Governance News

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Contents

Diversity

United States | 2019 US Spencer Stuart Board Index released: S&P 500 boards are (very) slowly becoming more diverse

Key Takeouts

- Directors appointed this year were more diverse (ie gender, ethnically, age, and skills/experience diverse) than previously, however the overall rate of change on boards is slow due to the very low rate of board turnover. The report argues that without change in current board refreshment practices, this is likely to remain the case.
- Director compensation is on the rise: The average total compensation for S&P 500 non-employee directors, excluding independent chairs, is around $303,000, a 2% year-over-year increase

The 34th annual US Spencer Stuart Board Index examines data and trends in board composition, board governance practices and director compensation among S&P 500 companies.

Some Key Findings

Increased diversity in new board appointments

432 independent directors were appointed this year, which according to the report is the highest number since 2004. Of this group:

- 59% of the new independent directors are diverse (defined as women and minority men), a 9% increase on last year.
- Women constitute 46% of newly appointed directors, up from 40% last year.
- 23% of new directors are minorities (African American/Black, Asian, Hispanic/Latinx). Minority women represent 10% of this group, up slightly from 9% last year. Minority men represent 13% of the new directors, an increase from 10% last year but still down from 14% two years ago.

The report suggests that the apparent focus by boards on improving board diversity signals that they are responding to shareholder pressure and to pressure from other stakeholders to make progress on the issue.

Looking beyond the usual candidate pool? Though CFOs are still in high demand, the professional profile of newly appointed directors is shifting

- 27% of newly appointed directors are serving on their first public company board
- 65% of the newly appointed directors are not either top executives (ie not CEOs, chair/vice chair, presidents or COOs
- 23% have experience as division/subsidiary heads or as EVPs, SVPs or functional unit leaders
- Financial talent remains a priority with 27% of newly appointed directors having a financial background. The report comments that candidates with experience as CFO/finance executive or investment professionals are in highest demand.

Marked difference in the profile of diverse directors v non-diverse male directors

- According to the report, there are 'marked differences' between the profiles of newly appointed women and minority men joining boards and non-diverse men.
- According to the report, diverse directors are far less likely to be CEOs or experienced directors. Only 19% of the diverse directors are current or former CEOs, compared to 44% of non-diverse men. By contrast, 34% of the diverse directors are first-time corporate directors, nearly double the 18% of the non-diverse directors.

- In addition, diverse directors are more likely to bring non-financial skills and a broader range of professional skills to the boardroom: 31% of the women and minority men are current or former line or functional leaders, compared to just 11% of the non-diverse men. 18% of the diverse director professional experiences fall into the categories of academics/not-for-profit, consultants, government/military or other, compared to just 7% of the non-diverse directors.
- Diverse directors also tend to be younger than their male non-diverse counterparts with 18% of diverse directors 50 or younger compared with 12% of newly appointed non-diverse men.

Boards continue to add younger directors, but the average age of S&P 500 directors is unchanged

- More than 40% of newly appointed directors are 60 or older (for context the average age of new S&P 500 independent directors is 57.5 years).
- One out of six (16%) directors added to S&P 500 boards are 'next-gen' 50 or younger and most of this group (59%) bring experiences from the consumer, IT and private equity/ investment management sectors.
- Younger directors are more diverse than their counterparts, with 69% either women (57%) or minority men (12%). They are also more likely to be serving on their first corporate board; 54% are first-time directors.

Low boardroom turnover overall remains an impediment to increased diversity

- 29% of boards made no changes to their roster of independent directors while 15% reduced the number without adding any new independent directors.
- Because boardroom turnover remains low, with the new directors representing only 8% of all S&P 500 directors, changes to overall composition continues at a slow pace. The report argues that 'continued low boardroom turnover remains a 'persistent impediment to meaningful year-over-year change in the overall composition of S&P 500 boards'.

Board refreshment practices are an issue

- Currently, 71% of S&P 500 boards disclose a mandatory retirement age for directors, unchanged over the past six years. 46% of S&P 500 boards with a retirement age set it at 75 or older compared to just 15% ten years ago.
- More than three-quarters of the independent directors who left S&P 500 boards in the past year served on boards with mandatory retirement ages. The age limits influenced the majority of these departures, with 41% either exceeding or reaching the age cap and another 14% leaving within three years of the retirement age.
- Only 15% of the independent directors on boards with age caps are within three years of mandatory retirement. With these directors averaging 63 years of age, most S&P 500 directors have years of potential service before reaching mandatory retirement.

The report argues that in the absence of changes in refreshment practices, the report contends that low turnover rates are likely to persist.

Other Findings

Splitting the Chair and CEO roles: the trend continues

- More than half (53%) of boards split the chair and CEO roles, up from 37% a decade ago.
- 34% of S&P 500 boards have an independent chair, more than double the 16% in 2009.
- 75% report having an independent lead or presiding director, compared with 80% last year and 95% a decade ago.

Board compensation is rising

- For the first time, the average total compensation for S&P 500 non-employee directors, excluding independent chairs, is around $303,000, a 2% year-over-year increase.

- Director pay varies widely by sector, with a $100,000 difference between the average total director pay of the highest and lowest paying sectors.
- The highest-paying sectors for directors are: healthcare ($362,450); information technology ($331,840), telecommunications services ($331,076) and energy ($325,234).

[Sources: Spencer Stuart media release 11/11/2019; 2019 US Spencer Stuart Board Index; registration required] The FT 11/11/2019]

In Brief | The Fourth Hampton-Alexander Review has been released: Unless the appointment rate of women is nearer 50% in the coming year ie half of all available roles going to women and half going to men, the FTSE 100 and FTSE 250 will not achieve the 33% target by the end of 2020

[Sources: Hampton-Alexander Review FTSE Women Leaders November 2019; The Guardian 13/11/2019; The Times 13/11/2019]

In Brief | Time to address the Asian-American leadership gap? McKinsey Chief Diversity and Inclusion Officer Lareina Yee and two of her colleagues wrote a piece about Asian under-representation in business, and more particularly in leadership roles. While workers of Asian descent make up 13% of the US professional workforce, they account for only 7% of business leaders, and only 3% of Fortune 500 CEOs

[Source: Fortune 07/11/2019]

Remuneration

Top Story | Not wedded to the 50% cap on financial metrics? APRA Chair Wayne Byres has said that the regulator is considering other options

APRA Chair Wayne Byres has given a speech to the Women in Banking and Finance Series Luncheon, entitled Remuneration: reactions and responses, providing an update on the remuneration consultation.

Key Takeouts

- **The case for change:** Mr Byres reiterated the case for change stating that 'There is ample evidence of improperly designed incentives encouraging actions and attitudes that are contrary to the long-run interests of the company itself, let alone other stakeholders. In those cases, it has been a lose-win: firms were being damaged, but were rewarding staff for causing that damage along the way'.
- **No consensus on what change looks like:** Mr Byres said 'there does appear to be an underlying desire to improve remuneration practices in the financial system: few sought to argue that the status quo was optimal. Sadly though, there is no consensus on what improvement looks like'.
- **50% is contentious but no (real) alternatives suggested:** Mr Byres said that the proposed cap of 50% on the use of financial metrics was highly contentious and enumerated various concerns raised in submissions. However, he observed that few submissions suggested an alternative means to address the Financial Services Commission's concerns, beyond the exercise of increased board discretion.
- **Other options being considered:** Mr Byres said that APRA is 'not locked in to the specific 50 per cent proposal, and certainly recognise there are trade-offs involved, so will be looking at other options'.
- **Work in progress:** Mr Byres concluded by saying that APRA is still working through submissions and settling on a new framework — 'It is too early to say much more about where we will end up'.

In a speech to the Women in Banking and Finance Series Luncheon, Australian Prudential Regulation Authority (APRA) Chair Wayne Byres spoke on the topic of remuneration, APRA's rationale for the proposed changes to remuneration and the response to consultation.

[Note: APRA released a discussion paper and new draft Prudential Standard (CPS 511) proposing stronger and more prescriptive prudential requirements for remuneration across all APRA-regulated entities in the banking, insurance and superannuation sectors in July and consultation closed on 23 October. The proposed new standard aims to address the remuneration-related recommendations made by the Financial Services Royal Commission (Recommendations 5.1, 5.2 and 5.3) as well as insights gained from the Prudential Inquiry into the Commonwealth Bank of Australia (CBA), APRA's Review of Remuneration Practices at Large Financial Institutions and its summary of industry self-assessments of governance, accountability and culture. For a summary of APRA's proposals see: Governance News 24/07/2019]

The case for change

Though some progress has been made, APRA considers that more work is needed

Mr Byres said that ultimately, the interests of financial firms and others (their customers, investors) are not always in alignment and that in this context, relying on self-interest to deliver a financial sound financial system, producing fair outcomes for consumers won't work.

The weaknesses in the current system are reflected, he said in both the findings of APRA's 2017 review of remuneration frameworks and outcomes and were also highlighted by the Financial Services Royal Commission in recommendations 5.1,5.2 and 5.3.

'There is ample evidence of improperly designed incentives encouraging actions and attitudes that are contrary to the long-run interests of the company itself, let alone other stakeholders. In those cases, it has been a lose-win: firms were being damaged, but were rewarding staff for causing that damage along the way' he said.

Having said this, Mr Byres said that 'pleasingly' some firms have accepted the need for change and have taken some steps in this direction, but that APRA considers there 'remains more to do to make sure remuneration arrangements in the financial sector are robust and can be relied upon to genuinely deliver the sorts of outcomes we think are important'.

APRA's proposed changes

Mr Byres summarised the 'core' aspects of APRA's proposed, more prescriptive changes as follows:

1. a shift away from 'formulaic approaches' to determining remuneration outcomes in aggregate and for individuals, to an expectation of active board involvement and the application of judgment to better align rewards with outcomes

2. a suggested 50% cap on the use of financial metrics when determining remuneration outcomes, in order to promote a more holistic assessment of performance through elevating the importance of non-financial risks (including conduct) in the assessment of variable remuneration outcomes

3. longer vesting, combined with malus and clawback, to retain more 'skin in the game' for a longer period of time, and ensure short-term rewards cannot be enjoyed without regard to longer-term outcomes.

Mr Byres said that the proposed framework is 'undoubtedly more prescriptive than has traditionally been the case, reflecting the need to drive change' but noted that it retains a measure of flexibility. For example, APRA has not sought to: 1) cap the amount of variable remuneration; or 2) prescribe specific remuneration structures or forms; or 3) which performance metrics should be used.

Industry response to the proposed changes

'Strange and disappointing'

Mr Byres said that APRA's 'proposals have undoubtedly caused a fair amount of angst, as they would require significant change to established practice'.

He said that many large investors and proxy advisors had raised concerns about the proposed changes, largely, he suggested 'because they have been very influential in designing current practices to suit their particular interests'. Some boards, he said had been advised that if they change their arrangements to comply with APRA's proposed requirements, 'they will be met with protest votes at AGMs'. Mr Byres described this as a 'strange and disappointing response to a Board that would be seeking to comply with the law'.

