial firms regarding systemic issue identification, escalation and analysis. These include the following.

- **Requiring boards and financial firm owners to set clear accountabilities for complaints handling functions,** including setting thresholds for and processes around identifying systemic issues that arise from consumer complaints. Ms Chester commented that ASIC 'expects greater investment and attention by Boards to their own internal customer complaints data and complaints handling performance.'
- **Requiring reports to the board and executive committees to include metrics and analysis of consumer complaints** including about any systemic issues that arise out of those complaints.
- **Requiring financial firms to identify possible systemic issues from complaints** by: requiring staff who record new complaints and/or manage complaints to consider whether each complaint involves potentially systemic issues, regularly analysing complaint data sets, and conducting root-cause analysis on recurring complaints and complaints that raise concerns about systemic issues.
- **Requiring financial firm staff who handle complaints to promptly escalate possible systemic issues** they identify to appropriate areas for action.
- **Requiring financial firms to have processes and systems in place to ensure that systemic issue escalations are followed up** and reported on internally in a timely manner.

▪ **Complaints tracking requirements:** To facilitate complaints data reporting to ASIC, the regulator proposes that all firms be required to record an identifier or case reference number (unique to that complaint) for each complaint received. It's also proposed that firms be required to collect and record a prescribed data set for each complaint received.

▪ **Mandatory IDR reporting requirements:** The proposed changes give effort to the reforms introduced by the *Treasury Laws Amendment (Putting Consumers First—Establishment of the Australian Financial Complaints Authority) Act 2018* (AFCA Act) which established a mandatory IDR data reporting regime to improve the transparency of financial firms' IDR activities and performance. ASIC proposes that all financial firms required to report IDR data to ASIC must:

- for each complaint received, report against a set of prescribed data variables including a unique identifier and a summary of the complaint
- provide IDR data reports to ASIC as unit record data (ie one row of data for each complaint)
- report to ASIC at six monthly intervals by the end of the calendar month following each reporting period
- lodge IDR data reports through the ASIC Regulatory Portal as comma-separated-value (CSV) files (25 MB maximum size)

▪ **Core requirements to be enforceable:** ASIC states that once the policy settings are finalised, it intends to issue a legislative instrument that will have the effect of making the core IDR requirements set out in RG 165 enforceable.

Increased transparency — stakeholder views sought on the publication of aggregate and firm level data

ASIC proposes to publish IDR data at both aggregate and firm level in accordance with ASIC's powers under s1 of Sch 2 to the AFCA Act.

Ms Chester comments that 'Firm performance in how they handle customer complaints, and their interaction with AFCA, will increasingly be in plain sight. This greater transparency will inform consumer and broader public understanding of how well firms treat their customers. For a regulator, it also provides an invaluable insight into how non-financial risks are being managed by the firm and ultimately the Board. ASIC expects greater investment and attention by Boards to their own internal customer complaints data and complaints handling performance.'

The consultation notes that the regulator is aware that there are 'diverse views' about the publication of this information, particularly firm level data, and it is interested in hearing stakeholder views on what principles should guide it's approach.

ASIC adds that a separate consultation on the publication of IDR data will commence in early 2020.

Providing feedback

The consultation states that 'If you disagree with the policy proposals set out in this consultation paper, particularly around reduction of IDR timeframes and collection and recording of IDR data, evidence of your own IDR performance and experience will be required to persuasively support any counter position'.

Timeline

- ASIC seeks public input on the consultation documents by 9 August 2019 and aims to release new IDR standards (in a new Regulatory Guide 165) by end 2019. In addition to this consultation paper, ASIC will conduct a series of stakeholder meetings.
- A further, separate consultation on the publication of IDR data will commence in early 2020.
- ASIC proposes that all financial firms must comply with the requirements set out in the draft updated RG 165 and supporting legislative instruments immediately on the publication of the updated RG 165 (with certain exceptions).

[Sources: ASIC media release 15/05/2019; Consultation Paper CP Internal dispute resolution: Update to RG 165;]

Responses to the consultation

Industry response? Some media reports suggest that the proposals, especially the possibility that public rankings of which bank or superannuation fund is best at handling disputes, are expected to receive significant resistance from the banking and superannuation sector.

