Governance News

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Diversity

United States | Gender diversity fatigue? Most directors agree that gender diversity on boards is important, but they're sick of hearing about it according to a new PwC report

Snapshot | PwC Annual Corporate Directors Survey 2019

PwC's Annual Corporate Directors Survey presents insights into what directors of public company boards think about the changing governance landscape.

Who participated in the survey? In 2019, 734 directors participated. The respondents represent a cross-section of companies from over a dozen industries, 74% of which have annual revenues of more than $1 billion. 79% of the respondents were men and 21% were women. Board tenure varied, but 60% of respondents have served on their board for five or more years.

Some Key Findings

- **Almost half of directors are dissatisfied with at least one of their peers (but board turnover remains low):** 49% of directors believe at least one fellow board member should be replaced and 23% say two or more should be replaced. By comparison, 45% of directors in 2018 and 46% in 2017 were of the view that one or more of their peers should be replaced. The report comments that despite the trend in dissatisfaction with peers, board turnover remains low.
- **Evaluations are occurring and action is being taken in response (but not necessarily 'tough' action):** 61% of directors said that their boards conduct individual evaluations and 72% said their boards have made changes in response to their last assessment process (up from 49% in 2016). However, many boards are focusing on some of the easier things to change (eg adding more expertise to the board or refreshing committees) as opposed to what the report characterises as 'tougher actions' eg counselling directors (15%) or not renominating directors (15%).
- **Desire for 'collegiality' getting in the way of productive debate?** 43% of directors said it is difficult to voice a dissenting view on at least one topic. The report suggests that the 'desire for collegiality' may be getting in the way of productive debate.
- **Investors are focusing too much on ESG issues?** 56% of directors are of the view that investors are giving too much time and focus to environmental, social and governance (ESG) issues (up from 29% in 2018).
- **Consensus that board diversity is beneficial, but they're sick of hearing about it?** Though most directors agree that board diversity is beneficial in various ways eg 94% of directors said that they consider board diversity brings unique perspectives to the boardroom and gender diversity was ranked as the most important factor in achieving diversity of thought in the boardroom (88%), only 38% of directors said that gender diversity is very important to their boards, down from 46% in 2018 (the report comments that this is the lowest level since 2014). Further, 63% of directors said investors devote too much attention to board gender diversity, up from 35% last year. The report suggests that as is the case with respect to investor focus on ESG issues, directors are 'tired of the issue'.
- **Slight increase in support for racial/ethnic diversity on boards?** 38% of directors said that racial/ethnic diversity is very important to their board (up from 34% in 2018).
- **Room for improvement on workforce diversity?** Less than one-fifth of directors rated their companies as 'excellent' at give their companies an excellent score at recruiting a diverse workforce (16%), or at developing diverse executive talent (15%). And 83% of directors agree that companies should be doing more to promote gender/racial diversity in the workplace.
- **Directors (including a majority of women) do not support the introduction of diversity quotas:** 83% of directors overall, and 54% of female directors, are opposed to the introduction of laws (eg the Californian legislation) mandating board diversity on the basis that they do not believe that forcing diversity through regulation is the best way to make boards diverse.

- **Influences on executive compensation? The report found that influences on executive compensation are broadening.** Though compensation consultants exercise the most influence on executive compensation (88% down from 90% in 2018) directors indicated that the influence of other sources is increasing. The greatest influences after consultants were identified as: 1) institutional shareholders (61% up from 42% in 2018); 2) employees (51% up from 28% in 2018); and 3) CEO pressure (50% up from 34% in 2018).
- **Responsibility for culture/cultural issues?** The tone set by executive management is cited the most often (73%), but there is an increase in the proportion of directors nominating the tone set by middle management (59% in 2019 as compared with 45% in 2018). Boards are also taking more accountability for culture with 29% of directors strongly agreeing that a lack of board oversight contributes to problems (up from 18% in 2018).
- **Actions being taken to address cultural issues:** The most common steps that directors report taking to address corporate cultural issues are: 1) enhancing employee development/training programs (60%); 2) enhancing whistleblowing programs (43%); 3) increasing board level reporting of culture metrics (32%); and 4) conducting broad based employee cultural assessments (31%).

[Sources: PwC Annual Corporate Directors Survey – The collegiality conundrum: finding balance in the boardroom; Fortune 08/10/2019]

Canada | Yet to crack 20%? The total number of board seats occupied by women in Canada has increased to 17% in 2019 up from 11% in 2015

The Canadian Securities Administrators (CSA) — the CSA is the council of the securities regulators of Canada's provinces and territories and is responsible for co-ordinating and harmonising regulation for Canadian capital markets — has published data on board gender diversity based on the disclosures provided by 641 issuers with year ends between 31 December 2018 and 31 March 2019 under National Instrument 58-101 Disclosure of Corporate Governance Practices.

Key Points

- The total number of board seats occupied by women increased to 17% in 2019 up from 11% in 2015
- 5% of issuers had a female board chair
- 73% of issuers had at least one woman on their board (up from 49% in 2015)
- When board vacancies were filled, a third of those positions were filled by women
- Half of issuers adopted a policy relating to the representation of women on their board, representing a significant increase since 2015

The CSA said it will continue to monitor trends in this area, adding that it will publish the underlying data from the review by early 2020.

Louis Morisset, CSA Chair and President and CEO of the Autorité des marchés financiers commented that the data 'reflects our commitment to ensuring investors have information to help them make informed decisions'.

[Source: Canadian Securities Administrators media release 02/10/2019]

Mostly men with previous board experience: Heidrick and Struggles' latest report on the composition of European publicly listed company boards has identified that overall, most board appointments continue to go to men with previous board experience, but that viewed individually each country has a different approach to board diversity

Report Overview | Heidrick & Struggles, Board Monitor Europe 2019

Heidrick & Struggles has released a report identifying trends in board diversity in France, Germany Ireland, the Netherlands, Portugal, Spain the UK. A high level summary of the overall findings is below. The full text of the report, which includes country-specific findings is available here.

Some Key Findings

Of the 503 independent seats filled on the boards of Cotation Assistée en Continu (CAC 40), DAX 30, ISEQ, AEX 25, PSI 20, IBEX 35, and FTSE 250 companies in 2018:

- 70% (or 352) of seats were filled by directors with previous board experience, usually (62%) by current or former CEOs. This trend was strongest in France where 90% of new board appointments went to appointees with CEO or CFO experience.
- Overall, 19% of seats were filled by people with substantial experience in financial service, 9% of whom have experience in financial risk.
- Only 12% of new appointments overall had cybersecurity experience and 24% had digital or social media experience
- Overall, 62% of seats were filled by men and 38% (or 191) of the seats were filled by women. However trends towards board diversity differed markedly by country. Portugal's PSI 20 had the highest share of new female directors, at 44% in 2018. Companies on the United Kingdom's FTSE 250 increased female appointments from 35% in 2017 to 42% in 2018. By contrast, in France, the proportion of female appointments to boards on the CAC 40 decreased from 42% in 2017 to 35% in 2018. Likewise, companies on Germany's DAX 30 experienced a decline in female appointments, from 41% in 2017 to 31% in 2018.
- 36% of seats were filled by appointees with either cybersecurity experience (12% or 61) or digital or social media experience (24% or 121)
- 36% of seats (or 182) were filled by appointees from countries other than the country where the company's headquarters are located. However, there was wide variation in the approach taken by different countries from a high of 62% in the Netherlands to a joint low of 32% in Spain and the United Kingdom.
- Boards at companies in Portugal added the youngest new directors, with an average age of 53, well below the overall average age of 58.

[Sources: Heidrick & Struggles report: Board Monitor Europe 2019 25/09/2019; [registration required] The FT 26/09/2019]

In Brief | Global diversity report finds there is a link between diverse leadership and shareholder returns: The 2019 edition of the CS Gender 3000 report looks at the link between gender diversity and superior company performance and how this is evolving over time. The report is based on analysis of the gender diversity mix within the governance and executive leadership teams of over 3,000 companies across 56 countries

[Sources: Credit Suisse media release 10/10/2019; Credit Suisse Institute report: The CS Gender 3000 in 2019: The changing face of companies; [registration required] The AFR 10/10/2019]

Shareholder Activism

Bucking the trend? Activist Insight's latest report has identified a global slowdown in activist activity in Q3 2019, though activity in Australia has continued to increase

Report Overview | Activist Insight, Shareholder Activism Q3 YTD 2019

Activist Insight has released its latest quarterly analysis of shareholder activism. The report presents statistics and trends on shareholder activism in the US, Canada, Europe, Asia and Australia.

Global overview

- The number of companies publicly facing impactful campaigns in Q3 2019 YTD fell to its lowest level since 2014.
- The number of large cap companies targeted fell from 181 in 2018 to 156 in 2019. The trend was repeated for mid cap, small cap, micro cap and nano cap companies.
- Though the number of companies targeted globally dipped, activity in Australia actually increased with Australia among the most targeted countries overall.

Australia

- 57 Australia-based companies were publicly subjected to activist demands in Q3 2019, as compared with 56 for the same quarter in 2018 and 50 in 2017
- Basic materials companies were the most targeted (44% of campaigns) followed by financial companies (19%) and services companies (11%)
- 30 Australia-based companies faced impactful campaigns this quarter down from 38 in 2018 and 39 in 2017
- 79% of all Australia-based companies facing activist demands have a market cap of less than $50m
- Most activist demands (77%) are board related (up from 72% in 2018 and 58% in 2017). Activists gained 28 board seats from 23 contested votes at Australian based companies

United States

- The number of US based companies facing publicly impactful campaigns in Q3 fell to 210, down from 232 in 2018 and 2017 and 274 in 2016. Activist Insight comments that it is the lowest Q3 YT level since 2015 (240).
- The most targeted companies were services companies (26%), followed by financial companies (18%) and technology companies (15%).
- 72% of US-based companies facing activist demands have a market cap of over $250m
- Most activist demands (43%) are board related (up from 38% last year), followed by 'other governance' (25%) and M&A breakup (14%). Activists gained 10 seats from 9 contested votes at US-based companies

Canada

- 43 Canada-based companies faced activist demands in Q3 2019, down from 68 in Q3 2018 and 43 in Q3 2017
- 15 companies faced impactful campaigns, down from 33 in 2018
- Basic materials companies were the most targeted (33%), followed by financial companies (16%) and healthcare (12%) and technology (12%)
- 48% of campaigns are board related, followed by 'other governance' (17%) and M&A/break up 15%

Europe

- 80 Europe-based companies faced impactful campaigns in 2019 down from 93 in 2018
- The most targeted companies were financial companies (27%) followed by services companies (20%) and technology companies (15%)
- Most activist demands (52%) are board related (up from 44% last year), followed by M&A breakup (19%, up from 11% in 2018) and balance sheet (13%, down from 17% in 2018). Activists gained 31 seats from 33 contested votes at Europe-based companies
- The three most active activists in 2019 YTD are 1) Elliott; 2) Krupa Global Investments and 3) Trian Fund Management