Mr Byres said that there is also concern 'on a number of fronts' that APRA's proposals will not achieve the regulator's objectives, will be 'too onerous and therefore cannot be justified on a cost-benefit basis, and/or will have unintended consequences (such as challenges in attracting new talent, and significant shifts from variable to fixed remuneration)'.

Mr Byres said that APRA is considering these issues carefully. 'Any regulatory intervention involves trade-offs, and we obviously do not want to impose new regulation that does not deliver to the community the benefits it is designed to achieve. Equally, the community wants to see action in response to, in particular, the Royal Commission's recommendations. Balancing these trade-offs is our biggest challenge – inevitably, not everyone's preferences can be met'.

There is an 'underlying desire to improve remuneration practices' – but no consensus on what improvement looks like

Mr Byres went on to say that 'notwithstanding these concerns, there does appear to be an underlying desire to improve remuneration practices in the financial system' with few arguing that the status quo should be maintained, but that there is 'no consensus on what improvement looks like'.

Can boards be trusted to exercise more discretion?

Mr Byres said that one area where APRA and 'many submissions' are in agreement, is the need for boards to exercise more discretion to adjust remuneration to ensure appropriate outcomes are achieved. He added, that 'board discretion is often put forward as an alternative to some of the more prescriptive components of the draft standard'.

Mr Byres said that a key issue for APRA to consider is 'how much it can be relied upon. It would certainly make the standard much simpler to design, but having failed to exercise much, if any, discretion for many years, the challenge is why there should be confidence this will deliver genuine improvements in the future? We want to see more discretion used, but other reinforcements would seem necessary to help this take effect'.

The proposed 50% cap on financial metrics: response from industry

Mr Byres said that the proposed cap of 50% on the use of financial metrics was highly contentious. Arguments against the approach included that it: a) entrenches the use of a balanced scorecard approach (which is not universally supported); b) discourages consideration of other remuneration tools eg gateways, modifiers, pool allocation methodologies (among others); c) introduces complexity around how these other tools would count towards a limit; d) places undue weight on non-financial metrics that may not be as reliable, verifiable or transparent as profit-based measures; and e) potentially undermines, by setting a hard limit, APRA's broader goal of encouraging active use of board discretion.

Mr Byres went on to say that 'none of these are unreasonable concerns' but argued that, some concerns could be overcome. For example, he argued that the fact that some non-financial metrics are not perceived to be reliable as financial metrics is not a reason to avoid using them all together. 'It should not be beyond the wit of the industry to develop better measures that are suitably objective, transparent, reflect underlying performance and are subject to independent verification. Moreover, it should not be forgotten that some of the purportedly reliable financial metrics are themselves not free from management influence' he said.

Mr Byres further observed that few submissions suggested an alternative means to address the Commission's concerns, beyond the exercise of increased board discretion.

APRA is 'not locked in to the specific 50% proposal'

Mr Byres said that APRA is 'not locked in to the specific 50 per cent proposal, and certainly recognise there are trade-offs involved, so will be looking at other options'.

He said that these options could include a higher limit, a narrower definition of 'financial metrics', or an alternative way to use non-financial metrics. 'Whatever we do, however, the challenge is to find an alternative that gives sufficient comfort that a "profit alone" approach will not re-emerge in another guise' he said.

Expanded requirements on boards and remuneration committees

Commenting on proposed expanded requirements on boards and remuneration committees, Mr Byres said that the primary concern raised during consultation was the extent of board involvement in remuneration decisions. 'At its heart is a concern that Boards are being forced to undertake responsibilities that are more correctly the domain of management' Mr Byres said.

Responding to this, Mr Byres said that APRA 'will need to find a balance'. 'History tells us Boards have been, at least until more recently, relatively hands off in exercising much discretion and judgement even in the case of the most senior executives. Our goal of having more engaged Boards exercising more discretion based on a holistic assessment of performance will require Boards to do more than they have traditionally done. But equally there is little value in asking Boards to do something they cannot properly do. We will be looking further at where to appropriately draw the line, and how to define a clearer and tighter set of Board responsibilities that allow Boards to exercise the discretion that we are expecting them to exercise, while at the same time not overloading them with responsibilities they cannot, as non-executives, fulfil' he said.

Proposed deferral obligations

Finally, Mr Byres spoke about proposed deferral obligations, and calls for APRA to allow more flexibility. He said that concerns had been raised that the proposed deferral obligations may be too long for some individuals, and not reflective of their accountability, ability to influence and contribution to the outcomes of the firm; and though generally aligned to international better practice, the proposals don't recognise that deferral requirements in other jurisdictions are typically shorter for non-banks than they are for banks.

Mr Byres responded to this by saying that aligning risk and return is a key objective for the regulator and 'recognising that risks crystallise (or dissipate) differently in different types of businesses is certainly a legitimate issue to be concerned about'.

He added that APRA 'will certainly look at international practice in thinking about how to address this issue, but it won't be the sole determinant of how we ultimately set Australian requirements'.

Still working through submissions

Mr Byres said that APRA is still working through all of the submissions and settling on a new framework for remuneration.

'It is too early to say much more about where we will end up. Given the fervent views that have already been expressed, about the only thing I can confidently predict today is that not everyone will be happy! But, of course, that is not our objective: rather, our goal is remuneration systems that provide appropriate incentives, improve accountability and support the effective management of financial and non-financial risks. Achieving that will undoubtedly be a win: win for all'.

[Source: APRA Chair Wayne Byres' speech to Women in Banking and Finance Series Luncheon 13/11/2019; [registration required] The AFR 13/11/2019]

United Kingdom | The IA has written to Chairs of Remuneration Committees of FTSE 350 companies calling for clearer links between pay and performance

Key Takeouts

- The UK Investment Association (IA) has released updated Principles for Remuneration setting out investor expectations with respect to executive pay and highlighting key areas of investor concern
- The IA has also written to the Chairs of Remuneration Committees of FTSE 350 companies flagging the release of the principles, and calling on them to address various shareholder concerns. Among other things, the letter calls on companies to: a) simplify pay structures (including considering a shift away from LTIPs); b) clearly explain the link between pay and performance (ie justify executive pay); c) strengthen policies for departing directors to ensure the long term value of the company is prioritised; and d) broaden procedures for the use of malus/clawback provision triggers
- The IA's Institutional Voting Information Service (IVIS) will assess all FTSE All-Share companies' remuneration policies against the principles before they are presented to their companies' AGM for a binding vote, and will provide a 'colour-top for their report to reflect the level of concern shareholders should have with the policy'.

The UK Investment Association (IA) has released updated Principles for Remuneration (Principles) setting out investor expectations with respect to how executive pay should be structured and highlighting key areas of investor concern.

Director of Stewardship and Corporate Governance at the Investment Association Andrew Ninian, said that though companies are responding to investors' concerns on pay levels/structures, more work is required to ensure remuneration aligns with investor expectations. 'The 2020 AGM season will be a key year for many companies, with investors looking out for greater alignment on pay with long-term company strategy. Some companies have listened to investors over the last few years and made changes to their remuneration structures to take account of investors' views. However with the majority of remuneration policies up for renewal next year, investors will be looking for signs that companies continue to listen to key concerns and ensure the pay structures of their top team align with company performance' he said.

Key areas for improvement

The IA wrote to the Chairs of Remuneration Committees of FTSE 350 companies, flagging the release of the Principles and calling on them to focus on a number of specific areas including the following (among others).

1. **Consider simpler alternatives to long-term incentive plans:** The Letter says that IA members are increasingly of the view that the 'traditional Long Term Incentive Schemes' are not necessarily delivering optimal results, sometimes even driving outcomes which can cause concerns for shareholders eg increasing grant levels or 'volatile and significant vesting outcomes'. On this basis, the letter calls on Remuneration Committees to review remuneration arrangements to ensure they are aligned with company strategy and consider whether alternate arrangements may be more appropriate. The IA says that it will 'work with companies as they consider these alternative structures to see if they can be more widely adopted in the UK market'.
2. **Justifying the level of executives' remuneration and explaining performance-related pay-outs, with 'robust transparency on targets'**. The IA has called on companies 'to show restraint in growing the overall size of pay packets, and are calling for executive pension contributions to be brought in line with the majority of the workforce as soon as possible'.
3. **Strengthening policies for departing directors:** The IA has called on companies to ensure the long-term value of the company is prioritised suggesting that directors should now hold a proportion of their shares for at least two years once they've left the company.
4. **Broadening malus and clawback provision triggers and establishing procedures for their use:** The IA has called on companies to ensure there are measures in place to enable executive bonuses to be forfeited or recovered including where payments are made based on: erroneous or misleading data, misconduct, misstatement of accounts, serious reputational damage and corporate failure.

[Sources: Investment Association media release 05/11/2019; [registration required] The FT 06/11/2019]

In Brief | 'You can't fix what you can't see': The SMH reports that CEOS for Gender Equity WA has called for West Australian CEOs to undertake pay gap audits and then take steps, including reviewing executive hiring practices and making 'diversity adjustments' to remuneration where necessary

[Source: The Age 11/11/2019]

Corporate Social Responsibility

Fourth annual Governance Institute annual ethics index released: 90% support for action on climate change among the key findings

The Governance Institute has released its fourth annual Ethics Index. The index surveys more than 1,000 people from across Australia from various political and socioeconomic backgrounds about their perceptions of ethical issues and conduct.

This year the survey was extended to include questions regarding climate change, renewable energy and artificial intelligence.

Some Key Findings

Support for action on climate change: Nine in ten Australians want the Federal Government to take action on climate change, and a similar number say organisations must also take action — even if it impacts profits and job losses. The study also found that 53% of people believe Australia has an urgent ethical obligation to transition to renewable energy.

Commenting on the findings, Governance Institute CEO Megan Motto said that 'These results send a clear and compelling message to the government and business sector — climate change is now an ethical imperative for many Australians and those who ignore this, risk losing credibility and trust'.

Ms Motto went on to say that the survey found that leaders — CEOs, NEDs, and senior management — are perceived to be most able to influence ethical practices, including acting on climate change. Whereas, those further down the leadership ladder, general workforce and activists are perceived to wield the least influence.

Attitudes to Artificial Intelligence (AI)

AI based traffic management and public surveillance are seen as the most ethical uses of AI systems (40%+ ethical).

AI based social scoring of citizens are seen as the least ethical (60% unethical).

Other issues seen as unethical by the majority of Australians include: a) AI based hiring using private and public data; b) AI based autonomous lethal weapons; and c) AI systems created in ways that cannot be understood (50%+ unethical).

Australians appear less concerned by the use of big data to target consumers than previously, with a 10 point improvement on last year (scores going from -16 in 2018 to -6 in 2019).

Trust continues to be a challenges for the financial services sector in the wake of the Hayne Commission

The banking, finance and insurance sector continues to have the lowest Ethics Index score of all sectors. Within the sector, accountants scored the highest in ethical behaviour (50% ethical score), followed by tax agents (44%) and financial planners (36%).