AFCA has welcomed moves to track dispute resolution within financial firms: In a statement, the Australian Financial Complaints Authority (AFCA) welcomed ASIC's consultation and in particular, increased transparency. AFCA Chief Ombudsman and CEO David Locke said: 'Increased transparency is good news. It will help firms to continuously improve, and that will be good for the firms and their customers alike.' Mr Locke added that AFCA also welcomes the idea of requiring firms to provide a standard set of data as it on the basis that it will help companies know how they compare to their competitors and help to inform consumers about the companies they're dealing with. Mr Locke added that 'in this digital age, the move by ASIC to require firms to include complaints made on social media platforms, is entirely appropriate'.

Noting that ASIC is consulting with industry about the proposed changes, Mr Locke observed the timeliness of the process and the proposed regulatory changes. 'ASIC's aim to match dispute resolution data with AFCA data will provide a robust and accountable way to make sure the system is fully transparent.'

CHOICE and the Superannuation Consumers' Centre also welcomed the consultation, in particular, the proposed introduction of a legal requirement for firms to comply with dispute resolution processes on the basis that 'self-regulation of internal dispute resolution has clearly failed'. With respect specifically to the superannuation sector, the statement observes that 'The voluntary code for the superannuation funds is not enforceable and has no oversight, so we can't even be sure super funds are even keeping these exceptionally loose promises to their members. The Hayne Royal Commission called for an overhaul of industry codes, as too often financial service providers were either making poor promises or breaking promises without repercussions. The best solution is let ASIC get on with protecting consumers and set standards in line with reasonable community expectations.

[Source: registration required] The AFR 15/05/2019; [registration required] The Age 16/05/2019; [registration required] The Australian 16/05/2019; [registration required] The SMH 16/05/2019; AFCA media release 15/05/2019; CHOICE media release [accessed via LexisNexis Capital Monitor]

ABA CEO Anna Bligh has reportedly cautioned the ASIC Annual Forum that higher standards of professionalism/cultural shift in financial institutions will necessarily result in lower growth in the short term

The AFR reports that speaking at the Australian Securities and Investment Commission (ASIC) annual forum, Australian Banking Association (ABA) CEO Anna Bligh has cautioned that the cultural change and higher level of professionalism expected of the financial services industry will mean accepting lower growth levels. 'Every one of those banks is reporting to the market significant amounts of money have been set aside as provisions

for remediation…If you say you're changing and it doesn't hurt, then you're not changing….And I think everybody at the top of the banks is hurting and I think they understand there's some more pain to come' she is quoted as stating.

Mr Bligh also reportedly said that the half-year results of the three major banks and the quarterly results of the CBA reflect the cost of 'short-termism' (focus on short term profits). 'At least we can quantify the cost of getting this wrong. This is the cost of short-termism and it catches up and now you can quantify it' she reportedly said.

According to The AFR, head of New Zealand's Financial Markets Authority Rob Everett, agreed that raising standards would necessarily result in fewer sales in the short term as 'providing value for customers hasn't been anywhere near close enough to the top of the list'. In addition, he reportedly said that the 'evils' of quarterly reporting and short term shareholder metrics had driven a focus on short term gains.

BEAR? Commenting on the impact of the banking executive accountability regime (BEAR) (which commenced for large banks last year, and will apply to smaller/medium banks from July 2019) Ms Bligh reportedly said that it's still early days but that industry feedback to date is that accountability mapping had been said an 'incredibly useful and powerful process' for organisations. Having said this, Ms Bligh also said that the regime has encouraged overly cautious behaviour. 'Until people see how it's going to be monitored and enforced and what the consequences are when something in your area of accountability goes wrong … then there is a lot of risk averse behaviour at the moment. For very understandable reasons' she is quoted as stating.

[Source: [registration required] The AFR 17/05/2019]

APRA has granted Societe Generale a licence to operate as a foreign authorised ADI

The Australian Prudential Regulation Authority (APRA) has granted Societe Generale (SocGen) a licence to operate as a foreign authorised deposit-taking institution (ADI) under the *Banking Act 1959 Cth*.

The AFR reports that the bank is seeking more exposure to Asia's growing markets, including Australia (after giving up its licence in 2013). The Australian renewable energy sector is reportedly of particular interest, 'We know we will have a strong pipeline for years to come. This is not short term. It is something Australia needs to build' the bank is quoted as stating. According to the AFR, in addition to renewable energy, the bank has expertise in metals and mining finance and infrastructure, and believes there are opportunities in privatisations of energy and land registry assets. It is also reportedly considering opportunities from infrastructure privatisations, such as electricity grids and land registry sales.

According to The AFR Societe Generale stressed it had no intention of setting up retail operations to take deposits and, while it was looking to drum up securitisation business in asset-backed securities, it was not targeting mortgages.