Asia

- 85 Asia-based companies faced activist demands in Q3 2019, down from 105 in Q3 2018
- The most targeted companies were services companies (24%), followed by consumer goods (20%) and financial companies (14%)
- Most activist demands (48%) are board related (up from 40% last year), followed by balance sheet (24%, up from 21% in 2018) and 'other governance' (17%)

- Activists gained 24 seats from 9 settlements and 40 seats from 31 contested votes
- The three most active activists in the region were: 1) Quartz capital management, 2) Dalton investments; 3) Reno Inc (Murakami)

[Source: [registration required] Activist Insight report: Activist Insight, Shareholder Activism Q3 YTD 2019]

Meetings and Proxy Advisers

In Brief | Proxy adviser Institutional Shareholder Services (ISS) has released its 2020 benchmark voting policy for a two week comment period 7 October (submissions are due by 18 October). ISS is requesting feedback from all interested market constituents on 17 proposed new policies or potential policy changes

[Source: ISS proposed benchmark policy changes 2020]

Other Shareholder News

Top Story | Best to be cautious? High Court decision on the operation of s260A and what constitutes financial assistance

Case note | Connective Services Pty Ltd v Slea Pty Ltd [2019] HCA 33

Key Takeouts

- The case concerns the scope of the implied prohibition in s 260A(1) of the Corporations Act 2001 (Cth) against financial assistance by a company to acquire shares in the company where the financial assistance is said to materially prejudice the interests of the company or its shareholders.
- In a unanimous judgment, the High Court held that by bringing and funding legal proceedings in its own name and with the aim of enforcing the pre-emptive rights of some shareholders against a fellow shareholder (by compelling one shareholder to offer shares to the other shareholders), the company (Connective Services Pty Ltd) did contravene s 260A(1).
- Meaning of 'financial assistance': The court held that financial assistance need not involve any diminution or depletion of assets, but rather is a commercial/financial question. 'The financial assistance need not involve a money payment by the company to the person acquiring the shares. Any action by the company can be financial assistance if it eases the financial burden that would be involved in the process of acquisition or if it improves the person's "net balance of financial advantage" in relation to the acquisition'.
- Best to be cautious: The Court held that 'If a company wishes to bring proceedings to enforce pre-emptive rights in its constitution, for the benefit of some of its shareholders but at the company's expense, then the company is liable to be enjoined from doing so unless the assistance is approved by shareholders under s 260B, or unless the company can satisfy the court that bringing the proceedings at its own expense does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors'.

The High Court delivered its judgment in Connective Services Pty Ltd v Slea Pty Ltd [2019] HCA 33 on 9 October. The case concerns the operation of s260A(1) of the Corporations Act 2001 (Cth) and the question of what constitutes financial assistance. Is funding by a company of legal proceedings directed at enforcing the pre-emptive rights of some shareholders (by compelling one shareholder to offer shares to fellow shareholders), financial assistance?

[Note: The full text of the decision is available on the High Court's website here. High Court's summary of the decision is available here.]

In a nutshell…

Slea Pty Ltd (Slea) was one of three shareholders in a mortgage aggregation business called Connective Services Pty Ltd (Connective Services). Connective Services' constitution included a pre-emption clause requiring that shareholders offer their shares to their fellow Connective Services shareholders before the shares could be transferred to any other party.

Slea entered into an agreement to transfer its shares to a third party, Minerva Financial Group (without complying with this pre-emptive rights provision). To prevent this, Connective Services commenced proceedings to compel Slea to offer its shares to the other Connective shareholders. Slea then sought an injunction under s1324, to restrain Connective Services from prosecuting the proceedings on the basis that the proceedings contravened the prohibition against financial assistance in s 260A(1).

The High Court held that the legal proceedings brought by Connective Services against Slea to enforce a pre-emptive rights provision for the benefit of the other Connective Services shareholders at Connective's expense, did constitute 'financial assistance' and issued the injunction.

Further, the court found that 'if a company wishes to bring proceedings to enforce pre-emptive rights in its constitution, for the benefit of some of its shareholders but at the company's expense, then the company is liable to be enjoined from doing so unless the assistance is approved by shareholders under s 260B, or unless the company can satisfy the court that bringing the proceedings at its own expense does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors'.

Section 260A(1)

Section 260A(1) provides that a company may financially assist a person to acquire shares in the company only if giving the assistance does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors.

The Court considered that the three elements necessary to establish a contravention of s 260A(1) (relevant to the case in question) are: 1) financial assistance given by the company; 2) to acquire shares or units of shares in the company; and 3) which materially prejudices the interests of the company or its shareholders or its ability to pay its creditors.

Clarification: what is 'financial assistance'?

The court held that financial assistance need not involve any diminution or depletion of assets, but rather is a commercial/financial question. 'Financial assistance need not involve a money payment by the company to the person acquiring the shares. Any action by the company can be financial assistance if it eases the financial burden that would be involved in the process of acquisition or if it improves the person's "net balance of financial advantage" in relation to the acquisition. For instance, the assistance might involve the company paying a dividend by means other than by payment of cash, issuing a debenture, granting security, or agreeing to pay consultancy fees' the Court held.

Approach to determining whether there has been 'material prejudice'

The Court held that 'the issue of material prejudice to the interests of the company or its shareholders or creditors requires an assessment of and comparison between the position before the giving of the financial assistance and the position after it to see whether the company or its shareholders or its ability to pay its creditors is in a worse position'.

'It does not assist to gloss the concept of material prejudice by the introduction of further concepts, which themselves require further explanation, such as whether there has been a diminution of the assets of the company, whether there has been a transaction, or whether there was a net transfer of value to the person acquiring the shares'.

'To acquire shares or units of shares'

The Court held that the words 'to acquire' require a 'sufficient link between the financial assistance and the acquisition of the shares or units of shares. Section 260A(1) does not require that an acquisition actually take place, since the provision can be contravened and injunctions can be ordered before any acquisition actually takes place. In this sense, 'to acquire', like the express words of s 205(1) of the Corporations Law, includes conduct that is in connection with the process of an acquisition of the shares or units of shares and not limited

to conduct for the purpose of acquisition. Acquisition also has broad connotations. It does not require a transaction or transfer. It includes acquisitions by issue or transfer or any other means.'

Onus was on Connective Services to prove that there was no 'material prejudice'

Section 1324(1B)(a) provides that where the ground relied on in an application for an injunction under s 1324 is an alleged contravention of s 260A(1)(a), the Court must assume that the conduct constitutes or would constitute a contravention of s 260A(1)(a) unless the company or person proves otherwise.

In this case, Connective Services was required to disprove that its conduct constituted a contravention of s260A(1). The Court held that it ultimately did not do so. The Court reasoned that if the other two Connective Services shareholders had brought proceedings against Slea to vindicate their pre-emptive rights, and the proceedings were funded by Connective Services, then it would have constituted financial assistance (in contravention of 260A(1)) because it would have eased the financial burden incurred in the process of the acquisition of the shares by those shareholders.

As it was, the Court held that the commencement of the pre-emptive rights proceedings by Connective Services was financial assistance within the meaning of s 260A(1) and that Connective Services 'did not discharge their onus of proving that there was no material prejudice to the Connective companies or their shareholders'.

Best to exercise caution?

The judgment states that 'If a company wishes to bring proceedings to enforce pre-emptive rights in its constitution, for the benefit of some of its shareholders but at the company's expense, then the company is liable to be enjoined from doing so unless the assistance is approved by shareholders under s 260B, or unless the company can satisfy the court that bringing the proceedings at its own expense does not materially prejudice the interests of the company or its shareholders or the company's ability to pay its creditors'.

[Source: Connective Services Pty Ltd v Slea Pty Ltd [2019] HCA 33; HCA summary: Connective Services Pty Ltd v Slea Pty Ltd [2019] HCA 33]

Markets and Exchanges

Top Story | Final changes to the ASX Listing Rules released

Key Takeouts

- Following consultation, the ASX has released final changes to the ASX Listing Rules and guidance and a statement outlining its response to consultation.
- The broad range of changes are aimed at improving disclosures to the market, making the listings rules easier to understand and comply with, and enabling the ASX to better monitor and enforce compliance.
- Key changes include (among others): a) new measures to address breaches of the listing rules (eg the option for the ASX to publicly censure entities for breach of the rules); b) changes to ASX's quarterly reporting regime to provide a more robust disclosure framework for start-up entities; c) more guidance and direction on the information that should be given to shareholders in notices of meetings; d) more guidance and direction on the voting processes that should be followed at shareholder meetings and more consistent reporting of voting outcomes; e) new education requirements for those appointed to deal with the ASX; f) the extension of ASX's 'good fame and character' listing condition to include non-director CEOs and CFOs; g) simpler and clearer processes and forms to announce a proposed issue of shares and to seek their quotation; and h) measures to ensure better and timelier disclosure by listed investment companies and listed investment trusts of their net tangible assets (NTA) backing.
- Timing: The new rules will come into effect from 1 December this year (with two exceptions). The new education requirements will apply from 1 July 2020. Changes to the Appendix 4C and Appendix 5B quarterly cash flow reports will come into effect for the quarter beginning 1 January 2020 and ending 31 March 2020.
- ASX will be conducting a national roadshow on its rule and guidance changes in late October and early November.

The Australian Securities and Exchange Commission (ASX) has released its final response to submissions to its November 2018 consultation paper: Simplifying, clarifying and enhancing the integrity and efficiency of the ASX listing rules. The response includes a range of rule amendments as well as new, updated and expanded guidance.

Broad changes

The changes are fairly broad. For ease, the consultation grouped them into eight areas: 1) enhancing ASX's powers to operate the market and to monitor and enforce compliance with the listing rules; 2) improving market disclosures and other market integrity measures; 3) making the rules simpler and easier to follow; 4) making aspects of the listing process and ongoing compliance with the listing rules more efficient for issuers and for ASX; 5) updating the timetables for corporate actions; 6) correcting gaps or errors in the listing rules; 7) general drafting improvements, including removing redundant rules; and 8) more and better guidance.

The response document explaining the final changes and setting out ASX's response to the community consultation broadly follows the same structure as the consultation.

Snapshot: Key changes?

Announcing the release of the changes, the ASX highlighted the following as 'key initiatives':

- new measures to address breaches of the listing rules
- more guidance and direction on the information that should be given to shareholders in notices of meetings
- more guidance and direction on the voting processes that should be followed at shareholder meetings and more consistent reporting of voting outcomes
- simpler and clearer processes and forms to announce a proposed issue of shares and to seek their quotation
- changes to ASX's quarterly reporting regime to provide a more robust disclosure framework for start-up entities
- better and timelier disclosure by listed investment companies and listed investment trusts of their net tangible assets (NTA) backing

Other changes highlighted by ASX include: a) the simplification of ASX's escrow rules and guidance to make the escrow process less burdensome for listed entities; b) an extension of ASX's 'good fame and character' listing condition to include non-director CEOs and CFOs; c) measures to address inappropriate behaviours by promoters and professional advisers in new and back door listings; and d) new education requirements (for any person appointed to be responsible for communicating with ASX about listing rule matters.