Pay-day lenders have improved their net score ratings compared to 2018 (from -54 to -43) though they are still perceived as unethical by 60% of Australians.

Executive remuneration is a key concern: The top ethically important issue within the banking and finance sector continues to be executive salaries (51%). This is followed by bribery and corruption issues (50%) and insufficient regulation ranks third (49%).

Executive bonuses (48%), lack of government action (48%) and treatment of customers (47%) were also of concern. The Governance institute comments that lack of government action is mentioned more often in 2019 (from 42% to 48%).

The higher the CEO's pay the more unethical they are perceived to be? According to the survey, there is a link between high pay and perceptions of ethical behaviour and more particularly, respondents appear to perceive that the higher a CEO's pay is, the more unethical they are. The majority of respondents (74%) pf perceive that it is unethical if the CEO o company with up to 5,000 employees is paid $3 million per annum (ie 35x the average Australian's yearly income); a similar situation is seen for the CEO of company with up to 15,000 employees (72% of Australians perceiving it to be unethical).

What is the most effective way to ensure ethical conduct?

Accountability (61%) continues to be the top element of importance to ensure ethical conduct in society, with no change compared to 2018. This is followed by transparency (57%), whistle-blower protection (50%), and highly ethical leaders (49%).

Least effective ways to ensure ethical conduct?

Respondents ranked having a chief ethics officer last on the list of eleven available options to ensure ethical behaviour. Oversight by industry associations was ranked tenth (21%) and oversight by regulators at 9th (27%). Financial penalties ranked eighth (37%).

Most ethical sectors/occupations?

Health, education and not for profits were ranked as the most ethical sectors. The most ethical occupations were: ambulance services, nurses and fire services. Federal politician ranked as the least ethical occupation.

[Sources: Governance Institute media release 12/11/2019; Governance Institute Ethics Index 2019; Governance Institute CEO Megan Motto blog post 12/11/2019]; [registration required] The Australian 12/11/2019]

Westpac will reportedly set targets for its loans book that correspond with the 2016 Paris Agreement to keep global warming below 2 degrees

The Australian reports that Westpac has signed up to the Science Based Targets Initiative (SBTI).

The new standard requires the lender to set emissions targets for its loans book that correspond with the 2016 Paris Agreement to keep global warming below 2 degrees.

The Australian comments that though the big four banks have made commitments in relation to their operational emissions, and have publicly backed the Paris Agreement, Westpac is the only one to sign on to the SBTI.

[Source: [registration required] The Australian 12/11/2019]

Socially responsible (and also encourages customers to fly Qantas)?

Qantas has announced that it will cap its net carbon emissions at 2020 levels, and commit to net zero emissions by 2050.

Starting immediately, the airline has said it will double the number of flights being offset.

In addition, the airline will invest $50 million over ten years to help 'kickstart' a sustainable aviation fuel industry in Australia. Announcing the measures Qantas CEO Alan Joyce said that 'we're doing this because it's the responsible thing to do, but hopefully it will also encourage more people to choose Qantas and Jetstar because of the action we're taking'

[Sources: Qantas media release 11/11/2019; The New Daily 11/11/2019]

Time to look beyond shareholder activism and instead consider governance reform?

Writing in The Conversation, RMIT academics Warren Staples and Andrew Linden argue that institutional shareholder activism is unlikely to 'systemically improve governance and accountability because they're primarily concerned with returns' and further, because there is no evidence that institutional investors will consistently cooperate/collaborate with other in furtherance of the broader community interest.

Instead, they argue 'real corporate governance reform' is required to drive social reform. This could potentially include, they suggest: two tiered boards and worker/union representation on boards to improve accountability, stricter lobbying prohibitions, 'better leadership from government, and regulatory oversight'.

[Source: The Conversation 12/11/2019]

Meetings and Proxy Advisers

BHP AGM result: ACCR sponsored ESG resolution failed to be carried, but did secure 29.58% support

The BHP Australian AGM was held on 7 November.

Shareholder ESG resolution failed

- **Almost 30% proxy support for lobbying resolution:** A shareholder resolution, coordinated by the Australasian Centre for Corporate Responsibility (ACCR) calling for BHP to suspend its membership of industry associations whose advocacy is inconsistent with the Paris Agreement received 72.93% votes against, (29.58% support) at the Australian AGM. BHP noted that it consulted extensively with its shareholders on the resolution in the lead up to both the Sydney and London AGMs and would be 'conducting further consultations in the next few months in relation to shareholders' views on this matter'. BHP adds that shareholder consultations conducted to date helped inform the enhancements to the scope and methodology of BHP's 2019 Industry Association Review.

  [Note: The result is consistent with the result at the London on 17 October where 22% of London shareholders voted in favour of the resolution (70% of shareholders voted against it). See: Governance News 23/10/2019]

  [Note: The shareholder resolution was contingent on the passage of a constitutional amendment. The constitutional amendment received 15.32% support and failed to carry. As such, it follows that the ACCR resolution was not valid.]

- **Important to continue to engage:** The resolution was not supported by the BHP board on the basis that the board considers it is more important, and likely more effective, to continue to engage with industry groups. The resolution did reportedly have the support of the Australian Council of Superannuation Investors (ACSI), Danish pension fund MP Pension, Church of England Pensions board in the UK and Dutch fund ACTIAM as well as Vision Super and Grok Ventures.

- **'Huge result'?** Noting the level of support was even higher than the vote in London last month, ACCR Executive Director Brynn O'Brien said 'This is a huge result on a very direct call for suspension, and represents an awakening for the Australian investment community'.

  For context, the result was short of the record 46.3% of proxy votes cast at Origin Energy's 2018 annual meeting for an ACCR-backed resolution calling on the company to review its membership of industry associations and publish the results.

- **Number of other companies facing similar resolutions:** ACCR has filed identical resolutions with ANZ and NAB for consideration at their AGMs in December. In addition, Mr O'Brien said that the ACCR intends to pursue the issue with Rio Tinto, Santos and Woodside in the new year**.**

[Sources: BHP AGM result 2019; BHP AGM speeches 07/11/2019; Market Forces media release 07/11/2019; ACCR resolution; ACCR media release 07/11/2019; Reuters 07/11/2019; The SMH 07/11/2019; Mining.com 07/11/2019; [registration required] The Australian 07/11/2019; [registration required] The FT 07/11/2019; [registration required] The AFR 07/11/2019; Investor Daily 11/11/2019]

Disclosure and Reporting

Top Story | Myer class action: finally guidance on guidance?

The landmark Federal Court decision by Justice Beach in the Myer class action - TPT Patrol Pty Ltd as trustee for Amies Superannuation Fund v Myer Holdings Limited [2019] FCA 1747 - is the first final judgment in a shareholder class action in Australia.

MinterEllison's class action experts have unpacked what this decision means for companies seeking to comply with their market disclosure obligations.

The full text of the article can be accessed on the MinterEllison website here: **https://www.minterellison.com/articles/reflections-on-myer-class-action**

ACSI/RIAA have released a 'best practice' guide to reporting under Australia's Modern Slavery Act

The Australian Council of Superannuation Investors (ACSI) and Responsible Investment Association Australasia (RIAA), have released a best-practice guide, building on the government's guidance, to reporting under the Modern Slavery Act (Cth).

[Note: The full text of the guide is available here.]

The guide is intended to be used as a framework for investor reporting, providing practical tips, hypothetical examples and broad context on matters investors may wish to consider in preparing their modern slavery statements. It is also intended, ACSI/RIAA state to be used in conjunction with the guidance provided by the Australian Border Force (Government Guidance).

ACSI/RIAA note that though both supply chains and investments are addressed in the guide, it is primarily focused on providing additional information for investors on how they might address their investment activity in their modern slavery statements.

It also does not address: the requirements under the NSW Act, the obligations entities, directors or trustees might need to take into account under applicable laws or address remediation.

Announcing the release of the guide, ACSI CEO Louise Davidson said it was developed to assist investors to meet their reporting obligations under the Commonwealth Act. 'Modern Slavery is likely to exist in the operations or supply chains of most businesses. Beyond the devastating human impact, poor management of human rights impacts upon the commercial success, stability and longevity of investments…ACSI and RIAA have collaborated to ensure investors have a clear path on how to tackle these issues and promote sustainability in their operations and supply chains. We encourage investors and companies to report within the spirit of the new law and work to develop their capacity to identify, manage, address and remediate modern slavery risks and impacts' Ms Davidson said.

RIAA CEO Simon O'Connor added that the guide is designed to help investors lead with action in respecting human rights and tackling modern slavery. 'We encourage superannuation funds, fund managers and others to use this guide to strengthen their own reporting under the new law. In doing so, investors will be in a stronger position to guide companies around better disclosures and human rights risk management' he said.

Assistant Minister for Customs, Community Safety and Multicultural Affairs, Jason Wood, welcomed the launch of the guidance saying 'The investor community has a vital role to play in combating modern slavery. This initiative between the Australian Council of Superannuation Investors and the Responsible Investment Association Australasia is an example of collaboration that can lead to best-practice guidance for specific industries. This guidance complements the Government's official guidance and will provide a useful resource to support investors to meet their obligations under the Modern Slavery Act'

[Sources: ACSI media release 11/11/2019; Modern Slavery Reporting — Guide for Investors November 2019]

ASIC guidance on companies' whistleblower policies released: relief granted to certain not for profits/charities

Following public consultation through ASIC Consultation Paper 321 Whistleblower policies (CP 321), the Australian Securities and Investments Commission (ASIC) has provided guidance to assist companies meet their obligation to have a whistleblower policy available to their officers and employees by 1 January 2020.

Regulatory Guide 270 Whistleblower policies (RG 270) is intended to assist companies — public companies, large proprietary companies and proprietary companies that are trustees of registrable superannuation entities — to establish policies that support and protect whistleblowers. RG 270 also includes good practice guidance to assist companies develop and implement policies that are tailored to their operations.

Details

RG 270 sets out the components that a whistleblower policy must include to meet legal requirements. These include: a) types of matters covered by a policy; b) who can make and receive a disclosure; c) how to make a disclosure; d) legal and practical protections for disclosers; e) investigating a disclosure; and f) ensuring fair treatment of individuals mentioned in a disclosure.

Relief for certain not for profits/charities

RG 270 grants relief to public companies that are not-for-profits or charities with annual revenue of less than $1 million from the requirement to have a whistleblower policy.

Commenting on this, ASIC Commissioner John Price said that the relief had been provided 'because we understand that these entities may face a compliance burden that outweighs the benefits a policy might otherwise offer'.

Broader application

ASIC notes that all companies are bound by the whistleblower protections in the Corporations Act from 1 July 2019, regardless of whether they are required to have a whistleblower policy. As such, ASIC suggests that the guide will also be of more general use in assisting in the management of whistleblowing in accordance with the Corporations Act.

Review of compliance next year

ASIC says that it plans to survey the whistleblower policies of a sample of companies next year to review compliance with the legal requirements.