[Sources: APRA media release 16/05/2019; [registration required] The AFR 16/05/2019]

Update on new BEAR registration form for smaller ADIs: APRA has left the BEAR registration form (for small and medium ADIs) unchanged, but has clarified parts of the instruction guide in response to submissions

The Australian Prudential Regulation Authority (APRA) has published a letter to authorised deposit-taking institutions (ADIs) responding to submissions on a new registration form for the Banking Executive Accountability Regime (BEAR) and providing guidelines for submitting applications for the registration of accountable persons.

APRA released the draft *ARF 550.0 Banking Executive Accountability Regime – Registration Form* for consultation in December 2018. The form is to be used by small and medium ADIs to register responsible persons under the BEAR, which comes into effect for these entities from 1 July 2019.

Reporting form unchanged: Based on feedback in the submissions, APRA has left the reporting form unchanged, but has clarified parts of the accompanying Instruction Guide.

Timeline: Medium and small ADIs must submit a final version of ARF 550.0 by 14 June 2019 for accountable persons to be registered by 1 July 2019. ADIs are able to submit their BEAR applications for registrations from 20 May 2019 and are 'encouraged' to submit as soon as they have finalised their applications.

[Sources: APRA response letter 15/05/2019; BEAR - Additional support information for submitting applications to register accountable persons 15/05/2019; Registration Form ARF 550.0 - Banking Executive Accountability Regime Registration Form - Instruction Guide - Marked up]

Not 'intended to signify any lessening' in the importance the regulator places on 'sound lending standards? APRA is consulting on proposed amendments to its guidance on residential mortgage lending

The Australian Prudential Regulation Authority (APRA) is consulting on proposed changes *to Prudential Practice Guide APG 223 Residential Mortgage Lending*. More particularly APRA seeks feedback on three proposed changes to its guidance on the serviceability assessments that authorised deposit-taking institutions (ADIs) perform on residential mortgage loan applications. The proposed changes are as follows.

Proposed changes

1. **ADIs to set their own minimum interest rate floor for use in serviceability assessments:** In a letter to authorised deposit taking institutions (ADIs), APRA proposed removing its guidance that ADIs should assess whether borrowers can afford their repayment obligations using a minimum interest rate of at least 7%. Instead, it's proposed that ADIs would be permitted to review and set their own minimum interest rate floor for use in serviceability assessments.
2. **Increase the expected level of the serviceability buffer from at least 2% (most ADIs currently use 2.25%) to 2.5%**
3. **Remove the expectation that a prudent ADI would use a buffer 'comfortably above' the proposed 2.5%, to improve clarity of the prudential guidance**

In announcing the consultation, APRA Chair Wayne Byres said the current guidance was being reassessed in light of changes in the operating environment for ADIs since the interest rate floor and buffer were introduced in 2014. In 2014, these measures were necessary, Mr Byres said, to reinforce sound residential lending standards. However, though many of the same risk factors — high house prices, low interest rates, high household debt and subdued income growth — remain in play, two factors in particular suggest a reconsideration of the current approach may be justified. Namely: the fact that the historically low interests rate environment is now expected to persist for longer than originally envisaged and the introduction of differential pricing for mortgage products.

'With interest rates at record lows, and likely to remain at historically low levels for some time, the gap between the 7 per cent floor and actual rates paid has become quite wide in some cases – possibly unnecessarily so. In addition, the introduction of differential pricing in recent years – with a substantial gap emerging between interest rates for owner-occupiers with principal-and-interest loans on the one hand, and investors with interest-only loans on the other – has meant that the merits of a single floor rate across all products have been substantially reduced' Mr Byres said.

Allow greater flexibility and ensure sufficient prudence: APRA 'considers that the proposed changes will provide greater flexibility for ADIs to manage and set floor rates which reflect the outlook for interest rates, while still ensuring sufficient prudence is retained in serviceability assessments through the proposed higher buffer rate'.

Not 'intended to signify any lessening' in the importance the regulator places on 'sound lending standards? Mr Byres said that though the proposed changes are likely to increase the maximum borrowing capacity for a given borrower, they are 'not intended to signify any lessening in the importance that APRA places on the maintenance of sound lending standards'. Instead, Mr Byres said that 'the proposed changes will provide ADIs with greater flexibility to set their own serviceability floors, while still maintaining a measure of prudence through the application of an appropriate buffer to reflect the inherent uncertainty in credit assessments.'