ASX Chief Compliance Officer, Kevin Lewis, said that the changes are intended to improve disclosures to the market, make the listings rules easier to understand and comply with and finally, to enable ASX to better monitor and enforce compliance with the listing rules.

Further detail

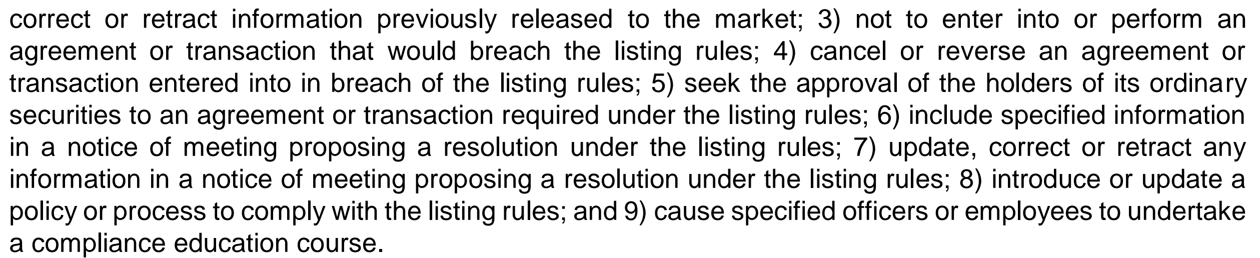
A high level overview of some of the key changes impacting ASX's monitoring and enforcement of compliance with the listing rules and changes aimed at improving market disclosures and market integrity is below.

[Note: A mark-up of the changes to the listing rules can be accessed on the ASX website here. Marked up copies of the changes to the Guidance Notes can be accessed on the ASX website here. The full text of the ASX response paper is here]

Monitoring and enforcing compliance with the listing rules

The ASX has made a number of rule changes aimed at enhancing its powers to operate the market and to monitor and enforce compliance with the listing rules. These include the following.

- **Compliance requirements:** Rule 18.8 has been amended to list specific examples of the types of requirements ASX may impose on a listed entity to ensure compliance with the listing rules. These include (among others) requirements to: 1) give specified information to ASX for release to the market; 2) update,



correct or retract information previously released to the market; 3) not to enter into or perform an agreement or transaction that would breach the listing rules; 4) cancel or reverse an agreement or transaction entered into in breach of the listing rules; 5) seek the approval of the holders of its ordinary securities to an agreement or transaction required under the listing rules; 6) include specified information in a notice of meeting proposing a resolution under the listing rules; 7) update, correct or retract any information in a notice of meeting proposing a resolution under the listing rules; 8) introduce or update a policy or process to comply with the listing rules; and 9) cause specified officers or employees to undertake a compliance education course.

- **Option to publicly censure entities for breach of the rules:** A new rule (18.8A) has been added which gives ASX the power to formally censure a listed entity for breach of the listing rules, or condition imposed under the listing rules, and to publish the censure and the reasons for it to the market.
- **Conditional no-action letters:** Rule 18.5 has been amended to make clear that ASX can impose conditions in connection with its decision not to take action against an entity for breaching the listing rules, and to make clear that and if it does impose any such conditions, that the entity must comply with them.
- **Giving ASX information:** Rule 18.7 has been amended to provide that ASX can require information to enable it to be 'satisfied that the entity is, and has been, complying with, or will comply with, the listing rules or any conditions or requirements imposed under the listing rules; or reasonably requires to perform its obligations as a licensed market operator'. In addition, ASX has expanded rule 18.7 to require that the information documents or explanation be verified under oath.
- **Granting waivers:** Rule 18.1 has been amended to make it clear that ASX can grant waivers to a specific class of entities or to all entities generally.
- **Discretion applying the rules:** A new rule (18.5A) has been included to make clear that ASX can exercise or decide not to exercise any power or discretion conferred under the listing rules in relation to an entity in its absolute discretion. The new rule also makes clear that ASX may do so on conditions, and if it does so, that the entity must comply with the conditions.

Improving market disclosures and other market integrity measures

Enhancing the quarterly reporting regime to provide a more robust disclosure framework for start-up entities

ASX proposed a number of changes to its quarterly reporting regime to provide a more robust disclosure framework for start-up entities and to give them a vehicle to communicate developments in their business to the market on a regular basis.

ASX says that generally, the proposed changes were supported and consequently it is proceeding them (with some modifications to those proposed in the consultation). Final changes include the following.

Quarterly activity reports

- A new rule (rule 4.7C) has been added requiring start-up entities that currently lodge an Appendix 4C quarterly cash flow report with ASX under rule 4.7B, to also lodge a quarterly activities report with ASX. The rule also sets out the information that the report must include with the aim (according to the consultation document) of making start up entities: 1) more accountable for the 'use of funds' statements and expenditure programs included in their listing prospectuses and product disclosure statements (PDSs); 2) more transparent about quarter to quarter differences in projected and actual cash outflows; and about related party payments. Rules 5.3 and 5.4 have also been amended to require the quarterly activity reports of mining exploration entities and oil and gas exploration entities under those rules to include certain information.
- Adding rule 4.7C and 4.12 (discussed below) to the list of documents in rule 17.5 failure to lodge documents that attract an automatic suspension if not lodged with ASX on time

'Better and timelier disclosure' by listed investment companies and listed investment trusts of their net tangible assets (NTA) backing

The changes include a number of measures aimed, according to the consultation document, at improving the disclosure by listed investment companies (LICs) and listed investment trusts (LITs) of their NTA backing. These include (among other changes):

- amending the definition of 'net tangible asset backing' in rule 19.12 to clarify its intended operation
- amending rule 4.10.20 to require a LIC/LIT to disclose certain information (eg the net tangible asset backing of its quoted securities at the beginning and end of the reporting period and an explanation of any change therein over that period) in its annual report
- amending rule 4.12 to require a LIC/LIT to disclose its monthly NTA backing as soon as that information is available and in any event not later than 14 days after the end of that month

According to the consultation document, the changes are intended to 'address issues ASX has experienced recently with some LICs regarding their valuation methodology for investments in unlisted securities' and a desire by ASX to 'standardise and improve NTA reporting by LICs and LITs'.

Disclosure of closing dates for the receipt of director nominations

Rule 3.13.1 has been amended to make clear that entities must give five business days notice to the market of the closing date for the receipt of director nominations. Though the amended rule provides that the 'failure to give such notice does not invalidate the meeting or the election of any director at the meeting'.

Disclosure of voting results at meetings of security holders

Rule 3.13.2 has been amended to standardise the disclosure of voting results at meetings of security holders. Among other things, the amended rule now requires an entity to disclose for each resolution put to a meeting of security holders: a) both the number and a short description of the resolution; b) whether the resolution was passed or not passed; and c) whether the resolution was decided on a show of hands or a poll.

ASX notes that one respondent to the consultation suggested that the listing rules make polls mandatory on all resolutions. The ASX response document states that the revised guidance included in the consultation package makes clear that because of the possible application of voting exclusions, all resolutions under the listing rules should be decided by a poll and not by a show of hands. The response goes on to say that 'It is not clear to ASX that the LR [listing rules] could properly require this in relation to non-LR resolutions. ASX would also note that this matter has been addressed in a non-mandatory way in the fourth edition of the Corporate Governance Principles and Recommendations (see recommendation 6.4) and this should lead to a greater adoption of voting by poll over time'.

The ASX also notes that one respondent to the consultation suggested that there should be a requirement to disclose the proxy outcomes of proposed resolutions where the proxy deadline has passed but the resolution is subsequently not put to the meeting. ASX states that it 'considers the proposed new requirement in LR [listing rule] 3.13.2 [which is included in the final version of the rules] to include an explanation as to why a resolution was not put to a meeting is sufficient for these purposes'.

Disclosure of underwriting agreements

New rule 3.10.9 has been inserted requiring a listed entity to notify the market if it has entered into an agreement to underwrite a DRP and to disclose the name of the underwriter, the extent of the underwriting, the fee or commission payable, and a summary of the significant events that could lead to the underwriting being terminated.

Rules 3.11.3, 7.2 and 10.12 and Appendix 3B (announcements of new issues) have been amended to require an entity to disclose the details mentioned above about the underwriting agreements referred to in those provisions.

Good fame and character requirement extended to CEOs and CFOs

The 'good fame and character' requirement in the conditions for admission as an ASX Listing (rule 1.1 condition 20) has been expanded to cover an entity’s CEO or proposed CEO, it's CFO or proposed CFO as well as its directors and proposed directors.

The ASX notes that one respondent to the consultation suggested that the ASX extend the requirement to other C-suite executives. Though ASX has extended the requirement to CFOs (in response to this feedback) 'given the pivotal role they play at listed entities' the response states that it is 'wary of extending it any further at this stage, given the administrative burden it would create for applicants for listing in obtaining good fame and character documentation for a broader set of executives'.

New education requirements for persons responsible for communication with ASX on listing rule issues

To improve listing rule compliance, ASX has amended rule 1.1 condition 13 and rule 12.6 to require the person who has been appointed by an entity to be responsible for communication with ASX in relation to listing rule matters to have completed an approved education course and examination covering listing rule compliance matters and to have achieved a 'satisfactory pass mark in the examination for that course'.

The changes to condition 13 come into effect on 1 July 2020 and apply to entities that lodge an application to be admitted to the official list on or after that date. The changes to rule 12.6 similarly apply from 1 July 2020.

Voting by employee incentive scheme securities

New Rule 14.10 provides that securities held by or for an employee incentive scheme must only be voted on a resolution under the listing rules if, and to the extent that they are, held for the benefit of a nominated participant in the scheme who is not excluded from voting on the resolution under the listing rules and who has directed how the securities are to be voted.

Market announcements

Listing Rules 15.5 has been amended to make it clearer how a document should be given to ASX.

A document given by an entity to ASX must: include, or be sent with a covering letter that includes, the entity's name, address and corporate logo, unless a form prescribed by the listing rules or an Australian law is used; be dated; identify the title of the body, or the name and title of the officer, of the entity who authorised the document to be given to ASX; and if the document is an announcement under rule 3.1, include the name, title and contact details of a person who security holders or other interested parties can contact if they have any queries.

Distribution schedules

New rule 3.10.5(b) has been inserted and requires that where an entity issues a new class of quoted equity securities, the distribution schedule should include the number of recipients in the following categories — 1 - 1,000, 1,001 - 5,000, 5,001 - 10,000, 10,001 - 100,000, 100,001 and over — and the total percentage of those securities held by the recipients in each category.

Announcing issues of securities and seeking their quotation

ASX has implemented a number of changes aimed at simplifying and rationalising the current process for announcing issues of securities and applying for their quotations. These include changes to listing rules 2.7, 2.8 and 3.10.3 and Appendix 3B; the replacement of LR 3.10.5; and the introduction of new listing rules 3.10.3A, 3.10.3B and 3.10.3C as well as the inclusion of a new Appendix 2A.20.

When do the changes apply?