[Sources: ASIC media release 13/11/2019; Regulatory Guide 270]

Regulators

US SEC enforcement results released: A 'successful year for the division of enforcement' but the Kokesh decision poses an ongoing challenge to SEC's ability to disgorge and return funds to investors injured by long-running frauds

The Securities and Exchange Commission (SEC) Division of Enforcement has issued its annual report for fiscal year 2019. A high level overview of some of the achievements highlighted by the regulator in the report is below.

Two key areas of focus: retail investors and cyber threats

SEC says that it continued to focus resources on two key priority areas: retail investor protection and combating cyber threats during fiscal year 2019. As in Fiscal Year 2018, the largest percentage of cases related to asset management, securities offerings, and issuer reporting and accounting issues.

In addition, SEC also remained focused on individual accountability by pursuing charges, where appropriate, against executives at all levels of the corporate hierarchy—including C-suite executives, as well as registered individuals, accountants, and auditors.

Focus on the retail investor: A particular area of focus was misconduct that occurs in the interactions between investment professionals and retail investors. SEC says that the Share Class Selection Disclosure Initiative, which was launched in February 2018 'has achieved extraordinary results' in this context. In March 2019, just over one year after the Initiative was announced, the Commission ordered 79 investment advisers to return more than $125 million to affected investors. In September 2019, the Commission ordered another 16 advisory firms to return an additional $10 million to affected investors.

Focus on cyber related misconduct: SEC investigated and recommended a number of cases involving distributed-ledger technology and digital assets in Fiscal year 2019 including pursuing issuers suspected of fraudulent conduct. SEC also brought a number of actions against third parties that violated the federal securities laws through their participation in the offer, sale, or promotion of digital asset securities.

The Cyber Unit within SEC and the enforcement division as a whole also continued to focus on cybersecurity threats to public companies and regulated entities. In addition, SEC leveraged technology to enable investigations into unlawful trading that without ability to analyse the voluminous amounts of data involved, would not have been possible.

Accelerating the pace of investigations: The time taken between opening a case and filing an enforcement action slightly improved in fiscal year 2019, taking 24 months on average. SEC says that it is aiming to improve this in Fiscal year 2020. In particular, SEC is looking to shorten timeframes in financial fraud and issuer disclosure cases. In Fiscal Year 2019, these cases took, on average, 37 months from opening to filing.

Statistics: Overall activity

SEC brought a diverse mix of 862 enforcement actions (as compared with 821 in 2018) addressing a broad range of 'significant issues' including: including issuer disclosure/accounting violations; auditor misconduct;

investment advisory issues; securities offerings; market manipulation; insider trading; and broker-dealer misconduct.

The SEC obtained judgments and orders totalling more than $4.3 billion in disgorgement and penalties as a result of these actions, and returned roughly $1.2 billion to harmed investors.

526 were 'standalone' actions brought in federal court or as administrative proceedings

- SEC comments that the number of standalone enforcement actions was nearly 7% higher in Fiscal Year 2019 (526) than Fiscal Year 2018 (490). SEC attributes this in part to the self-reporting nature and accelerated resolution process of the Share Class Initiative.
- Consistent with 2018, the majority of the SEC's 526 standalone cases concerned investment advisory and investment company issues (36%), securities offerings (21%), and issuer reporting/accounting and auditing (17%) matters. The SEC also continued to bring actions relating to broker-dealers (7%), insider trading (6%), and market manipulation (6%), as well as other areas such as FCPA (3%) and Public Finance (3%).
- In Fiscal Year 2019, 69% of the Commission's standalone actions, excluding actions brought as part of the Share Class Initiative (which applied only to entities), involved charges against one or more individuals. This percentage is in line with the results of the last several fiscal years. If the Share Class Initiative actions are included, the percentage of actions involving charges against one or more individuals was 57%.

  SEC notes that individuals charged in SEC actions include those at the top of the corporate hierarchy — such as CEOs, CFOs and COOs — as well as gatekeepers such as accountants, auditors, and attorneys.

210 were 'follow-on' proceedings seeking bars based on the outcome of Commission actions or actions by criminal authorities or other regulators (this number is unchanged from 2018).

126 were proceedings to deregister public companies (typically microcap) that were delinquent in their Commission filings. By comparison, in 2018 the number was 121.

Disgorgement and penalties ordered: 10% increase on 2018

- In Fiscal Year 2019, parties in the SEC actions and proceedings were ordered to pay a total of $3.248 billion in disgorgement of ill-gotten gains. Penalties imposed totalled $1.101 billion. Total monetary relief ordered in Fiscal Year 2019 was $404 million higher than in Fiscal Year 2018, an approximately 10% increase.
- The 5% of cases that involved the largest financial remedies accounted for the majority of all financial remedies SEC obtained. The remaining 95% of cases, which constitute the bulk the SEC enforcement division's overall activity, accounted for roughly 30% of monetary remedies. SEC comments that this proportion has remained broadly consistent over time.
- SEC returned a substantial amount of money, nearly $1.2 billion in 2019 (as compared with $794 last fiscal year).

Kokesh continues to pose a challenge

The report comments that the 2017 Supreme Court decision in Kokesh v SEC [2017] — in which the court held that SEC's claims for disgorgement are subject to a five year statute of limitations — 'continues to impact adversely the Commission's ability to disgorge and return funds to investors injured by long-running frauds, such as Ponzi schemes, that often directly impact retail investors'.

SEC explains that the impact of the decision is significant because 'many securities frauds are complex, well concealed, and are not discovered until investors have been victimized over many years'. According to SEC, the decision has so far caused it 'to forgo approximately $1.1 billion dollars in disgorgement in filed cases'. SEC adds that the actual impacts of the decision are likely greater than this number as in light of the decision, SEC has shifted its resources to investigations which hold the most promise for returning funds to investors.

[Sources: SEC media release 06/11/2019; SEC Division of Enforcement annual report 2019]

APRA's superannuation data transformation project: APRA has launched a project to improve data collection practices

The Australian Prudential Regulation Authority (APRA) has released a discussion paper, topic paper draft reporting standards for consultation as part of a broader three phase project to upgrade the collection of superannuation data.

Purpose of the project? The project is intended to drive better industry practices and improve member outcomes by enhancing the comparability and consistency of reported data. Announcing the project, Deputy Chair Helen Rowell said that APRA will use the insights gained from a more complete and granular data collection to sharpen its supervision priorities and drive better industry practices.

APRA said that a 'key element underpinning the objectives of the Superannuation Data Transformation is improved industry transparency' which will be achieved through proposals to enable more data (including data collected under phase 1 of the project) to be non-confidential, enabling APRA to publish it.

Ms Rowell added that 'Heightened transparency will also intensify the pressure on underperformers to lift their game. The improved data collection will also support the implementation of other key regulatory requirements including the business performance review, and the legislated outcomes assessments which form a key input to these reviews. It also enables the planned expansion of our new performance heatmap to include choice products'.

Three phases: The project is divided into three phases as follows.

1. **Phase 1 (Breadth) will address the most urgent gaps in data collection:** This is intended to 'address the most urgent data gaps' to enable APRA, industry and stakeholders to assess member outcomes and industry operations and performance. APRA says a key area of improvement for Phase 1 will be to boost coverage of the data collected for the superannuation industry, particularly to include all choice products and investment options. Other areas of improvement include expense reporting, member demographics and asset allocation classifications.
2. **Phase 2 (Depth) will increase the granularity of the entire collection and explore different types of data collection**: APRA says the purpose is to explore new and better approaches to data reporting, across all areas of RSE licensee operations, including governance and risk management. A key outcome from Phase 2 is the improvement of the 'granularity of the superannuation data collection' and to explore different types and methods of collecting data in addressing the data needs of APRA, the industry and other stakeholders.
3. **Phase 3 (Quality) will assess the quality and consistency of the additional data reported during Phases 1 and 2, and address any implementation issues**

Timeline: Consultation on Phase 1 closes on 17 January 2020. APRA intends to respond to Phase 1 of the consultation and finalise changes to its reporting standards by mid-2020. The first tranche of data collected under Phase 1 is due to be published in late 2020.

[Sources: APRA media release 07/11/2019; Discussion paper: Superannuation Data Transformation Phase 1]

The Economics Legislation Commission has recommended that the Treasury Laws Amendment (Recovering Unpaid Superannuation) Bill 2019 be passed

The Economics Legislation Commission has recommended that the Treasury Laws Amendment (Recovering Unpaid Superannuation) Bill 2019 be passed.

The Bill proposes to provide for a one-off amnesty to encourage employers to self-correct historical superannuation guarantee non-compliance; and to limit the Commissioner of Taxation's ability to remit penalties for historical superannuation guarantee non-compliance, where an employer fails to disclose information relevant to their historical superannuation guarantee shortfall.

The Committee made two recommendations:

1. Recommendation 1: that the Australian Taxation Office develop and implement a communication strategy to maximise employer awareness and engagement with the superannuation guarantee amnesty.

2. Recommendation 2: that the bill be passed.

In a dissenting report, Labor Committee members recommended against the passage on the Bill on the basis that it 'is a poorly conceived bill. It is the product of a government that is soft on wage theft. The evidence to this committee was that the bill was unlikely to achieve even its modest aims, at the cost of rewarding and incentivising poor behaviour from employers'.

[Source: Treasury Laws Amendment (Recovering Unpaid Superannuation) Bill 2019 [Provisions] Report 07/11/2019]

Going after 'general advice' again? ASIC has commenced Federal Court proceedings against a super trustee, promoter and others

On 6 November, the Australian Securities and Investments Commission (ASIC) commenced proceedings in the Federal Court against: MobiSuper Pty Limited (the promoter of the MobiSuper Fund); Tidswell Financial Services Ltd (an AFS licensee and super trustee); ZIB Financial Pty Limited (Mobi's AFS licensee); and Andrew Richard Grover (a director of Mobi and ZIB) in connection with the promotion of the MobiSuper Fund, a division of the Tidswell Master Superannuation Plan (Fund).

What is the issue?

ASIC says that Mobi offered an obligation-free 'lost super' search to consumers through internet advertising campaigns with the primary objective of convincing consumers to join the fund and roll over any 'lost super' into Mobi-promoted products.

ASIC's allegations

[Note: The concise statement and originating process are available on the ASIC website]

ASIC alleges that:

- Tidswell and ZIB failed to do all things necessary to ensure the financial services covered by their Australian Financial Services Licences were provided efficiently, honestly and fairly.
- Both Tidswell and ZIB failed to adequately monitor Mobi's promotion of the Fund through a purported 'general advice model' that ASIC considers had insufficient regard for consumers' best interests.
- In marketing telephone calls to consumers, Mobi customer service officers made misleading claims about fee savings and equivalent insurance cover, and provided personal financial product advice (as opposed to general advice) that was allegedly not in consumers' best interests.

Penalties sought

ASIC is seeking civil penalties against:

- Tidswell and ZIB for advice given to consumers by Mobi customer service officers in breach of the best interest obligations
- Mobi and Mr Grover for the misleading internet advertising campaigns
- Mobi for the false and misleading claims made by customer service officers during marketing calls

ASIC is also seeking various declarations, that Tidswell and ZIB failed to comply with their obligations as AFS licensees and that Mobi engaged in (and Mr Grover was knowingly concerned in) misleading conduct.