Timeline: Submissions are due by 18 June. APRA plans to release a final version of the updated APG 223 'shortly afterwards'.

[Sources: APRA media release 21/05/2019; Letter to ADIs: Consultation on revisions to Prudential Practice Guide APG 223 Residential Mortgage Lending 21/05/2019; [registration required] The AFR 21/05/2019]

In Brief | Is APRA downplaying competition risk? A new report commissioned by the Customer Owned Banking Association (COBA) and compiled by Pegasus Economics entitled Reconciling Prudential Regulation with Competition, has found (among other things) that changes to the regulatory capital framework have undermined competition in the mortgage market

[Source: COBA media release 14/05/2019; Key Facts; Full report; Investor Daily 16/05/2019]

Accounting and Audit

United Kingdom | KPMG UK will reportedly change its executive governance structure to separate audit from the rest of the business

KPMG UK will reportedly change their executive governance structure, to separate audit from the rest of their business in an effort to deliver on some of the recommendations made by the Competition and Markets Authority (CMA) and the Business Energy and Industry Strategy (BEIS) committee reports into the audit sector.

[Note: The recommendations referred to, appear to be the Competition and Markets Authority's final report into competition in the UK audit sector which among other things recommended an operational split of the big four accounting firms' audit work. See: Governance News 01/05/2019. The reference to the recommendations of the BEIS committee appears to be a reference to the Future of Audit report which also recommended among other things, a 'structural split' or failing that, an 'operational split' between audit and non-audit functions. See: Governance News 05/04/2019. In addition, the Brydon Review (announced at the end of 2018) is currently seeking views on audit quality and effectiveness, as part of a broad based review into the sector. See: Governance News 17/04/2019]

KPMG UK chairman Bill Michael is quoted as saying that the 'The sole aim and focus of our chair of audit, our new audit executive and our Audit Oversight Committee is to drive audit quality, via strong leadership, good governance, rigorous controls, independent decision-making and separate performance management from the rest of the firm'.

The Audit Executive Committee will reportedly be headed by Jon Holt, who will become head of audit. The restructuring is intended to enable faster management decisions to be made by those closest to the firm's clients.

Changes don't go far enough? Professor Richard Murphy, from City University, has reportedly questioned whether the changes go far enough arguing that 'so called Chinese walls' are insufficient to restore credibility. He has reportedly called for KPMG to 'entirely separate its audit firm from the rest of its activities'.

Are other firms considering similar measures? The WSJ reports that PwC has said it is working on strengthening governance and audit quality but provides no further detail and Ernst & Young said it favours having auditing and consulting in one business. Reportedly, Deloitte declined to comment.

[Sources: Accountancy Age 16/05/2019; The WSJ 16/05/2019]

Risk Management

Culture

Top Story | Lessons from the Financial Services Royal Commission about how to use technology

A recent MinterEllison article, Lessons from the Financial Services Royal Commission, reflects on the lessons from the Financial Services Royal Commission for organisations in all industries about how technology can be used to ensure compliance and create a better customer experience.

The full text of the article can be accessed on the MinterEllison website here: https://www.minterellison.com/articles/lessons-from-financial-services-royal-commission-technology-business

Ethical lapses the primary reason behind forced CEO resignations in 2018? New global study into CEO turnover has found a sharp rise in the number of CEOs forced to resign due to ethical lapses

Report Overview | PwC's Strategy& annual CEO Success Study

PwC's Strategy& has released its 19th annual CEO Success study. The study analyses trends in CEO turnover at the world's 2500 largest companies and the impact of the departures of longer serving CEOs (CEOs who have served longer than 10+ years in the role) on their companies. A high level overview is below.