Subject to the receipt of the necessary regulatory approvals — and with two exceptions outlined below — the listing rule amendments and new and updated guidance notes will come into effect on **1 December 2019.**

Exceptions?

The first exception is the changes to Listing Rule 1.1 condition 13 and Listing Rule 12.6 to require the person who has been appointed by an entity to be responsible for communication with ASX in relation to listing rule matters to have completed an approved education course and examination covering listing rule compliance matters. To allow more time to complete the development of ASX's online education course and examination, ASX has decided to push back the transition date for these particular rule changes to **1 July 2020.**

The second exception is the changes to the Appendix 4C and Appendix 5B quarterly cash flow reports, which will come into effect for the quarter beginning **1 January 2020** and ending 31 March 2020.

Education Roadshow

ASX will be conducting a national roadshow on its rule and guidance changes in late October and early November. The Sydney event will be held on 7 November.

[Sources: ASX media release 10/10/2019; ASX media release 10/10/2019; The Consultation document: Simplifying, clarifying and enhancing the integrity and efficiency of the ASX listing rules; ASX response to consultation 10/10/2019; Markup of the final changes to the ASX Listing Rules; Financial Standard 11/10/2019; [registration required] The AFR 10/10/2019]

In Brief | UK listings have fallen to 10-year low in Q3 2019? The FT Reports that the London listing market has suffered its quietest quarter in a decade. The FT attributes this to the impact of persistent political uncertainty

[Source: [registration required] The FT 08/10/2019]

In Brief | The FT reports that Hong Kong Exchanges and Clearing has abandoned its £32bn offer for the London Stock Exchange Group, ending its attempt to create a global capital markets operator. Reportedly, HKEX CEO Charles Li said the board had concluded an offer was not in the best interests of its own shareholders

[Source: [registration required] The FT 09/10/2019; The Guardian 08/10/2019]

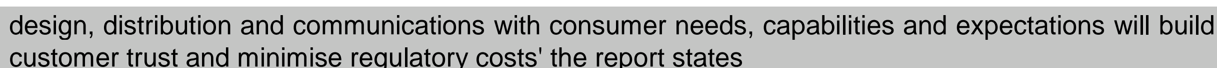
Disclosure and Reporting

No 'silver bullet' after all? A joint ASIC/AFM report details the limitations of disclosure and identifies a need for policy makers to rethink the role of disclosure as the 'default option' to protect consumers

Report snapshot | ASIC report 632 Disclosure: Why it shouldn't be the default

Key Takeouts

- The Australian Securities and Investments Commission (ASIC) and the Dutch Authority for the Financial Markets (AFM) have released a report into how disclosure operates in their respective retail financial services markets.
- The reports details (based on various case studies and various studies) the limitations of disclosure in driving good consumer outcomes. Overall the report found that: 1) disclosure cannot address the inherent complexity in many financial products and processes; 2) firms can work around and undermine disclosure requirements and in some cases make their products 'strategically complex' confusing consumers; 3) the effectiveness of disclosure is limited because it must compete for consumer attention; and 4) mandatory disclosure/warnings may backfire in some instances.
- The report concludes that though mandatory disclosure has become a 'default' tool for policy makers to protect consumer interests and to drive competition, lack of information is ultimately not the primary driver of poor consumer decision-making and therefore, disclosure (though necessary) has limited impact.
- Given the limitations of disclosure, the report suggests that there is a need to rethink, at a policy level: a) the role of disclosure as the default option relied on to protect consumers; b) assumptions about competitive market forces and what role disclosure actually plays in shaping 'effective' demand-side pressure; and c) the appropriate balance between consumers and industry for effecting good consumer outcomes, and avoiding poor ones.
- The report suggests that alternate regulatory tools — product design, governance and distribution — to improve consumer outcomes, should be considered.
- Industry should not hide behind 'technical compliance': 'It is also incumbent on industry not to hide behind technical compliance with disclosure obligations. Firms that are proactive in aligning their product



design, distribution and communications with consumer needs, capabilities and expectations will build customer trust and minimise regulatory costs' the report states

The Australian Securities and Investments Commission (ASIC) and the Dutch Authority for Financial Markets (AFM) have jointly released a report into how disclosure works in their respective retail financial services markets.

Some Key Points

The report found, based on analysis of various case studies (and other materials), that though disclosure is necessary, it alone is often insufficient to drive good consumer outcomes for a number of reasons. These include the following.

Disclosure cannot 'solve complexity that is inherent in products and processes'

The report found that disclosure cannot solve the complexity inherent in many products and processes — 'Simplifying disclosure does not "solve" complexity because, as Professors Omri Ben-Shahar and Carl E Schneider assert, the complex is not simple and cannot easily be made so' the report states. For example, detailed home insurance disclosure documents were found (in a Monash University study) to have limited effectiveness in driving good consumer outcomes. Asked, based on detailed product disclosure statements/or a two page fact sheet, to identify the 'optimal' home insurance product, 42% of participants in the research project chose the 'worst product on offer' and 59% made 'suboptimal choices'.

The report also observes that the decision making process is further complicated because of the multiple options available and the need to compare/trade off features across multiple product types. One of the examples given to illustrate this, is insurance sold with credit cards.

Firms can work around and undermine disclosure requirements

The report found that some firms exacerbate the issues outlined above by making their products and processes 'strategically complex' confusing consumers. For example, bundled products and pricing, 'confusing and opaque discounts' and unclear fee descriptors.

The report also found that firms can make products easy to sign up for, but harder to get out of. Consumer Credit Insurance (CCI) is one example used to illustrate this in the report. 'In Australia, "sludge" is a feature in the design of CCI, as well as in sales and claims handing processes. This sludge can exacerbate the problems created by unfair sales practices and further reduce the ability of disclosure to drive good consumer outcomes' the report concludes.

Expert advice is unlikely to help?

The report also found where consumers sought expert advice to assist in making decisions, they had difficulties in judging the quality of advice. For example, an ASIC 'shadow shopping' research exercise found a gap between ASIC's assessment of the quality of retirement advice provided to consumers and the perceptions of the consumers who received it. Though 86% of consumers felt they had received good advice, ASIC rated on 3% of the advice as good.

Disclosure must compete for consumer attention

The report found that 'many firms have the commercial opportunity and means to effectively attract, distract and influence us; but regulators, and the disclosures they mandate, generally do not. Firms can also work around or undermine disclosure requirements that, once set, are generally slow to change'.

Disclosure is a blunt instrument

The report found that 'mandated disclosure requirements are often "one size fits all" interventions' and as such are limited, because they do not adapt to different contexts eg context-specific differences in consumer behaviour, decision making or engagement/processing of information.

Disclosure can 'backfire'

'At worst, disclosure creates unintended detrimental outcomes for some consumers – in effect contributing to consumer harm (eg by increasing rather than decreasing trust in conflicted advisers, and decreasing rather than increasing credit card repayments)' the report cautions. In consequence, the report concludes that ongoing monitoring of disclosure is needed.

Warnings are not a cure-all?

- **Warnings have limited impact:** The report found that disclosure and warnings which 'have become a regulatory tool of choice for policy makers' because they are easy to mandate firms to provide and are assumed to be effective in informing consumers and influencing behaviour, can be less effective than expected, or even ineffective. For example, Dutch credit providers are required to include a warning: 'Caution! Borrowing money costs money' in advertisements for consumer credit but empirical research found that that it had no short-term effects on the behaviour of consumers, or the way that they experienced the advertisements. Similarly, in Australia, providers of high-cost small amount loans must provide a warning about the expense of borrowing small amounts of money, including messages about the availability of alternative sources of assistance and low/no cost sources of credit, but ASIC-commissioned research determined that current warnings were unlikely to be effective in 'disrupting consumers' immediate transactions' because consumers' were already largely aware of the potential for longer term issues that could result from a cycle of small loans and their decision to take out such a loan was driven by 'urgent need, limited choice, and the ease and convenience'. Another example discussed in the report is the limited impact the 'general advice' warning has on consumers (in terms of assisting them to understand its limitations'; the limited impact of the inclusion limitations of general advice despite the general advice warning.
- **Warnings may in some cases contribute to consumer harm:** In some instances the report found that disclosure and warnings can have unintended consequences ie backfire, by actually contributing to consumer harm. One example discussed in the report is the impact of minimum repayment warnings on credit card statements which were found (in the US) to actually reduce the repayments made by some customers.
- **Need for caution?** The report concludes that 'warnings are not a cure-all for problems in financial services markets' and that there is 'a need for caution in the use of warnings, particularly in the absence of evidence that they will work as intended by policy makers'. The report suggests that 'real world testing and monitoring is required' to assess the effectiveness of warnings before implementing them on the basis that they will necessarily deliver better outcomes for consumers.

No 'silver bullet': Why disclosure should not be the 'default' tool adopted by regulators to drive better outcomes for consumers

The report concludes that though mandatory disclosure has become a 'default' tool for policy makers to protect consumer interests and to drive competition, lack of information is ultimately not the primary driver of poor consumer decision-making and therefore, disclosure (though necessary) has limited impact.

Given this, the report states that 'disclosure is not then the silver bullet it was once believed to be' and that this 'raises both opportunities and challenges for policy makers, regulators and industry to progress public policy discussions beyond disclosure, and understand and address consumer harms on a case-by-case basis'.

The report suggests that there is a need to rethink, at a policy level: a) the role of disclosure as the default option relied on to protect consumers; b) assumptions about competitive market forces and what role disclosure actually plays in shaping 'effective' demand-side pressure; and c) the appropriate balance between consumers and industry for effecting good consumer outcomes, and avoiding poor ones.

Conclusions: what do the findings in the report mean for regulators, and for industry?

- **The report suggests that alternate regulatory tools — product design, governance and distribution — to improve consumer outcomes, should be considered.**
- **Continuous monitoring by regulators**: The report concludes that regulators, regardless of the type of intervention they take, should 'contribute to the evidence base of what works by monitoring the effect of interventions over time'.

- **Industry should not hide behind 'technical compliance':** 'It is also incumbent on industry not to hide behind technical compliance with disclosure obligations. Firms that are proactive in aligning their product design, distribution and communications with consumer needs, capabilities and expectations will build customer trust and minimise regulatory costs'.

[Sources: ASIC media release 14/10/2019; Report 632: Disclosure: Why it shouldn't be the default]

In Brief | ASIC has reminded all AFS licensees to lodge their annual financial statements and auditor reports by the due date (or face possible regulatory consequences): Noting that ASIC has observed a 'high rate of non-compliance' ASIC Commissioner Sean Hughes cautioned that the regulator will pursue AFS licensees who fail to comply with their reporting obligations and where appropriate, 'will consider taking action to suspend or cancel a licence.' Since October 2016, ASIC has suspended 9 AFS licences and cancelled 22 AFS licences for failing to lodge their annual financial statements and auditor reports

[Source: ASIC media release 04/10/2019]

Regulators

Australian Securities and Investments Commission

ASIC performance review: ASIC will appear before the House Economics Committee on 16 October

As part of its review of the ongoing monitoring of the Australian Securities and Investments Commission (ASIC), the House of Economics Standing Committee on Economics will hold a public hearing on 16 October at which ASIC will appear.