The action was taken following consultation and collaboration with APRA

ASIC says that the action was taken in 'consultation and collaboration with APRA'. 'APRA has supported ASIC with its investigation and has provided ASIC with a delegation of certain functions and powers under the SIS Act in relation to Tidswell in order to achieve appropriate regulatory outcomes' ASIC states.

Context

- The announcement that the regulator has commenced proceedings follows last week's landmark decision Australian Securities and Investment Commission v Westpac Securities Administration Limited [2019] FCAFC 187 in which the Federal Court held that outbound calls to customers made by callers on behalf of Westpac to Westpac customers aimed at convincing customers to consolidate their superannuation accounts into a single Westpac-related account, did involve giving 'personal advice' within the meaning of s766B(3) of the Corporations Act 2001 (Cth). Flowing from the finding that personal financial product advice was provided, the Court found that Westpac failed to comply with other sections of the Corporations Act, including (s961B) (best interests obligation). The Court also agreed with the primary judge's view that Westpac failed to comply with s912A(1)(a) (obligation to 'do all things necessary to ensure that the financial services covered by their licences were provided honestly, efficiently and fairly'), and in doing so lent weight to the emerging view that holders of an Australian Financial Service Licence (AFSL) are subject to an objective duty to act 'fairly'. For a summary of the decision and expert insights into the practical implications, see: Governance News 30/10/2019]
- ASIC's latest corporate plan includes 'delivering as a conduct regulator in superannuation' as a key priority for the regulator. The plan indicates that ASIC will look to improve outcomes in superannuation through (among other things) taking decisive regulatory and enforcement action to deter misconduct.

[Sources: ASIC media release 06/11/2019; Investment Magazine 06/11/2019]

Superannuation funds reportedly asked to provide the total value and returns of their unlisted assets and listed investments ahead of upcoming public hearings

Context: As part of its inquiry into the big four banks and financial institutions (superannuation sector, smaller banks, financial advice sector and the insurance sector), The House of Economics Standing Committee will hold public hearings on 21 and 22 November with a number of superannuation funds as well as the Association of Superannuation Funds of Australia (ASFA).

[Note: The programs for each of the hearings listing the entities due to appear are available on the Inquiry website here]

The AFR reports that the Committee has written to superannuation funds ahead of the hearings, asking them to provide the total value and returns of their unlisted assets and listed investments and explaining how they value unlisted assets, corporate entertainment at sports events and infringement fines.

Reportedly, some Liberal politicians are of the view that one of the reasons industry funds have better financial performance is due to their heavier weighting to unlisted assets such as infrastructure and commercial property (as well as having generally lower fees).

The AFR quotes unnamed 'industry fund sources' as commenting that retail funds tend to churn members through more liquid and publicly listed stocks and avoid more complex unlisted infrastructure in order to maximise their fees.

[Source: [registration required] The AFR 13/11/2019]

Time to act on PC super reform recommendations says Super Consumer Australia

Newly launched Super Consumers Australia (partnering with consumer group Choice) says research shows that over 170,000 people were defaulted into a 'poor performing super product in 2017-18' (MySuper products in the bottom 25% of performers) costing them up to half a million dollars in retirement.

The group called for action on the Productivity Committee's recommended superannuation reforms (see: Governance News 16/01/2019), including giving consideration to the proposed 'best in show' recommendation.

Super Consumers Australia Acting Director, Xavier O'Halloran said: 'We need the regulators to take real action to weed out these laggards, but we acknowledge that this will take time. The regulators job will be made much easier if we stop growing underperforming products through a poorly designed default system' he said.

[Source: CHOICE media release 25/09/2019]

Consumer groups have released a report into the impact of payday loans on consumers and have called for the government to introduce legislation to enact stronger consumer protections

Stop The Debt Trap Alliance a 20 member, national coalition of consumer advocacy organisations, has released a report - The Debt Trap: How payday lending is costing Australians – looking at the growth of the payday lending sector and the impact on consumers.

Some Key Findings

- The report projects that the gross amount of payday loans undertaken in Australia will reach1.7 billion by the end of 2019.
- Over 4.7 million individual payday loans were taken on by around 1.77 million households between April 2016 and July 2019, worth approximately $3.09 billion.
- Victoria is the state leading the country with the highest number of new payday loans. Payday loans are also rapidly growing in Western Australia and Tasmania, with these households showing the highest growth rates at 13.5% and 15.5% respectively over the last six months (January-July 2019).
- Most digital loans originate online, with the total number of expected to reach 85.8% by the end of 2019
- The number of women using payday loans has risen from 177,000 in 2016 to 287,000 in 2019, representing a rise to 23.13% of all borrowers. According to the report, almost half (41%) of these loans are made to single mothers. The report comments that 'women who are most vulnerable and under the most significant financial pressure are more likely to access payday loan services'.
- According to the report, over a five-year period, around 15% of payday loan borrowers fall into a 'debt spiral' (which may result in an event such as bankruptcy).

Time to introduce legislation to enact stronger consumer protections?

The report calls for tougher regulation of the payday lending sector. More particularly, the report calls on government to introduce legislation to amend the National Consumer Credit Protection Act (2009) (NCCP) Act to strengthen consumer protections.

The report notes that it has been 'over 1,000 days since the Coalition government accepted the recommendations from its own 2015 review into payday loans and consumer leases, which recommended that critical protections were passed into law'.

[Note on 16 September, National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2019 was introduced into the House of Representatives by Rebekha Sharkie as a private members Bill. Ms Sharkie said that the Bill 'replicates' the government's own exposure draft legislation released in October 2017. For a summary of the Bill see: Governance News 18/09/2019.]

[Sources: Stop the Debt Trap Alliance media release 12/11/2019; The Debt Trap: How payday lending is costing Australians; The New Daily 11/11/2019] payday

Parliamentary inquiry into the big four banks: Westpac and CBA appeared before the House of Representatives Standing Committee on Economics

On 8 November the Standing Committee on Economics held a public hearing as part of its inquiry into the four major banks.

Representatives from the Commonwealth Bank (CBA) Deputy CEO David Cohen and CEO Matt Comyn, and Westpac representatives CFO Peter King and Managing Director and CEO Brian Hartzer appeared before the Committee. A high level overview of some of the opening statements made by each of the lenders, and some of the issues discussed during the hearing is below.

[Note: The full transcript of the hearing is available here. The terms of reference for the inquiry are on the second page. The next hearing will be held on 15 November and the program indicates that NAB and ANZ will appear.]

Opening statements: Westpac and CBA

Westpac's opening statement

- **Update on Financial Services Royal Commission recommendations:** Mr Hartzer began by providing an overview of progress on implementation of the Financial Services Royal Commission recommendations. He said that of the 49 Financial Services Royal Commission recommendations applying directly to Westpac, 27 require legislative or regulatory action in order to be implemented (though preparatory work is underway in so far as it is possible). Westpac has implemented 11 of the remaining recommendations and is in the processing of implementing a further 11. Mr Hartzer said that he expects this, together with regulatory change, to be a focus for the lender over 'coming years'. Mr Hartzer went on to say that in addition to implementing the recommendations, Westpac is taking into account other issues 'raised by our customers in a range of forums' and that this has resulted in 'substantial changes' to the business over the course of 2019 eg exiting from financial planning business on 30 September.

- **Vulnerable customers:** Mr Hartzer said that in line with his statement the last hearing, Westpac has implemented new policies and approaches for supporting vulnerable customers including making a 'substantial investment' in a new complaints system, and a focus on resolving long-standing complaints. At the end of the financial year, he said Westpac had closed 'almost all longstanding customer disputes', (with the exception of some still with AFCA for review).

CBA's opening statement

- **Economic outlook:** Mr Comyn said that since his last appearance before the committee uncertainty with respect to the global economic outlook had increased due to a range of geopolitical issues. In this context, he said that though 'we would all like to see higher wage growth and greater business investment', he considers Australia's economy has 'some notable strengths' eg low unemployment, strong performance of export industries and a sound budget footing. He went on to say that he recognises the role banks play in helping to stimulate the economy and said CBA is committed to assisting in a number of ways eg through lending to businesses.

- **Building a 'simpler better bank':** Mr Comyn outlined a number of changes CBA has made, many of which he said were in response to customer feedback to 'simplify our portfolio, simplify the way we operate and put things right for our customers' for example by removing a 'significant number of fees and providing smart alerts/notifications to assist customers to avoid fees and better manage their finances.

- **Vulnerable customers:** Like Mr Hartzer, Mr Comyn also spoke about the steps CBA has taken/is taking to support vulnerable customers. Mr Comyn said that by the end of this year, CBA will have spent $30 million on these measures. They include: the establishment of a dedicated community and customer vulnerability team and the provision of assistance to customers experiencing financial abuse and domestic and family violence (over the past five years).

Culture and governance changes

ABA Code of Banking Practice: Both CBA and Westpac representatives were asked about how they were measuring the impact of the new Banking Code of Conduct and its implementation.

- **Westpac:** Mr Hartzer described the control and compliance arrangements in place and the reporting process to track complaints, the nature of complaints and any whistleblowing issues raised by staff. He said that a Code monitoring committee had been established to provide feedback to the Australian Banking Association (ABA) on implementation.

- **CBA:** Mr Comyn said that the lender is monitoring implementation of the Code and the impact of the changes on the behaviour/culture at the lender. Asked what the timeframe is for implementing the Code, Mr Cohen said that monitoring compliance with the ABA Code entails 'continually' adapting the lenders' practices, adding that there have been no self-reported breaches to date.

Financial Services Royal Commission recommendations 5.6 (changing culture and governance) and 5.7 (supervision of culture and governance)

Both lenders were asked a number of questions about their response to recommendations 5.6 and 5.7 (see: Financial Services Royal Commission Final Report at p392-393).

- **Westpac:** Mr Hartzer was asked why the bank's vision statement was 'largely unchanged' from before the Financial Services Royal Commission. 'If you've got this quite detailed framework of what the organisation is about and it doesn't change at all pre and post royal commission, it just seems to me that some pretty major themes perhaps might slip between the cracks, potentially, in a cultural sense' Dr Mulino (Committee) observed. Mr Hartzer responded by saying that he considers that the issues discussed such as focus on vulnerable customers and the resolution of complaints, are 'embedded' already within the existing principles but that he was 'happy to reflect' on whether this needs to be made more explicit. Mr Hartzer went on to say that Westpac 'continues to look for ways to reinforce the fact that we do need to make changes, we do need to think differently and we need to be much more intensely focused on these aspects of service delivery'. Asked to describe the measures implemented post Financial Services Royal Commission and post self-assessment to change staff culture/behaviour, Mr Hartzer described a number of measures including 'Service TV' (a means of sharing and reinforcing 'best practices around the company'), a pilot internal net promoter score survey and a 'massive online training capability' that automatically requires people to reaccredit on an annual basis. He added that though supportive of the idea of thinking of banking as a profession, he considers that 'recognising it's a service business and not a product business' to be more important in this context.
- **CBA:** Mr Comyn was also asked why there hadn't been a change to the bank's vision statement. Mr Comyn responded by saying that he was 'surprised and disappointed that that was the Google search return' because the statement has been 'updated and replaced' to reflect the purpose of the organisation. Further, he said that this shift is reflected in other changes to promote/support adherence to that purpose eg changes to the way in which people are paid and the ways in which performance is measured. He then described some of the changes in detail.