Some Key Points

Turnover trends

- **The global median tenure for all CEOs has remained steady at five years for the last decade**, and the 53-year median age of incoming CEOs has also been steady over the period. The share of incoming CEOs with previous experience as CEO of a public company has been increasing for the past several years, particularly in Western Europe, where 39% of incoming CEOs in 2018 had previous CEO experience.
- **Turnover among CEOs escalated to a record high of 17.5% in 2018** (3% higher than the 14.5% rate in 2017 and above what has been the norm for the last decade).
- **CEO turnover rose in every region in 2018 except China**. Turnover was highest (21.9%) in 'other mature' economies (such as Australia, Chile, and Poland), followed by Brazil, Russia, and India (21.6%). The next-highest turnover numbers were in Western Europe (19.8%), and the lowest were in North America (14.7%.
- **Turnover was highest in communication services companies** (24.5%), followed by materials (22.3%) and energy (19.7%). Healthcare saw the lowest rate of CEO turnover in 2018, at 11.6%
- **Most CEO departures are planned:** According to the report, percentages of the types of turnovers — planned, forced, and M&A-related — remained in line with long-term trends, with planned successions continuing account for the majority (two thirds) of all turnovers. According to the study, from 2004 to 2018, 82% of long-serving CEOs left office in a planned succession. Over the last three years, this has increased to 85% (as compared with 76% of other CEOs). The number of departures resulting from an M&A transaction is almost the same for long-serving CEOs and other CEOs.
- **There were more forced departures due to ethical lapses than for poor financial performance in 2018?** According to the report, though at 20%, the overall rate of forced turnovers was in line with recent trends, the reasons behind these moved was different from previous years. According to the study, more CEOs were dismissed for ethical lapses (eg fraud, bribery, insider trading, environmental disasters, inflated resumes, and sexual indiscretions) than for poor financial performance or board struggles. The report attributes the rise in these kinds of dismissals to a several societal and governance trends, including: a) more aggressive intervention by regulatory and law enforcement authorities; b) new pressures for accountability about sexual harassment and sexual assault brought about by the rise of the "Me Too" movement; and c) a shift towards boards adopting a 'zero tolerance' stance toward executive misconduct. The report also suggests that the growing pressure of activist investors could also be a contributing factor.
- **Forced departures are increasingly less likely the longer a CEO has served:** 32% of CEOs who depart in the first five years of their tenure are forced out. This falls to 22% for those who leave after serving between five and 10 years, 18% for those who leave after serving between 10 and 20 years, and to 15% for those who have served 20+ years. This trend 'obviously reflects the fact that long-serving CEOs are performing better than other CEOs, and it may also be due in part to the fact that a much larger percentage of long-serving CEOs hold joint CEO–board chair titles' the report suggests.

Women CEOs?

- The share of incoming women CEOs decreased to 4.9% in 2018 (from a 'record' high of 6% in 2017). The decrease is attributed in the report to the lower numbers of female CEO appointments in the US and Canada in 2018 (as compared to 2017), though there was an uptick in the number of women appointed in Brazil, Russia, India, China and 'other emerging' countries.

- The industries with the largest share of incoming female CEOs were: utilities (9.5%), followed by communications services (7.5%) and financials (7.4%).
- The industries with the lowest share of incoming female CEOs were: industrials or information technology companies (0%)

Impact of long-serving CEO departures on organisations (and on successor CEO The report also reviewed successions at the largest 2500 companies from 2004-2018 (5,253 turnovers) to analyse the impact of the departure of long-serving CEOs (10+ years tenure) on organisations. According to the report:

- **994 CEOs (of the 5,253 in the sample) were long-serving** ie had served 10 or more years at the time of their departure.
- **Long-serving CEOs are more likely (84%) than were shorter-serving CEOs (77%) to be insiders.** This trend has increased over the past three years. 90% of all long serving CEOs in 2018 were insiders before their appointment.
- **CEOs in North America were 122% more likely to be long-serving than CEOs in the rest of the world:** Over the period, 30% of the CEOs in North America were long-serving, compared with 19% for Europe, 10% for the BRI countries (Brazil, Russia, and India), 9% for Japan, and only 7%in China.
- **CEOs in the healthcare sector were the most likely to be long-serving** (28%), followed by those in information technology (26%). There was little variation among long-serving CEOs by industry.
- **The median tenure of a long-serving CEO is 13.9 years, compared with 4.0 years for other CEOs**. The primary reason for the long tenure of these CEOs the report suggests, is that longer serving CEOs 'generally' outperform their shorter serving peers.
  - The median regionally adjusted annual increases in total shareholder return (TSR) for long-serving CEOs was 5.7% which is 3.3% higher over the 2004-2018 period than for other CEOs.
  - 59% of the long-serving CEOs were in the two upper quartiles of TSR performance, compared with 47% of non-long-serving CEOs.
  - 8% of the long-serving CEOs were in the bottom performance quartile, compared with 28% for shorter-serving CEOs.
  - Over the last three years, the performance of long-serving CEOs has improved even more, with 64% in the top two quartiles, and only 7% in the bottom quartile. The report concludes from this, that boards of directors have become stricter about allowing CEOs to continue long tenures unless the performance is notably positive.

Challenges for successor CEOs?