In a statement, Committee Chair Tim Wilson said that the hearing would provide the Committee with an opportunity to question the regulator on its performance and operation, including its progress toward implementing the recommendations of the Financial Services Royal Commission. In addition, he said that the 'the Committee will scrutinise ASIC on its new enforcement strategy and supervisory approach as well as its efforts to restore trust, eliminate conflicts of interest, and raise standards of professionalism in Australia's financial services industry.'

[Sources: House of Economics Standing Committee: Inquiry — Review of the Australian Securities and Investments Commission Annual Report 2018 media release 11/10/2019]

No excuse not to cooperate? ASIC's new 'why not litigate?' approach is no excuse for companies failing to cooperate with the regulator says ASIC Commissioner John Price

In a recent speech, Australian Securities and Investments commission (ASIC) Commissioner John Price reiterated and explained ASIC's new, 'why not litigate enforcement approach' and cautioned that the regulator expects cooperation.

Going to court is not the 'default' option for ASIC

Mr Price said, 'our adoption of the Why not litigate stance does not suggest that we will take every matter to court as the default option. Whilst a lot of the media coverage of ASIC's remit is focussed on enforcement, the reality is that we use a variety of regulatory tools, often in a multi-dimensional way, to achieve our goal – and that is to create a fair, strong and efficient financial system for all Australians'.

Mr Price said that the release of the Corporate Governance Taskforce's report into non-financial risk and the regulator's work in having ASIC staff on the ground more regularly inside large financial institutions is one example this. The work, Mr Price said 'shows our commitment to enhanced supervision practices. It enables us to heighten engagement, assessment and feedback loops between ASIC and the people we regulate and it also helps deal with issues in a proactive way, not just to litigate after things have gone wrong'.

Mr Price went on to say that where there have 'been significant failings over a prolonged period in regulated entities, it should be very unsurprising that there is a focus on a more robust response to deal with the issues at hand'.

ASIC's why not litigate stance is not an excuse not to cooperate

Mr Price also rejected concerns that ASIC's regulatory stance may operate as a disincentive for companies to cooperate with the regulator, arguing that a cooperative approach to dealings with ASIC may benefit a person or entity in many ways even in an 'why not litigate' world. Mr Price gave the following examples in support of this view.

- Mr Price said that early notification of misconduct or a cooperative approach during an investigation would often be relevant to ASIC's consideration of which type of action to pursue and what remedy or combination of remedies to seek
- Mr Price said that in any proceedings commenced by ASIC, the regulator will give 'due credit for any cooperation we have received from the person or entity against whom the proceedings are brought'
- Further to this last point, Mr Price said that he considers 'good regulatory relationships are valued both by companies and the market. The point here, of course, is that the question of cooperating with regulators is not simply a legal one and indeed I would argue is not even primarily a legal one in today's environment. And we are well beyond the days when merely fulfilling legal obligations and nothing more is seen as cooperation'.

Mr Price concluded by saying, 'For the corporate Australia, in deciding what next, I can do no better than again refer to Financial Services Royal Commission report that suggested very close attention be given to culture, governance and remuneration practices. And on that front, I commend the AICD for its recent Forward Governance Agenda'.

[Source: Keynote address by ASIC Commissioner John Price at the AICD Fellows Victorian Division Event 03/10/2019]

Product intervention order challenged: Cigno seeks judicial review of ASIC's decision to make short term credit product intervention order

Context: Following consultation, on 12 September, the Australian Securities and Investments Commission (ASIC) deployed its new product intervention power for the first time to target a specific short term lending model that it considers causes 'significant consumer detriment' (see: Governance News 13/09/2019). The order came into force on 14 September 2019.

Cigno seeks judicial review

On 20 September, the affected party, Cigno Pty Ltd (Cigno) made an application in the Federal Court seeking the following relief under s39B of the Judiciary Act 1903:

- an order to quash the ASIC Corporations (Product Intervention Order – Short Term Credit) Instrument 2019/917 (Short Term Credit PIO);
- a declaration that the Short Term Credit PIO is invalid; and
- costs.

The short term credit product intervention order remains in force while the matter is before the court.

In a statement, ASIC said that it is 'considering the application.'

[Source: ASIC media release 27/09/2019]

Australian Prudential Regulation Authority (APRA)

APRA has announced a number of new executive roles

The Australian Prudential Regulation Authority (APRA) has announced a number of new executive appointments which the regulator says reflect its new organisational structure.

APRA will move to an industry-based supervision model, with separate supervisory divisions responsible for superannuation, insurance and banking. Under the new structure, each of APRA's six operating divisions will be led by an Executive Director. The new appointments and organisational changes will formally take effect from 1 December.

The following appointments have been made: 1) Mr Sean Carmody has been appointed as Executive Director, Cross-Industry Insights & Data; 2) Mr Brandon Khoo has been appointed to the role of Executive Director, Insurance; 3) Ms Therese McCarthy Hockey has been appointed as Executive Director, Banking; 4) Ms Suzanne Smith has been appointed as Executive Director, Superannuation; and 5) Mr Steve Matthews has been appointed Chief Operating Officer and Executive Director, Enterprise Services.

Ms Heidi Richards will act in the role of Executive Director, Policy & Advice pending a permanent appointment to that role.

In line with the recommendations of the Capability Review APRA says that it will also strengthen and intensify its focus and resourcing allocated to the supervision of governance, culture, remuneration and accountability (GCRA), as well as technology-related risks and operational resilience.

The responsibilities falling under each role are set out in an organisational chart available on the APRA website here.

Further changes? In addition, a new Accountability Regime unit is being established, dedicated to delivering on the government's planned extension of the Banking Executive Accountability Regime (BEAR) across all APRA regulated industries.

APRA says that further appointments to the new structure will be announced in due course.

APRA Chair Wayne Byres said the changes will assist APRA to maintain its focus on protecting the financial well-being of the Australian community, while sharpening focus and lifting capabilities in supervising newer and emerging risks.

[Sources: APRA media release 03/10/2019; APRA organisational chart effective 1 December 2019]

Other Developments

United Kingdom | Expect a different approach? The FRC's new CEO and Chair have taken up their respective roles and have committed to progress the transition to the new regulator (which will replace the FRC)

The UK Financial Reporting Council's (FRC's) new leadership team of Simon Dingemans and Sir Jon Thompson have taken up their respective leadership roles as Chair and CEO. They replace Sir Win Bischoff who steps down as Chair after six years in post and Stephen Haddrill who steps down as CEO after nine years leading the FRC.

They join the regulator as the transition to a new regulator — the Audit, Reporting and Governance Authority (ARGA) — progresses, following Sir John Kingman's independent review.

Simon Dingemans was previously Chief Financial Officer of GlaxoSmithKline and Sir Jon Thompson was previously Chief Executive of HMRC.

The FT reports that Mr Dingemans has said that he intends to run a 'very different' regulator, 'I want to see much greater challenge, focus and pace from the FRC as we move to establish [the new regulator] and deliver this important reform programme…Success will also need delivery at pace of the legislation to give us the powers we need. We will be working closely with the department for business to achieve this' he is quoted as saying.

[Sources: FRC media release 08/10/2019; [registration required] The FT 09/10/2019]

United Kingdom | Why the delays? Delays in progressing SFO cases largely come down to a failure to consistently implement existing processes according to HMCPSI report

An inspection by Her Majesty's Crown Prosecution Service Inspectorate (HMCPSI) into the arrangements the UK Serious Fraud Office (SFO) has in place to ensure the timely progression of cases has found there is a need for improvement, and more particularly a need to ensure greater consistency in the way in which processes are implemented in practice to support swift case progression.

Commenting on the report, HM Chief Inspector Kevin McGinty, said, 'There are undoubtedly ways the SFO can improve but, for the most part, it already has in place the frameworks within which the necessary improvements can be achieved. It would be wrong to read this report negatively and from the view that the SFO is ineffective: it is not. Getting staff to comply with process and be consistent, for line management to be more effective and for there to be better and more effective quality control will go a long way to tackle the recommendations set out in this report.'

[Sources: Her Majesty's Crown Prosecution Service Inspectorate media release 08/10/2019; HMCPSI report: Case Progression in the Serious Fraud Office; [registration required] The WSJ 09/10/2019]

In Brief | On track? IOSCO has released a Thematic Review report which concludes that most of the participating jurisdictions have implemented the necessary rules aimed at preventing the mis selling of complex financial products consistent with IOSCO standards

[Sources: IOSCO media release 27/09/2019; Thematic Review report]

Financial Services

Insurance

Revised and enforceable insurance code of practice (with new sanctions for breach) on the way?

The Australian reports that after three years of stakeholder engagement, and in response to the findings of the Financial Services Royal Commission, the final version of a revised insurance industry code of practice will be put to the board of the Insurance Council of Australia (ICA) on 31 October.

Changes? Reportedly, the changes to the code include: a) a 'plain English rewrite'; b) a new focus on vulnerable consumers (eg a focus on increased protections for consumers who are mentally ill, experiencing family violence); c) enhanced financial hardship provisions and standards for investigators; and d) sanctions for breach of code provisions.

ASIC approval: Reportedly, the ICA board will seek Australian Securities & Investments Commission (ASIC) approval of the new code and will take into account that legislation around code enforceability is expected next year.

Timing? The Australian quotes an ICA spokesperson as saying that 'subject to board approval, the ICA is expected to announce that the new code will be launched in 2020 with a 12-month implementation on most provisions for all signatories…A provision requiring signatories to have a family violence policy will have a six-month transition period.'

[Note: The planned revisions referred to above appear to respond to the Recommendations 4.9 (Enforceable Code Provisions), and 4.10 (Extension of the sanctions power) by the Financial Services Royal Commission.

Recommendation 4.9 recommends that in line with recommendation 1.15, the law should be amended to provide for enforceable provisions of industry codes and for the establishment and imposition of mandatory industry codes. In respect of the Life Insurance Code of Practice, the Insurance in Superannuation Voluntary Code and the General Insurance Code of Practice, the Financial Services Council, the Insurance Council of Australia and ASIC should take all necessary steps, by 30 June 2021, to have the provisions of those codes that govern the terms of the contract made or to be made between the insurer and the policyholder designated as ‘enforceable code provisions’.

Recommendation 4.10 recommends that the Financial Services Council and the Insurance Council of Australia should amend section 13.10 of the Life Insurance Code of Practice and section 13.11 of the General Insurance Code of Practice to empower (as the case requires) the Life Code Compliance Committee or the Code Governance Committee to impose sanctions on a subscriber that has breached the applicable Code. For a discussion of the reasoning behind these recommendations see: Financial Services Royal Commission Final Report volume 1 at pp310-316. The recommendations are at pp 316.]

[Source: [registration required] The Australian 15/10/2019]

Is the insurance policy delivering value for money? Reportedly, ASIC is expected to release its report into total and permanent disability insurance and life cover in the coming months

The SMH reports that the Australian Securities and Investments Commission (ASIC) will release its review of total and permanent disability (TPD) insurance and life insurance in the coming months. Reportedly the review is expected to compare direct insurance and group cover and consider whether they offer 'value for money' for consumers. In addition, the review will reportedly assess whether default, opt-out insurance inside superannuation delivers value to members.