  Asked to describe some of the practical ways things had changed 'at the coalface' over the past year, Mr Comyn said that one change had been that senior leaders are focused on setting the tone from the top, and are therefore spending time serving customers, appearing at public forums and being prepared to answer questions. 'There's a number of different ways that we seek to engage with our people. There's no substitute for face to face…From my perspective, it's not something that we should ever feel satisfied that, "We're done." We've got to keep making sure that each day we can be a better organisation for our customers, and, while I believe we've made good progress in the last 18 months, I still feel like there's certainly room for improvement, and that's what we're focused on, going forward'.

  Mr Cohen added that the bank had shifted from a 'can we legally?' to a 'should we, actually' approach, especially in the context of dealing with customers.

Information flow to boards

Westpac was asked what steps had been taken to improve information flows and board processes/oversight following the Financial Services Royal Commission (and in light of the Commissioner's findings).

Mr Hartzer said that Westpac have implemented a number of changes. Including: a) a more explicit focus in the agendas of the board itself and in the risk and compliance committee on nonfinancial-risk matters; increased reporting on complaints (volume and the root-causes of complaints); embedding of non-financial risk into assessments of executives' and managers' performance/remuneration. 'The board themselves have very clearly heard the messages around the need to focus on this, and therefore are being much more forensic in their questioning and challenging on topics around this to make sure that we are in fact closing issues out and making progress' Mr Hartzer said.

Asked to comment on whether the way in which reporting is done has changed, Mr Hartzer said that there's a more quantitative and qualitative reporting mechanisms in place than previously. Given more information is being reported, he agreed that the board is sitting more frequently and for longer and directors are also spending more time meeting with management and getting detailed briefings.

Cyber-risk

Westpac was asked how it is preparing to make sure they can manage cyber-risks (eg the risk of foreign actors hacking systems) and customer privacy.

Mr Hartzer said that Westpac invest 'probably $50m a year' in upgrades around various cybersecurity capabilities and have 'extensive teams' dedicated to monitoring activity/making improvements in systems and processes to lessen the likelihood of foreign actors accessing systems/disrupting business as well as controls around responding, should foreign actors be successful in accessing systems. 'I feel that we are in pretty good shape; but it is certainly nothing that we can be complacent about. I would also say that there is much more coordination and collaboration across the sector and between the sector and various government agencies to make sure that we share intelligence and continue to help each other to strengthen our protections' he said.

'Model litigant' approach

Both lenders confirmed to the Committee that they had committed to act as 'model litigants'. Mr Hartzer said that Westpac has sought to codify its approach as a set of principles, which recently have been published. These, he said have been place for a year and half.

Mr Comyn said that the CBA is applying its own 'model litigant principles' not only to new cases, but to existing ones. Asked what impact this has had on conduct, Mr Comyn said that changes had been made to improve the internal complaints handling process as part of the increased focus on customers (including spending time himself with customers). This he said, is an ongoing area of focus. 'We want to make sure that, for the customers who haven't received a good experience, the way we deal with that going forward is very different to the way it was dealt with previously' he said.

Asked if CBA had published the model litigant principles, Mr Comyn said that CBA was yet to publish them on the bank's website but would do so.

Interest rates

Both lenders were asked a series of questions concerning interest rates and whether they had modelled/considered the operational implications of a negative interest rate environment.

Westpac: Mr Hartzer said that though Westpac is preparing for the 'possibility' he considers it 'much more likely from here that, if there was a desire for further monetary stimulus it would probably end up taking a different form, rather than actually going to negative headline rates'.

Mr Hartzer went on to say that he considers measures to stimulate business confidence and business investment as potentially of more benefit. 'Steps that give businesses certainty, that reduce red tape, that encourage them to invest in research and development and the renewal of their infrastructure, and their plant and equipment are probably better things to focus on in this environment' he said.

CBA: Asked to comment on investors' appetite to invest in the CBA as a result of the low-rate environment, Mr Comyn referring to the latest quarterly report, said that the results of the three other major banks, showed that there is more 'volatility and some downward pricing pressure around shares'. He added that 'we hope the Commonwealth Bank is a good investment proposition for investors. In a low interest rate environment, as you would appreciate, for many customers who are feeling the impact of lower interest rates, they are very cognisant of the income they might receive from either bank deposits or investments in any shares'.

Competition in the banking sector

A number of questions centred around the issue of the competitiveness of the banking sector, particularly the mortgage market.

- **Westpac:** Mr Hartzer said that he considers it to be a 'very competitive market for mortgages. For the simple evidence of that, you could look at the growth in the mortgage market over the last little while'. This is in part due to the growing role of non-bank lenders in this space and the different regulatory requirements applying to that sector.
- **CBA**: Mr Comyn said that banks and non-banks are not operating in a competitively neutral environment, pointing to the fact that non-bank lenders are subject to different obligations. He added that he would 'prefer a competitively neutral environment' but that CBA has a number of strengths that some competitors lack eg scale, brand and physical distribution.

'Red tape' and responsible lending

Westpac was asked a number of questions around responsible lending and whether existing laws and/or regulators' interpretation of them was lessening competition in the banking sector and making it less 'convenient' for customers.

Mr Hartzer said that he recognises that the 'goal around responsible lending is a good one' and that Westpac does not want to make loans to people who can't pay them back but 'I certainly would have some sympathy for the view that it should be up to banks to determine how to implement their obligations and make sure that there is room for people to continue to exercise judgement as opposed to be overly prescriptive about the process.' Mr Hartzer went on to agree that existing laws could have a 'partial unintended consequence' of potentially making it more difficult for businesses to secure loans.

A number of questions to both lenders centred around the impact of regulation and 'red tape reduction'.

- **Westpac:** Asked if there is any demand for credit, Mr Hartzer said that overall business credit demand has been 'pretty weak' especially at the small end of the market. He attributed this to lack of business confidence and a level of operational uncertainty. The 'No 1 issues when we talk to customers about the certainty aspect has really been around red tape and the perception of the difficulties of navigating regulation as well' he said. Mr Hartzer agreed to provide the Committee with specifics as to what regulations, in particular he considers pose a 'barrier to doing business'. Mr Hartzer was also asked to provide feedback on what regulatory barriers there are to accessing credit.

  He said that 'there are a number of quite prescriptive APRA requirements' around responsible lending that he considers are impacting small businesses, not least 'because a lot of small businesses use the family home as part of their financial structure. That's had a significant consequence'.

- **CBA**: Mr Comyn nominated responsible lending requirements, and more particularly use of a security (eg vehicle or home) for both personal and a business facility as an area that could be clarified.

Role of the lenders in responding to ESG issues (including climate change)

A number of questions centred around the role of lenders in ESG issues, their stance on climate issues and their perceptions of whether environmental advocacy (in the form of shareholder activism) is harming Australia's business growth prospects.

Impact of environmental advocacy on business?

Westpac: Mr Hartzer said that he considers climate change to be an important issue and that there is a 'role for advocacy' on the issue. However, he considers that there are 'trade-offs and challenges to be addressed' particularly in the context of the transition to a low carbon economy. 'I do think that it's important that there continues to be a recognition that, without a healthy, vibrant business community, many of the things that we want to do aren't possible' he said.

Asked whether he considered there should be changes to the Corporations law to ensure that shareholder activists put forward their views 'respectfully', Mr Hartzer said that though he had seen examples of organisations buying shares in order to make statements/put motions at the AGM, in general it had been done respectfully and 'we don't have a fundamental issue with people putting their views forward'. He said that he would be 'happy for you [Mr Falinski/Committee] to suggest' how changes to the Corporations Law might happen.

CBA: Asked whether he considers CBA has been responsive to shareholder activists, Mr Comyn agreed that the bank has been responsive to the issues/concerns raised by various stakeholders but that ultimately the 'board of the bank and the management team have a responsibility and obligation to act in the organisation's best interests' and that they make decisions/act in the best long term interests of the company. 'I think that is demonstrated in the approach that we have taken in some of our financial disclosures as it relates to climate, as well as some of the scenario analysis. It has led to good, healthy debates at both the board and management tables. I think that is an important aspect of running an organisation well' Mr Comyn said.

Climate stance

Westpac: Mr Hartzer was asked several questions about Westpac's climate stance and the reasons behind it. Mr Hartzer said that 'as a major institution, we need to think carefully about these things. They are important to a variety of stakeholders. We try to take principled decisions on the way we run our business and we do that independently'. Mr Hartzer was then asked to describe how the lender ensures its lending practices are in accordance with the Paris Agreement goal, and how the lender is planning for the transition to a low-carbon economy.

Asked to explain Westpac's position on lending to coalmines, Mr Hartzer said that Westpac's policy is to support the extension of coalmining in existing basins where the quality of the coal is in the top 15% of quality in terms of its calorific value'. This is due, he explained to both the timeframe required to see a new basin become economically viable and in light of the bank's support of the transition to a low carbon economy. Asked whether he was suggesting coal as a source of fuel would not be around in 50 years' time, Mr Hartzer said, 'we were supportive of the transition away from fossil fuels, and so when we think about the long-term time frames we don't have enough certainty about whether the economics of building those new basins will make sense for us from a lending point of view over the time frame'.

Mr Hartzer was also asked why Westpac 'is happy to publicly comment…on Uluru, mining and climate policy, but there doesn't seem to be the same emphasis on red tape, small business or business tax reduction or even housing policy'. Mr Hartzer responded that the bank engages on all of these topics but cannot necessarily control which the media chooses to talk about more publicly. He added that he considers that Westpac's 'engagement with government at all levels is far more tilted towards the topics you are referring to than some of the other community issues'.

CBA: Asked to explain the decision to exit exposure to thermal coal by 2030, Mr Comyn said that the bank is 'trying to strike the appropriate balance…We have a small exposure to thermal coal. We thought it was appropriate, as part of the transition, to work towards exiting thermal coal by 2030 but subject to a secure energy platform being available inside Australia'.

Asked to explain the 'business case for ESG', Mr Comyn said that he considered it part of the bank's 'obligation to ensure that we're thoughtful and comprehensive about the variety of risks that we should consider as part of responsible lending to businesses and institutions'. Asked whether this is necessary for the bank to 'continue to have a licence to operate in the Australian market' Mr Comyn said that he views it as 'important discipline'. 'From a financial institution perspective our job is to manage risk. Some of those risks are financial and obvious; others are non-financial but clearly also required consideration. That's our approach overall as we think about it' Mr Comyn said.

Exiting financial advice (or not)?

Both lenders were asked a series of questions around the shift in the sector away from financial advice.