Overall, the report found that it is much harder for a successor to a long-serving CEO to succeed, and the longer the predecessor's tenure, the more challenging it is for the successor to perform.

- **Successor CEOs are unlikely to perform as well as their predecessors (in financial terms):** According to the report, close to half of the successors who replaced long-serving CEOs moved the company's TSR down by one or more quartiles, 27% saw TSR hold steady and less than a quarter of new appointees (24%) moved it up to a higher quartile. The longer the long-serving CEO's tenure, the worse the successor performed. Among successors who replaced a CEO with a tenure of 10 to 15 years, 42% had a TSR in the top two quartiles, compared with 35% for those following a CEO with a 15- to 20-year tenure, and 25% for those following a CEO with a tenure of 20 or more years.
- **Where the departing long-serving CEO was a 'top performer' the challenge appears to be greater:** In cases in which the outgoing CEO was in the top performance quartile, 69% of the successors ended up in the bottom two TSR quartiles.
- **Successor CEOs are less likely to be in the role as long as their predecessors and more likely to be forced out?** The median tenure of the successors to long-serving CEOs was found to be shorter than those of the leaders they replace (5.3 years versus 13.7 years). Also successor CEOs were found to be 35% more likely to be forced out than their predecessor (19%).

- **Why so hard to replace a long-serving CEO (especially a high performing one)?** The report offers a number of reasons for this. These include that the outgoing CEO may not set up his/her successor to succeed and there may be a lack of effective oversight of the long-serving CEO's decision making. For example, above average TSR performance could mask lack of investment/planning for longer term success, which if unchallenged, could only become apparent after the successor takes over.

Implications of the findings for boards and for CEO candidates

Suggested steps for boards to take

1. **Boards should be careful not to delay CEO succession plans**
2. **Boards should take care not to become complacent and continually evaluate whether the CEO is best placed to perform the role in light of changing conditions.** Term limits, mandatory retirement ages, or other mechanisms aimed at limiting CEO tenure 'are not a panacea' the report cautions.
3. **Boards should be 'generally mindful' of the merits of separating the roles of chief executive and board chair.** This is not only agreed, by governance experts to be 'best practice' but is also linked to an increased rate of ethical lapses the report argues. The 2017 study, found that among CEOs who were forced out, 24% of those with joint titles were dismissed for ethical lapses, compared with 17% of those with the CEO title only.
4. **Boards should also consider whether the best candidate to succeed a long-serving CEO may be an outsider rather than an insider**. Given the rate of business disruption/change, the most effective candidates may be those whose backgrounds, perspectives, and skill sets are different from those possessed by the in-house candidates.

Suggested steps for CEO candidates to take?

The study also identifies steps CEO hopefuls should take to help ensure their own success. These include: a) building your own brand eg by spending time with external stakeholders building credibility. In planned successions, much can be done following the announcement of impending change; b) setting your own agenda eg commence a thorough review of all operations and strategy and then 'break the frame' by implementing a fundamental (and necessary) improvement/change (but not change for change's sake); c) finding the right pace for change; d) engaging the board as a strategic asset and partner; and e) tap into the company's culture to help drive it forward.

[Sources: Strategy& report: Annual CEO Success Study; Succeeding the long-serving legend in the corner office 15/05/2019; The Washington Post 15/05/2019; CNBC 15/05/2019]

Climate Risk

Top Story | Heightened expectations of climate-related disclosure and assurance

MinterEllison's Sarah Barker and Ellie Mullholland have written an article providing insights into how financial report preparers can prepare to meet new expectations concerning the disclosure of the financial impacts associated with climate change.

The full text of the article can be accessed on the MinterEllison website here: https://www.minterellison.com/articles/heightened-expectations-on-climate-related-disclosure-and-assurance

62 climate experts have signed an Australian Institute petition urging the next parliament to make climate action a top priority

Sixty two scientists and climate experts have signed an open letter/petition to the 'next parliament of Australia' calling on the incoming government to make climate change a top priority. 'The consequences of climate change are already upon us; including harsher and more frequent extreme weather, destruction of natural ecosystems, severe property damage and a worldwide threat to human health' the letter states. In addition, the letter states that Australia institute research has found that current emission reduction targets are not compatible with the goal of the Paris Agreement.

Prominent signatories include (among others): Nobel Prize winners Professor Peter Doherty AC and Dr Sue Wareham OAM, former Australian of the Year Professor Fiona Stanley AC, and former Chief Scientist for Australia Professor Penny Sackett.

[Source: Australia Institute media release/petition 16/05/2019]