The SMH quotes ASIC Commissioner Danielle Press as saying that regulator's focus is on whether the cost of policies is justified. 'It's about how much you are paying for insurance and is it a good-quality policy' Ms Press reportedly said.

[Source: The SMH 13/10/2019]

CommInsure charged with 'hawking' offences in connection with phone sales of life insurance products

The Australian Securities and Investments Commission (ASIC) has announced that The Colonial Mutual Life Insurance Society Ltd (trading as CommInsure, a wholly owned subsidiary of the Commonwealth Bank of Australia (CBA)) has been charged with 87 alleged contraventions of the anti-hawking provisions of the Corporations Act 2001 (Cth).

The Commonwealth Director of Public Prosecutions is prosecuting the matter.

ASIC allegations

The allegations relate to allegedly unsolicited telephone sales of life insurance policies (known as Simple Life) made by a telemarketing firm (Aegon Insights Australia Pty Ltd) engaged by CommInsure during the period October and December 2014.

ASIC alleges that CommInsure provided customer contact details to Aegon from CBA's existing customer database.

ASIC alleges that the calls to CBA customers were unsolicited, and that CommInsure did not comply with all of the hawking exceptions in section 992A(3) of the Corporations Act.

The maximum penalty for each of the charges is 125 penalty units ($21,250), so it potentially faces a total penalty of $1.859 million.

Next steps?

The matter has been listed for the first mention on 19 November 2019 at the Downing Centre Local Court in Sydney.

CBA response?

In a short statement, acknowledging the proceedings CBA said that CommInsure self-reported breaches of anti-hawking provisions to ASIC and that the proceedings follow an ASIC investigation. The statement also confirms that the practice to which the proceedings relate ceased in 2014.

The statement goes on to say that CBA and CommInsure are considering the matter and CBA does not intend to comment further at this time.

Consumer Action Law Centre says that the charges underline the need for law reform

In a statement, the Consumer Action Law Centre (CALC) said the charges underscore the need for urgent law reform to address the consumer detriment caused by hawking. 'Hawking, otherwise known as unsolicited selling, is an outdated practice that is proven to cause harm to Australians who are pressured into purchasing low-value products that they don't want or need. Consumer Action Law Centre has long-been calling for an economy-wide ban on this detrimental practice to protect people from high-pressure sales tactics' CALC said.

Consumer Action CEO Gerard Brody is quoted as saying 'It's great to see the corporate cop prosecute breaches of the law, but today serves as a reminder that our existing laws don't go far enough – they don't

apply to all insurance products, and it's too easy to exploit loopholes'. Mr Brody went on to express support for the government's commitment to implement the recommendations of the Financial Services Royal Commission to address the issue. 'Commissioner Hayne recommended a clear and comprehensive ban on hawking of insurance products to prevent this harm. We welcome the government's commitment to implement this recommendation, and in light of today's criminal charges the Morrison Government must urgently legislate to put an end to the unsolicited sales of all financial products. A ban on unsolicited selling should actually go across all goods and services—we shouldn't be harassed by companies calling to sell us stuff we haven't asked for' Mr Brody said.

Context

Financial Services Royal Commission recommendations: The Final Services Royal Commission's final report includes recommendations that the hawking of superannuation products (3.4) and insurance products (4.1) be prohibited. The government's latest 'implementation roadmap' which sets out proposed timeframes for implementation of the government's response to the Financial Services Royal Commission's recommendations indicates that the government plans to consult on and introduce legislation to implement its response to recommendations 3.4 and 4.1 by 30 June 2020.

Proposed ban on direct telephone sales: ASIC consulted — CP 317 Unsolicited Telephone sales of direct life insurance and consumer credit insurance — on a proposed a total ban on direct telephone sales of life insurance and consumer credit insurance in July. Consultation closed on 29 August. For a summary of ASIC's proposal see: Governance News 24/07/2019.

[Sources: ASIC media release 04/10/2019; CBA media release 04/10/2019; Consumer Action Law Centre media release 04/10/2019; [registration required] The AFR 04/10/2019; [registration required] The Australian 04/10/2019; The ABC 04/10/2019]

APRA has proposed directions to integrate new accounting standard AASB 17 into the prudential framework and has sought feedback from insurers on their level of preparedness

On 27 September, The Australian Prudential Regulation Authority (APRA) issued a letter outlining its proposed directions for integrating AASB 17 Insurance Contracts into the prudential capital and reporting frameworks for insurers and an update on the policy development timeline.

Submissions on the indicative directions are due by 22 November 2019.

Information request: APRA also requested information from all insurance entities on their preparedness for AASB 17. Insurers are asked to complete the information request electronically, and provide a response to APRA by 8 November 2019.

APRA has called for insurers not to wait: 'APRA expects insurers to be actively planning for the implementation of AASB 17, including managing the risks arising from the transition to AASB 17 and considering how the implementation and requirements of AASB 17 may impact on their capital position. APRA's engagement with industry, and the accounting and the actuarial professions has highlighted that comprehension of AASB 17 is still developing and implementation challenges are not yet thoroughly understood. However, insurers should not defer implementation preparation until there is full certainty regarding both the accounting and prudential regulatory treatments' the letter states.

Publication of insights from the information request: APRA writes that the insights from APRA's information request will be communicated to industry in early 2020, enabling insurers to benchmark their implementation progress against peers and the wider industry. The insights will also inform APRA's supervisory engagement and assist in identifying areas of focus to be pursued with insurers.

[Source: APRA Letter: Information request and consultation on directions for integration of AASB 17 insurance contracts into the capital and reporting framework for insurers 27/09/2019]

Implementing FSRC recommendation 4.2: Consultation on the proposed removal of the exemption for funeral expenses policies

Key Takeouts

- Draft regulations and legislation proposing to remove the Corporations Act exemption for funeral expenses policies (ie proposing to treat funeral expenses the same as other financial products) has been released for consultation.
- The proposed changes implement the government's response to Financial Services Royal Commission recommendation 4.2
- Benefits of the changes? The Treasurer said that the regulations will improve consumer outcomes by requiring providers of funeral expenses policies to hold an Australian Financial Services Licence (AFL) and be fully regulated by the Australian Securities and Investments Commission (ASIC).
- Other impacts? In addition, the Treasurer said that providers of funeral bonds, who operate under the exemption, will also be required to hold a licence. The regulations, however, will not require funeral directors to hold a licence when distributing a funeral bond in conjunction with the arrangement of a prepaid funeral, cremation, or burial service.
- Consultation on the proposed changes closes on 18 October. The government's latest implementation roadmap for implementing the Commission's recommendations indicates that the government intends to consult on and introduce legislation to implement recommendation 4.2 by the end of 2019

Context: Recommendation 4.2 of the Financial Services Royal Commission's final report recommended the removal of carve outs for funeral expenses policies. More particularly, the report recommended that the law should be amended to: a) remove the exclusion of funeral expenses policies from the definition of 'financial product' in the Corporations Act 2001 (Cth); and b) 'put beyond doubt that the consumer protection provisions of the ASIC Act apply to funeral expenses policies'.

Consultation on implementing the government's response

Treasury is consulting on draft regulations and legislation to implement this recommendation:

- **draft regulations** — [exposure draft] Financial Services (Improved Consumer Protection) (No. 1) Regulations 2019: funeral expenses facilities — to remove the exemption for funeral expenses policies from the definition of financial products for the purposes of the Corporations Act 2001
- **draft legislation** — [exposure draft] Financial Services (Improved Consumer Protection) (No. 1) Bill 2019: funeral expenses facilities — to ensure that it is clear that the consumer protection provisions of the Australian Securities and Investments Commission Act 2001 apply to funeral expenses policies. The Bill proposes to amend the Australian Securities and Investments Commission Act 2001 and Corporations Act 2001 to ensure that it is clear that the consumer protection provisions of the Australian Securities and Investments Commission Act 2001 apply to funeral expenses policies.

The draft regulations and legislation seek to enhance the accountability of funeral expenses policy providers by ensuring they act efficiently, honestly and fairly and abide by the financial service licence requirements in the Corporations Act. Providers of funeral expenses policies will also be subject to anti-hawking obligations.

Announcing the consultation, Treasurer Josh Frydenberg said the removal of the funeral expenses exemption 'will ensure that consumers have appropriate protections when taking out funeral expense policies to help fund the costs associated with a funeral'. Mr Frydenberg added that 'in particular, the government is acting on the evidence presented by Commissioner Hayne that many indigenous people living in regional and remote communities are being misled and pressured into funeral expenses policies'.

Commenting on the operation of the proposed changes, the Treasurer said that though providers of funeral bonds, who operate under the exemption, will be required to hold a licence, funeral directors will not be required to hold a licence when distributing a funeral bond in conjunction with the arrangement of a prepaid funeral, cremation, or burial service.

Timeline: The deadline for submissions is 18 October.

[Note: The government's latest 'implementation roadmap' setting out proposed timelines for implementation of its response to the Financial Services Royal Commission recommendations indicates that that the government intends to consult on and introduce legislation to implement recommendation 4.2 by the end of 2019. See:

Financial Services Royal Commission Implementation Roadmap. For a summary, see: Governance News 21/08/2019]

[Sources: Treasury media release 01/10/2019; [exposure draft] Financial Services (Improved Consumer Protection) (No. 1) Bill 2019: funeral expenses facilities; [exposure draft] Financial Services (Improved Consumer Protection) (No. 1) Regulations 2019: funeral expenses facilities; Exposure Draft Explanatory Memorandum; Exposure Draft Explanatory Statement]

ASIC is consulting on a proposal for using its product intervention power to address the 'significant consumer detriment' it considers results from the sale of financial products 'added on' to the sale or lease of a motor vehicle sold through caryard intermediaries

ASIC consultation | CP 324 Product intervention: The sale of add-on financial products through caryard intermediaries

The Australian Securities and Investment Commission (ASIC) is consulting on a proposal for using its product intervention power to address the 'significant consumer detriment' it considers results from the sale of financial products 'added on' to the sale or lease of a motor vehicle sold through caryard intermediaries.