- **Westpac:** Mr Hartzer said that Westpac's decision to exit the financial planning business was unrelated to the Financial Services Royal Commission. Rather the decision was made because it was 'an unprofitable business for us for a long time. We concluded that it was uneconomic for us to meet all the compliance requirements around it and earn a reasonable return'. Mr Hartzer added that 'I regret that because I continue to believe that providing financial advice to Australian consumers is important and that all Australians should have access to good cost, reliable and unconflicted advice. But, that was the reality of a decision that we had to make'.
- **CBA:** Mr Comyn was asked to comment on whether there 'may be more of a reputational cost than a benefit to the bank to stay in the financial advice business'. Mr Comyn said that ultimately CBA remains committed to retaining the financial advice business. 'Financial advice is a critically important service and needs to be provided to the highest possible standards to customers, because what is at stake is often a customer's life savings, and if something goes wrong there then, of course, that can have very serious consequences for our customers. So we've made a number of different changes in recent times to make sure that we're providing a high-quality and consistent level of advice. It certainly is a very challenged business and industry at the moment but, as I said, even though we're exiting some elements of the advice businesses in the past—our aligned advice in particular—we're committed to retaining our current financial advice proposition' he said.

'Loyalty tax'

Asked to comment on whether Westpac charges different rates to new customers vs existing customers, Mr Hartzer said that 'there are differences in what a new customer in the market might be able to get compared to what a customer historically has received, and again I'm happy to talk about the rationale around that'. Mr Hartzer disagreed with the characterisation of this as a 'loyalty tax'.

Asked to 'justify' new customers paying lower rates than existing customers, Mr Hartzer said 'I think everyone would agree that we want a competitive market for mortgages, and businesses of all industries and types will often compete for new customers. That's a fundamental tenet of a competitive market economy. Mortgages are no different'. He added that though supportive of more transparency in pricing, mandating the same price at all times across all products and for all customers was not necessarily in the interests of a more competitive market for mortgages over time.

Further, he observed that customers are able to have a 'discussion about their needs at any time' and that interest rates are at 50-year lows. As such, he rejected the suggestion that different rates for existing vs new customers could 'exploit' vulnerable existing customers.

CBA agreed with the Committee that not charging a 'loyalty tax' is 'important to your [CBA's] ability to rebuilt trust with your [CBA's] customer base'.

Remediation

- **Westpac:** Westpac confirmed that it has paid or set aside $1.4bn for remediation to around 500,000 customers, and that the bulk of the remediation is for fee for no service refunds.

  Asked to explain what 'structural factors' led to the error, Mr Hartzer said that most of the remediation was due to an 'inability to 'demonstrate that customers received the service that they paid for. We would say that the majority of it is, effectively, a poor operating control around the record keeping for the provision of advice' though in a minority of cases, planners may have deliberately charged someone knowing they weren't going to provide a service. Mr Hartzer commented 'if I had my time over again, we'd take a very different approach to positively collecting, storing, demonstrating and confirming that customers were happy with the service that they had received, before we charged them'.

- **CBA:** CBA confirmed that it has paid $1.2bn so far in remediation, and has made $2.2bn in total provisions to date. Of the $2.2 billion since 2014, 80% relates to wealth management and 20% relates to banking. On the wealth management side, approximately $800 million, relates to fee-for-no-service or ongoing service and within this, $534 million relates to aligned advisers or self-employed advisers. Other categories include: refunding or remediating customers who had received inappropriate advice and remediation or refunds associated with insurance products.

  On the banking side, the larger categories include: where fees and interest haven't been calculated accurately (including proactively checking existing products to ensure that this is occurring) and product specific remediation (eg bank guarantee product). Mr Comyn commented that 'alongside the work that we're putting into the remediation is investing to make sure that they can't and don't re-occur'.

  Asked about the timeframe for remediating customers, Mr Comyn said that in some cases it would take time (due to the complexity of the task). He added that the bank is focused on resolving long-standing disputes. Asked how many customers he expected to be compensated in total, Mr Comyn said that it could be up to 600,000.

School banking program

The CBA was asked a number of questions around the school banking program. Mr Comyn said that CBA is 'fortunate to have an association with thousands of schools for, now, 88 years, and we're proud of that. We certainly have responded, and will continue to respond, to reviews and any criticism. We've evolved the program over time, and we think it's a very worthwhile one'.

Asked if schools are paid on an incentive basis for participating in the program (ie whether they are paid more if more children open accounts) and if so whether he considered it to be an issue, Mr Comyn said that changes had been made to ensure payments were not driving 'wrong behaviour' and agreed to provide detail on the payments that are made through the program on a school by school basis to the Committee.

Payment to suppliers

Both lenders were asked what the timeframes are for paying suppliers. CBA said that standard timeframe is 30 days and that it is looking to 'streamline' this timeframe. Westpac said that the majority 'high in the 90 per cent range — are paid within 30 days'.

Remuneration

Westpac was asked to comment on changes to remuneration structures, and the shift away from remuneration based on employee incentives.

Mr Hartzer said that Westpac has made 'significant changes in our pay structures going back a couple of years ago' including for example, fully implementing the Sedgwick review recommendations, two years ahead of schedule, reducing the financial component of all incentive payments, and eliminating the use of 'leader boards' in assessing the relative performance of individuals.

Class actions

The Committee asked the lenders about their attitude towards the use of class actions as a vehicle.

- **Westpac:** Mr Hartzer said 'I think it has a role in society. Certainly there are cases where it's appropriate that class action be used. I guess it wouldn't surprise you to know that we feel that some of these things are probably a bit over the top, but we respect that that's the law and that they have a right to run the cases'. Asked whether he was concerned as a lender to large businesses, at the rapid increase in the number of class actions, Mr Hartzer said that 'its not a major concern but it's certainly something that we observe'.
- **CBA:** Mr Comyn confirmed that CBA is currently facing seven class actions.

Both CBA and Westpac agreed that director and officer liability insurance premiums have increased over the last few years. Mr Comyn said that it is his understanding there is less availability of insurance and that the pricing and terms have changed to reflect insurers' experiences in the Australian market.

Next public hearing: The next public hearing is scheduled for 15 November. NAB and ANZ are due to appear before the Committee.

[Source: Transcript, public hearing House of Representatives Standing Committee on Economics, Inquiry Australia's four major banks and other financial institutions: four major banks 08/11/2019; Program: 15/11/2019]

Australian financial regulators to investigate Facebook's proposed digital currency?

According to media reports, Australia's financial regulators – including ASIC, OAIC, AUSTRAC, and the ACCC - plan to investigate Facebook's proposed digital currency Libra after Facebook failed to allay various security concerns. Reportedly, concerns include: how a jurisdiction would exercise control over the currency; and whether it could threaten the financial system; the potential for Libra to undermine the efforts of central banks and other key institutions to manage the economy; privacy and consumer protections; compliance with AML/CTF laws and competition issues

[Sources: [registration required] The Australian 06/11/2019; IT News 06/11/2019]

AFCA has identified the resolution of systemic issues as a key focus

The Australian Financial Complaints Authority (AFCA) is recruiting for a newly created position, Lead Ombudsman– Systemic Issues and Remediation, which will provide professional and technical leadership for all of AFCA's systemic issues and serious contraventions investigations, along with overseeing AFCA's remediation work.

AFCA Chief Executive Officer and Chief Ombudsman David Locke said the new position demonstrates AFCA's commitment to resolving systemic issues. 'Our systemic issues work gives us the opportunity to help financial firms fix issues that cause complaints and prevent more from occurring. It also helps raise industry standards and prevents harm to consumers' Mr Locke said.

Mr Locke went on to say that over the past 12 months, AFCA has identified and resolved 167 systemic issues and referred 30 'possible serious contraventions o regulators'.

AFCA is also currently recruiting for the positions of Lead Ombudsman – Superannuation and Lead Ombudsman – Investments and Advice, both of which were previously held by Dr June Smith who was promoted to Deputy Chief Ombudsman in July 2019.

[Source: AFCA media release 8/11/2019]

In Brief | AFCA has released an online tool — AFCA datacube — which enables consumers to see how financial services providers (banks, general insurers, credit providers, superannuation funds and debit collectors/buyers) have previously responded to complaints. It includes information about the number of complaints received, how long it takes each member firm to resolve complaints and the number of times financial firms did not respond to a complaint. The tool also allows people to compare financial firms side-by-side. The Datacube contains AFCA's data between 1 November 2019 and 30 June 2019 and will be updated every six months

[Sources: AFCA media release 07/11/2019; AFCA datacube; Independent Financial Adviser 07/11/2019]

In Brief | The FT reports that QSuper and Sunsuper have held early-stage discussions about a possible merger. The FT cites this as evidence of a trend towards industry consolidation due to regulatory pressure for increased efficiency

[Source: [registration required] The FT 11/11/2019]

In Brief | Following consultation, the UK Financial Conduct Authority have loosened final responsible lending rules and guidance with a view to removing barriers to consumers switching to more affordable mortgages. The changes allow lenders to use a 'more proportionate affordability assessment' for consumers who are up to date with their existing mortgage, do not want to borrow more and want to switch to a more affordable mortgage. The changes are also aimed at reducing the time and costs of switching

[Sources: FCA media release 28/10/2019; Policy statement: Changes to mortgage responsible lending rules and guidance — feedback on CP19/14 and final rules policy statement (PS 19/27) 28/10/2019]

In Brief | 86 400 has reportedly become the first Australian digital bank to offer home loans. Reportedly the application process is entirely digital (no requirement for customers to submit any physical documents), but customers are required to go through a mortgage broker

[Source: Business Insider 12/11/2019]

In Brief | In a speech to the COBA annual conference, APRA Chair Wayne Byres' has described how competition fits within APRA's mandate and outlined recent initiatives the regulator has taken to support competition. He also suggested that the mutual sector has an opportunity to win market share in the current environment

[Sources: APRA Chair Wayne Byres - Speech to COBA 2019, the Customer Owned Banking Convention 11/11/2019; [registration required] The SMH 12/11/2019; [registration required] The Australian 11/11/2019]

Accounting and Audit

In Brief | The FT reports that FRC chairman Simon Dingemans has called for the breakup of the big four accounting firms on the basis that he considers that the separation of audit and consulting to be 'critical'

[Source: [registration required] The FT 07/11/2019]

In Brief | UK audit reform will be a top priority (following the 12 December General Election)? Writing in Economia Andrea Leadsom MP, secretary of state for business, energy and industrial strategy confirmed her commitment to taking forward audit reform writing, 'As a business secretary who is committed to raising standards across the board, you can be sure I will bring this forward. I want to see the UK leading the world in the next phase of improvements in corporate governance and audit reform'

[Source: Economia 05/11/2019]

In Brief | The WSJ reports that the auditing standards board of the American Institute of Certified Public Accountants is working to modernise standards governing nonfinancial information to include cybersecurity and environmental, social and corporate governance issues

[Source: [registration required] The WSJ 04/11/2019]

Risk Management

Top Story | Optimising data insights and governance outcomes through cultural transformation

At the recent Data Governance & Management Summit 2019, Head of Data and Analytics, Shaheen Saud, discussed some of the strategies organisations can employ to transform their data management.

A summary is available on the MinterEllison website here: https://www.minterellison.com/articles/optimising-data-insights-and-governance

Practice better cyber-hygiene and assume a breach mentality APRA tells industry

Key Takeouts

- **The number of reported breaches are not indicative of the scope of the threat:** There have been 36 data breach notifications the latest cyber guidelines in July, but this is not necessarily indicative of the scope of the issue. Rather it represents only the reported attacks.
- **Firms should assume a breach mentality** (ie assume every organisation's information security defences will, be compromised at some point and therefore have the systems/experienced personnel available to repel the attack, re-secure the network and rectify any damage).
- **Raise standards of cyber hygiene:** Mr Summerhayes said that APRA has identified 'basic cyber hygiene as an ongoing area of concern'. Issues include: 1) having systems for which the vendor is no longer providing support or security updates; 2) lack of a comprehensive security patching regime; and 3) poor access management practices and including poor controls around privileged access to systems.
- **Expect a tougher approach:**' We've set the floor with CPS 234 and will be enforcing these legally-binding minimum standards in a "constructively tough" manner' Mr Summerhayes said.
- **Mr Summerhayes called on entities to strengthen assurance processes** in light of evidence that cyber-adversaries are increasingly targeting third party vulnerabilities to carry out attacks. Mr Summerhayes added that APRA will 'have more to say' about provider management in the course of reviewing its standard around outsourcing (CPS 231)

In his speech to CyBSA 2019 Cyber Breach Simulation Australia, APRA member Geoff Summerhayes spoke about the need for industry to adopt a 'breach mentality' and in particular to raise standards of 'cyber hygiene'. A high level overview of some of the key points of his address is below.

- **Industry is 'under siege':** Mr Summerhayes said that to date, 'no APRA-regulated entity has experienced a breach material enough to threaten its viability, but I can assure you it's not for want of trying. We've warned repeatedly that it's only a matter of time until an Australian bank, insurer or superannuation licensee suffers a significant breach that, in a worst case scenario, could force it out of business'. In light of this, Mr Summerhayes called on institutions to adopt an 'assumed breach' mentality ie to assume every organisation's information security defences will, be compromised at some point and therefore have the systems/experienced personnel available to repel the attack, re-secure the network and rectify any damage.
- **APRA has increased its capabilities**: Mr Summerhayes said that in light of the risk, the improvement of cyber resilience across the financial system is now one of APRA's four strategic priorities (as set out in the latest Corporate Plan). He said that APRA has increased its capabilities to assess the cyber resilience of APRA-regulated institutions both by increasing internal capacity and through use of third party expertise (where necessary) as well as through strengthening alliances with peer organisations. Mr Summerhayes

added that APRA will 'improve our cyber incident response capabilities to support institutions to recover from an incident as well as ensure our ability to enact the Financial Claims Scheme is not compromised'.

- **Extent of the issue?** In the four months since CPS 234 came into force, APRA has received 36 incident notifications from 600 reporting entities, an indication Mr Summerhayes said that the financial sector broadly handles information security incidents well. Mr Summerhayes observed however that 'It's important to note that APRA's regulated flock would have been subject to vastly more attempted cyber-attacks; these are just the ones that succeeded – and that we know about. With some cyber-incidents taking years to detect, it's entirely possible that one of the banks, insurers or super funds has been compromised and we simply don't know about it'.

[Note: For an outline of the requirements under CPS 234 see: Prudential Standard CPS 234 to impose new information security requirements 12/04/2019]

- **Lack of basic cyber hygiene:** Mr Summerhayes said that APRA has identified a number of common weaknesses in the course of its supervisory work, many of which APRA has called out repeatedly, including in CPG 234. 'APRA has identified basic cyber hygiene as an ongoing area of concern' he said. This includes: 1) having systems for which the vendor is no longer providing support or security updates; 2) lack of a comprehensive security patching regime; 3) poor access management practices and including poor controls around privileged access to systems. Mr Summerhayes cited a recent survey, in which over 70% of APRA regulated entities self-assessed CPS 234 compliance gaps as further evidence of the need for improvement. Mr Summerhayes added that APRA will monitor progress in this area closely, and will seek 'an independent assessment of CPS 234 compliance in due course'.
- **Tougher approach:**' We've set the floor with CPS 234 and will be enforcing these legally-binding minimum standards in a "constructively tough" manner' Mr Summerhayes said.
- **Review of existing standard CPS 231 around outsourcing arrangements:** Mr Summerhayes also called on entities to strengthen assurance processes in light of evidence that cyber-adversaries are increasingly targeting third party vulnerabilities to carry out attacks. Mr Summerhayes added that APRA will 'have more to say' about provider management more broadly 'as we review our existing standard around outsourcing, CPS 231'.

[Sources: APRA speech: APRA Member Geoff Summerhayes - Speech to CyBSA 2019 Cyber Breach Simulation Australia 07/11/2019; [registration required] The Australian 07/11/2019; The SMH 08/11/2019]

Mandatory (and public) culture reviews for the ASX200? Transparency is a 'remarkable discipline from which you can never escape' The AFR quotes Graeme Samuel as saying

Mandatory culture reviews for ASX 200 companies: The AFR reports that Graeme Samuel has suggested that boards of ASX 200 companies should be required to undertake mandatory culture and governance self-assessments, and to publish the results as a means of addressing the kinds of issues identified by the Financial Services Royal Commission.

Reportedly, Mr Samuel also expressed the view that it is unnecessary for firms to engage external consultants to conduct this work, on the basis that executives are well-placed to do so. Reportedly, Mr Samuel said that executives 'who could not resolve their own governance issues should question whether they should remain in positions of leadership'.

Auditors should be given a broader remit? Mr Samuel also reportedly suggested that auditors should be given a broader remit to identify and report on governance issues. Reportedly, Mr Samuel also suggested that auditors should be required to disclosure governance failures in their auditing report, and that existing auditing standards such as the ASA 250 and ASA 260 (which in his view) provide conflicting advice about how auditors should handle discovery of non-compliance, should be clarified to make this clear.

Mr Samuel reportedly went on to say that auditors could not be expected to pick up every fraud, but that it is important that they do disclose governance issues where they identify them. 'It's important to say to the auditor, not that you won't suffer recriminations if you disclose, but rather that you will suffer recriminations if you don't tell us what is wrong with our governance practices' he is quoted as saying.

Reportedly, Mr Samuel also rejected the suggestion that the big four accounting firms should be broken to prevent conflicts of interest, reportedly branding the suggestion 'misguided'.

[Sources: [registration required] The AFR 08/11/2019; [registration required] The Australian 08/11/2019]

The Australian reports that Attorney General Christian Porter has said the government will consider empowering the Fair Work Ombudsman to pursue banning order applications against directors for failure to ensure employees are paid correctly

Key Takeouts

- The Australian quotes Attorney General Christian Porter as saying the government will consider: 1) empowering the Fair Work Ombudsman to pursue banning order applications against directors for failure to ensure employees are paid correctly; and 2) allowing individual workers to go to the Fair Work Commission to have underpayment claims dealt with via the small claims process
- Reportedly Mr Porter said that the measures (if implemented) would not operate retrospectively
- Reportedly the government will soon release a discussion paper canvassing views on the options
- Context: The Treasurer's comments follow the release of a discussion paper in September 2019, which proposed (among other reforms) criminalising underpayment of wages

The Australian reports that in response to the issue of companies failing to ensure workers are paid correctly Attorney General Christian Porter has said that the government will consider various options to address the issue.

These include potentially empowering the Fair Work Ombudsman to pursue banning order applications against directors for failure to ensure wages are paid correctly.

Reportedly, Mr Porter said 'it would seem reasonable that this list of responsibilities [for directors under Corporations and Consumer laws] could be expanded to include the responsibility to ensure their company pays its staff correctly…This would provide the real potential that directors of companies that fail to pay their staff -appropriately could lose their position and the ability to hold directorships in the future for a period of time. Any such changes would therefore apply to directors of Australia's largest companies.'

Mr Porter is quoted as commenting, 'I suspect the only way you will get board directors who sit on boards and get 180 grand a year for 12 meetings to take this stuff seriously is if there is something on the line for them' Mr Porter is quoted as saying.

A second option Mr Porter has reportedly flagged for consideration, is allowing individual workers to go to the Fair Work Commission to have underpayment claims dealt with via the small claims process (as suggested by the ACTU).

Reforms put forward in the September discussion paper? Mr Porter reportedly said that since an initial discussion paper was released in September, which proposed (among other things) introducing criminal penalties for wage underpayments, he had come to believe that 'tougher action' was required to 'ensure Corporate Australia takes notice'.

Next steps? Reportedly the government will soon release a new discussion paper canvassing views on the options. No timeframe was given. Reportedly Mr Porter said that should changes be made, they will not operate retrospectively.

Call for companies to prioritise the issue: Mr Porter also reportedly called on companies to prioritise and to put the necessary resources into ensuring workers are paid correctly. 'If their eye was on the ball, this wouldn't happen. These organisations have a massive amount of time, energy and resources devoted to ensuring they don't pay a cent more tax than they have to; they get involved in sporting teams and social issues. If they put commensurate resources into making sure they got their payrolls working in accordance with EAs (enterprise agreements), awards and the law, they wouldn't be having this problem' Mr Porter reportedly said.

[Sources: [registration required] The Australian 07/11/2019; 07/11/2019]

In Brief | Delaying legislation to implement Director Identification Numbers? The Federal Labor Party have criticised the government for delaying a vote on the Bill, alleging the delay is due to the 'IT upgrade expenditure' required to implement the bi-partisan measure

[Sources: [accessed via LexisNexis Capital Monitor — registration required] Joint media release: Brendan O'Connor and Stephen Jones 03/11/2019]

In Brief | CEO (involuntary) exits at a fifteen year high? Fortune reports that more S&P 500 CEOs were 'fired' in 2018 than at any point in the last 15 years. In addition, there was reportedly an uptick in the number of CEOs who left their roles as a result of personal conduct and #MeToo allegations as compared with 2017, with five leaving in 2018 for these reasons as compared with only one in the period 2013-2017

[Sources: Fortune 06/11/2019; 06/11/2019]

Other News

In Brief | Time to embrace a Bretton-Woods mentality? In a speech to the ANU Australian Studies Institute Treasurer Josh Frydenberg spoke about the 'importance of recapturing the cooperative spirit of Bretton Woods' in order to position Australia to meet global challenges and 'secure our peace and prosperity'. 'The compact at Bretton Woods which was agreed seventy five years ago, provides us with a framework which is based on cooperation and coordination that has underpinned our peace and prosperity. We need to recapture that moment and the lessons that got us there' he said

[Sources: Speech by Treasurer Josh Frydenberg Lecture at the ANU Australian Studies Institute, 'Australia and the Global Economy' 12/11/2019; [registration required] The AFR 12/11/2019]