Some Key Points

- **Why so narrow? Five reasons to focus on add-on products sold through caryard intermediaries:** ASIC is consulting specifically on sales of add-on products in this distribution channel for the following reasons: 1) there is broad, well-understood and continuing consumer detriment; 2) the market is characterised by the sale of multiple products (unlike sales of most other add-on products that are offered individually); 3) sales often take place face to face, creating opportunities for the use of unfair sales tactics or processes that exploit behavioural biases or other elements through direct pressure on the consumer (and because the salesforce is geographically diverse, supervision has been limited with low levels of sanctions imposed by product providers, notwithstanding the systemic poor sales practices identified by ASIC); 4) the cost of the premium is often paid through the related finance contract for the purchase or lease of the vehicle, making it easier for providers to make passive or unengaged sales and to charge high or uncompetitive prices; and 5) sales are largely made by intermediaries rather than by the insurer dealing directly with the consumer, with a consequent risk of unsuitable sales being driven due to commissions payable to the intermediary.
- **Significant consumer detriment?** The consultation paper outlines the significant consumer detriment that ASIC considers has resulted, and is likely to result, from add-on insurance products (based on ASIC's findings in three 2016 reports: REP 470: Buying add-on insurance in car yards; REP 471: The sale of life insurance through car dealers: taking consumers for a ride; and REP 492: A market that is failing consumers: The sale of add-on insurance through car dealers). Table 2 of the consultation paper (p14) summarises the findings of each of the reports. Despite some improvements, ASIC says that it considers the products continue to cause consumer detriment.
- **ASIC's proposals?** 1) the introduction of a deferred sales model to apply to sales of add-on insurance products and warranties by caryards (other than comprehensive or compulsory third party (CTP) insurance and manufacturers' warranties provided with new cars); 2) imposing additional obligations such as the use of 'knock out' questions to prohibit sales where the product has low or no value and prohibiting the sale of warranties that provide low levels of cover (where the maximum amount that can be claimed is $2000 or less); and 3) if a product intervention order is made, ASIC proposes to collect data from insurers and warranty providers to enable it to monitor whether the interventions are operating as intended.
- **ASIC says that the proposed actions complement the concurrent Treasury consultation** on a proposed model to implement Hayne Commission's recommendation that an industry-wide deferred sales model be implemented for all add-on insurance products (Recommendation 4.3)
- **Timeline:** The deadline for submissions is 12 November 2019.

[Note: ASIC has previously used its product intervention power to ban a model of lending in the short term credit industry which has been found to cause significant consumer detriment (see: Governance News 13/09/2019). On 20 September, the affected party, Cigno Pty Ltd (Cigno) applied for judicial review of the decision. This is covered in a separate post in this issue of Governance News.]

[Sources: ASIC media release 01/10/2019]

Superannuation

Independent review of the retirement income system announced

Assistant Minister for Superannuation, Financial Services and Financial Technology Jane Hume and Treasurer Josh Frydenberg have jointly announced an independent review of the retirement income system. The review was recommended by the Productivity Commission in their report Superannuation: Assessing Efficiency and Competitiveness.

[Note: Recommendation 30 of the Productivity Commission report recommends an independent inquiry into the retirement incomes system: 'The Australian Government should commission an independent public inquiry into the role of compulsory superannuation in the broader retirement incomes system, including the net impact of compulsory super on private and public savings, distributional impacts across the population and over time, interactions between superannuation and other sources of retirement income, the impact of superannuation on public finances, and the economic and distributional impacts of the non-indexed $450 a month contributions threshold. This inquiry should be completed in advance of any increase in the Superannuation Guarantee rate'. For a summary of the report recommendations see: Governance News 16/01/2019]

Scope of the Review

[Note: The statement includes the terms of reference in full. The terms of reference can be accessed here.]

The review will consider the current state of the system and how it will perform in the future as Australians live longer and the population ages. It will establish a fact base of the current retirement income system that will improve understanding of its operation and the outcomes it is delivering. The review will look at the three pillars of the existing retirement income system: 1) the Age Pension; 2) compulsory superannuation and 3) voluntary savings.

The Review will identify: a) how the retirement income system supports Australians in retirement; b) the role of each pillar in supporting Australians through retirement; c) distributional impacts across the population and over time; and d) the impact of current policy settings on public finances.

No increase in the pension age/family home not to be included in the pension asset test? The Australian reports that the Treasurer has confirmed the review will not result in an increase in the pension age. In addition, he reportedly confirmed that the family home would not be included in the aged pension assets test.

No plans to abandon incremental increases? The Australian comments that there is reportedly pressure from some liberal backbench MPs for the government to scrap the legislated increase in the compulsory superannuation guarantee. Reportedly the Treasurer has said that the government has no plans to abandon the incremental increases to 12% by 2025, starting with a rise to 10% in 2021.

The review will be conducted by an independent three person panel

- The review will be Chaired by Mr Michael Callaghan AM PSM, a former Executive Director of the International Monetary Fund and a former senior Treasury official.
- The two panellists joining Mr Callaghan are: Ms Carolyn Kay, who has more than 30 years' experience in the finance sector across roles both in Australia and overseas, including as a member of the Future Fund Board of Guardians, and Dr Deborah Ralston, who is a Professorial Fellow in Banking and Finance at Monash University, a member of the RBA's Payments System Board and most recently chair of the Alliance for a Fairer Retirement.

Timing? A consultation paper will be released in November 2019 and the final report provided to government by June 2020.

[Sources: Treasurer Josh Frydenberg, Assistant Minister for Superannuation, Financial Services and Financial Technology Jane Hume joint media release 27/09/2019; [registration required] The Australian 28/09/2019]

Response to the announcement?

- In a statement welcoming the review, and the members appointed to conduct it, **Financial Services Council (FSC)** CEO Sally Loane said that the review should not delay important reforms that the government has already committed to that will significantly improve consumer outcomes in superannuation

including the introduction of a 'default once' framework to prevent unintended multiple accounts and legislating an obligation for trustees to consider the retirement needs of their members. In addition, the FSC said that it would strongly advocate the following positions during the review process: a) the Government should retain its policy of increasing the Superannuation Guarantee to 12%; b) superannuation laws should be simplified, and red tape in the sector should be removed including barriers to rationalising legacy products; and c) 'there is no need for further tax increases on superannuation, because our system, as measured against OECD standards, is not unfairly beneficial to higher income earners'.

[Sources: FSC media release 03/10/2019]

- In a joint statement **Shadow Treasurer Jim Chalmers, Shadow Minister for Families and Social Services Linda Burney and Shadow Assistant Treasurer and Shadow Minister for Financial Services Stephen Jones** said that the Federal Labor party will 'engage with the review as appropriate'. The statement also called on the government to 'rule out the possibility' that the 'review will become a stalking horse for cutting the pension, including the family home in the pension asset test, and further delaying the legislated increase in the Superannuation Guarantee to 12 per cent'.
- In an open letter, advocacy group **Women in Super** called for the Treasurer to amend the terms of reference for the inquiry to include a focus on improving retirement outcomes for women. Women in Super Chair Cate Woos said that while the terms of reference are broad, an explicit focus on women's retirement outcomes was needed to ensure that the Review did not miss an important opportunity to address the gender retirement gap.

[Sources: Shadow Treasurer Jim Chalmers, Shadow Minister for Families and Social Services Linda Burney and Shadow Assistant Treasurer and Shadow Minister for Financial Services Stephen Jones media release 27/09/2019; Women in Super media release 14/10/2019]

Parliamentary Committee to scrutinise the superannuation sector over two days of public hearings as part of its ongoing review of the four major banks and other financial institutions

The House of Representatives Standing Committee on Economics will scrutinise the superannuation sector over two days of hearings in Canberra on 21 and 22 November 2019, as part of its ongoing review of the four major banks and other financial institutions.

The following funds (and industry body, the Association of Superannuation Funds of Australia) are scheduled to appear before the Committee

21 November 2019	Australian Super, IOOF, Suncorp, Q Super, Nulis Nominees Australia, REST, Hostplus
22 November 2019	Industry Super Australia, IFM Investors, Association of Superannuation Funds of Australia, AMP Super (AMP Group)

The Chair of the committee, Mr Tim Wilson MP said that 'as the superannuation system is a significant mechanism enabling Australians to support themselves in retirement, it is crucial that the superannuation sector is operating effectively, fairly and to the benefit of fund members'.

The committee's examination of the groups will include monitoring the sector's progress on implementing relevant recommendations from the Financial Services Royal Commission.

[Note: The Treasurer asked the Standing Committee on Economics to Review Australia's Four Major Banks and other Financial Institutions on 1 August 2019. The sectors that will be reviewed are the: four major banks, the superannuation sector, smaller banks, the financial advice sector and the insurance sector. The Terms of Reference are available on the Review homepage here.]

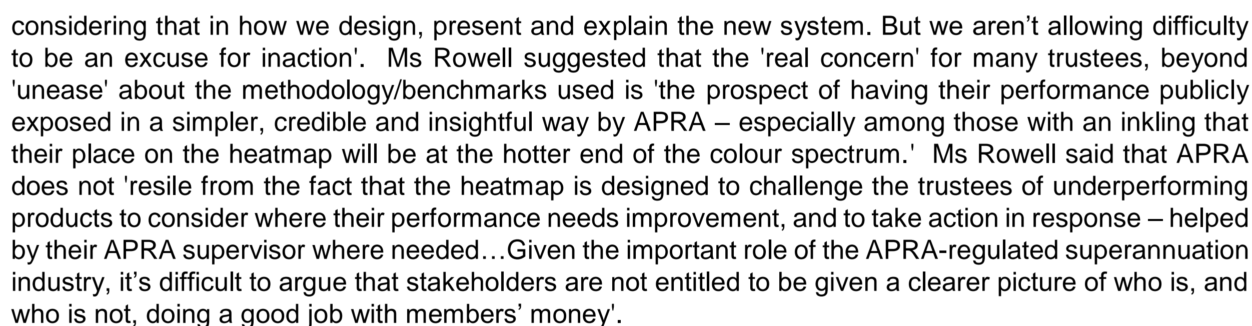
[Source: House of Representatives Standing Committee on Economics media release 10/10/2019]

'You can expect to feel a degree of discomfort': APRA Deputy Chair Helen Rowell's speech to the AIST cautioned superannuation trustees that APRA's increased focus on the superannuation sector will mean superannuation trustees should expect to feel a 'degree of discomfort'

In her address to the Australian Institute of Superannuation Trustees (AIST), Australian Prudential Regulation Authority (APRA) Deputy Chair Helen Rowell called on superannuation funds to embrace change, including increased transparency about fund performance, given the potential opportunities doing so could provide.

Some Key Points

- **Trustees can expect to feel a 'degree of discomfort' given APRA's increased focus on the superannuation sector:** Ms Rowell said that after 12 months of scrutiny, trustees face a period of substantial change in light of the findings of multiple inquiries which have recommended a range of reform of the sector. In making this observation, Ms Rowell also noted that APRA has also not escaped criticism with the productivity commission, the Hayne Commission and the Capability Review also recommending reform, including sharper focus on superannuation and more particularly member outcomes by the regulator. She said that in implementing these reforms, 'APRA will again raise the bar for trustees' and that this will entail a 'degree of discomfort' for trustees. In addition, she said that 'it also provides opportunities for trustees to improve: to strengthen their operations and, most of all, to deliver better outcomes for their members'.
- **Obligation for trustees to 'lift their game':** Ms Rowell all trustees should be well progressed towards the implementation of SPS 515 Strategic Planning and Member Outcomes from 1 January next year. The measures in SPS 515 — in particular, the legislated member outcomes assessment and APRA's Business Performance Review (BPR) — are intended, Ms Rowell said, to raise awareness among trustees of where they sit in comparison with the rest of the industry and relevant benchmarks. Ms Rowell observed that 'For some trustees, the path to self-discovery will be a confronting one, as it becomes clear they are responsible for funds, products and options that are underperforming, and therefore have an obligation to lift their game or exit the playing field' adding that where areas of underperformance are identified SPS 515 requires trustees to take steps to address them. Mrs Rowell cautioned that 'those that are unwilling or unable to rise to the challenge will find APRA intensifying the pressure to improve the member outcomes they deliver – and we have new tools and powers that we can exercise to make clear that change is not optional'.
- **Publication by APRA of heatmaps — the methodology is yet to be finalised but heatmaps will not be limited to a single overall product level assessment:** Ms Rowell said that the measure that has attracted the most attention APRA's plan to publish heatmaps (or traffic light information) providing the regulator's assessment of performance in terms of: investments, fees and costs, sustainability and (in due course) insurance, for all MySuper products expanding to choice and options over time. Ms Rowell added that APRA is in the process of finalising the details of the methodology and measures that will be used for the heatmap and how the information will be presented. She added that the heatmap will 'not include a single, overall product level assessment. Rather, the heatmap will display performance across a range of metrics in the areas of investments and fees and costs, and provide indicators of trends in sustainability measures'.
- **The 'heatmaps' are intended as a starting point only:** Ms Rowell said that the heatmap is intended to be a starting point for member outcomes and performance assessment and that trustees will be expected to build on the heatmap and consider a broader range of metrics appropriate to their operations, and to also consider performance at a cohort level. 'As we've said in our guidance supporting SPS 515, assessment at the product level may mask performance issues at the cohort level' Ms Rowell said. In addition, Ms Rowell said that the heatmap would inform APRA's 'supervisory intensity and approach, together with the rich sources of additional quantitative data available, and also the qualitative information and analysis we derive from our supervision activities'.
- **Response to 'vocal pushback against the publication of 'heatmap' information?** Ms Rowell said that it is 'disappointing to us that the prospect of APRA presenting already publicly available data with its own lens on performance is generating a considerable amount of vocal pushback'. Ms Rowell went on to say that APRA's aim in publishing the data in the proposed format 'is to find the optimum balance between presenting the data so that it can be understood by a broad audience, but is not so simplified as to be meaningless or misleading. We are well aware of the scope for misuse and misrepresentation and are



considering that in how we design, present and explain the new system. But we aren't allowing difficulty to be an excuse for inaction'. Ms Rowell suggested that the 'real concern' for many trustees, beyond 'unease' about the methodology/benchmarks used is 'the prospect of having their performance publicly exposed in a simpler, credible and insightful way by APRA – especially among those with an inkling that their place on the heatmap will be at the hotter end of the colour spectrum.' Ms Rowell said that APRA does not 'resile from the fact that the heatmap is designed to challenge the trustees of underperforming products to consider where their performance needs improvement, and to take action in response – helped by their APRA supervisor where needed…Given the important role of the APRA-regulated superannuation industry, it's difficult to argue that stakeholders are not entitled to be given a clearer picture of who is, and who is not, doing a good job with members' money'.

- **APRA to focus on collecting more 'granular superannuation data':** Ms Rowel said that one 'legitimate complaint' about the heatmaps is that they will not in the first instance, cover the choice sector (though this is something APRA intends to rectify once it starts expanding its superannuation data collection with sufficiently reliable and high-quality data on this sector. Ms Rowell said that APRA is 'embarking on a substantial uplift in both the breadth and granularity of the data we collect. As APRA Chair Wayne Byres noted last month, requests from regulators for more information tend to produce complaints about regulatory burden, but the current data collection has been deemed insufficient, and so the status quo is not an option'. Ms Rowell went on to reiterate Mr Byres' comment that 'if in this day and age a trustee cannot reliably, accurately and quickly provide information on assets, returns, fees and costs for all their products across a range of dimensions…one wonders how they will meet heightened standards for assessing the outcomes being delivered for their members.'
- **Other areas of focus for APRA, 'which should therefore also be top of mind for boards':** Ms Rowell said that in addition to the issues identified above, will also be focusing on trustee board capabilities and culture, risk governance, conflicts of interest, accountability and remuneration through thematic reviews, stronger prudential standards and a 'range of supervisory activities'. 'In each area we will be looking to see evidence that frameworks and policies are effectively implemented and delivering effective outcomes. That too should be the focus of you as trustees – what are the proof points that demonstrate that to you, and also to APRA? Remember the well-coined phrase: "show me, don't tell me!"' she said.

[Source: APRA Deputy Chair Helen Rowell - Speech to the Australian Institute of Superannuation Trustees Chairs Forum 14/10/2019]

New factsheet for investors: ASIC has urged investors considering establishing their own SMSF to consider whether it's the right option for them

The Australian Securities and Investments Commission (ASIC) has released a factsheet: Self-managed superannuation funds: Are they for you? to assist investors in assessing whether an SMSF is appropriate for them and highlighting the potential downsides. ASIC suggests that it will also be relevant for financial advisers when providing personal advice on SMSFs.

Why has the factsheet been issued

ASIC considers that though consumers are 'all too well aware of the potential benefits' of SMSFs they are 'not equally alive to the considerable risks and responsibilities that come with the deal'.

ASIC Commissioner Danielle Press emphasised that though SMSFs may be an attractive option for investors wanting more control over their superannuation investment strategy, they require 'real skill, care and diligence…SMSFs are not for everyone simply because not everyone can meet the significant time, costs, risks and obligations associated with establishing and running one.'

Ms Press added that ASIC research has previously identified eight 'red flags' (or indicators) of when it is 'extremely unlikely' that an investor would gain a financial advantage from using an SMSF. 'Where people have limited investment decision-making experience or prefer to delegate decision-making to someone else, they should carefully consider if an SMSF is right for them. As the trustees of their own fund, SMSF investors must remember that they are responsible for their fund's compliance with the law, even if they pay a professional to help,' Ms Press said.

Next steps: ASIC says that the fact sheet will be sent to all newly registered SMSF trustees as a pilot in November, when they register with and elect to be regulated by the Australian Taxation Office. ASIC will then survey a number of the SMSFs to assess the usefulness of the fact sheet.

[Sources: ASIC media release 11/10/2019; ABC 11/10/2019]

Proposed remake of sunsetting Unclaimed Money and Lost Members regulations released for consultation

The existing Superannuation (Unclaimed Money and Lost Members) Regulations 1999 are scheduled to sunset on 1 April 2020. Treasury has released exposure draft regulations — [exposure draft] Superannuation (Unclaimed Money and Lost Members) Regulations 2019 — for consultation with the aim of ensuring the ongoing operation of the lost and unclaimed money regime for certain superannuation amounts.

Additional regulations — [exposure draft] Repeal Regulations — to repeal the existing regulations are also being consulted on. These regulations repeal the 1999 regulations upon the commencement of the 2019 regulations should that occur before the scheduled sunsetting date of 1 April 2020.

Two 'Substantive changes'?

In addition to 'minor technical changes' to reflect current drafting practice/changes to numbering of sections, Treasury highlights the following as 'substantive' proposed changes from the existing regulations.

1. Proposed new provisions prescribe conditions of release whereby an account will not be an inactive low balance account and therefore will not be payable to the Commissioner of Taxation if the member has met one of the conditions specified.
2. Interest will apply to the payment of unclaimed amounts in relation to inactive low balance accounts.

Timeline: Consultation on the draft regulations closes on 25 October.

[Sources: Treasury media release 30/09/2019; [exposure draft] Superannuation (Unclaimed Money and Lost Members) Regulations 2019; [exposure draft] Repeal Regulations; [exposure draft] explanatory statement; [exposure draft] explanatory statement repeal regulations]

Other Developments

Implementing FSRC recommendation 2.4 Grandfathered Commissions: Legislation that will end grandfathered conflicted remuneration payments to financial advisers has passed both houses

Key Takeouts

- Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019 passed both houses on 14 October
- Under the legislation grandfathered conflicted remuneration will be banned from 1 January 2021 and product issuers will be required to rebate the amounts to consumers

In a joint statement, Treasurer Josh Frydenberg and Assistant Minister for superannuation, financial services and financial technology announced the passage of legislation — Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019 — which implements the government's response to Financial Services Royal Commission recommendation 2.4 Grandfathered Commissions.

[Note: Financial Services Royal Commission recommendation 2.4 recommended that grandfathering provisions for conflicted remuneration should be repeals 'as soon as is reasonably practicable'. See: Financial Services Royal Commission final report, vol 1 at pp185]

Timing: Under the legislation, grandfathered conflicted remuneration will be banned from 1 January 2021 and product issuers will be required to rebate the amounts to consumers.

Lower fees: The statement says that consumers will benefit from lower fees following the passage of the legislation. 'Grandfathered conflicted remuneration can compromise the quality of advice as financial advisers may be unwilling to switch consumers into newer, better products if it means the adviser will lose their entitlement to grandfathered conflicted remuneration. Ending grandfathering will also benefit consumers as

they will no longer have to pay higher fees that are needed to fund the payment of conflicted remuneration to an adviser' the statement reads.

ASIC directed to report: The statement adds that to 'support' the legislation and to 'facilitate the transition' the government has directed the Australian Securities and Investments Commission (ASIC) to report on the extent to which product issuers are acting to end the grandfathering of conflicted remuneration in the period between 1 July 2019 and 1 January 2021.

Response to the passage of the legislation

In a statement welcoming the passage of the Bill, the Financial Services Council (FSC) CEO Sally Loane said that the FSC has been consistent in its support for ending grandfathered conflicted remuneration payments. 'The FSC will continue working with government and relevant stakeholders to help ensure the effective implementation of the Royal Commission's recommendations, set out in the government's roadmap [for implementing the Financial Services Royal Commission recommendations], and that the arrangements reached are workable for business.'

[Sources: Joint media release: Assistant Minister for superannuation , financial services and financial technology and Treasurer Josh Frydenberg 15/10/2019; FSC media release 15/10/2019]

'Accelerating' implementation of FSRC recommendation 2.10: A new disciplinary system and single disciplinary body for financial advisers to be established by 2021

Treasurer Josh Frydenberg has announced the government's decision to accelerate the establishment of a new disciplinary system and single disciplinary body for financial advisers as recommended by the Financial Services Royal Commission.

[Note: Recommendation 2.10 of the Financial Services Royal Commission recommendations recommended that the law should be amended to establish a new disciplinary system for financial advisers that: requires all financial advisers who provide personal financial advice to retail clients to be registered; provides for a single, central, disciplinary body; requires Australian Financial Services Licence (AFSL) holders to report 'serious compliance concerns' to the disciplinary body; and allows clients and other stakeholders to report information about the conduct of financial advisers to the disciplinary body. The government's latest implementation 'roadmap' for implementing the Commission's recommendations indicates that the government intends to consult on legislation to implement recommendation 2.10 by the end of 2020. See: Governance News 21/08/2019]

Details

- **New body established by 2021:** Mr Frydenberg said that the government will work towards establishing the new body in early 2021, subject to the passage of legislation which will be introduced into the Parliament next year. He added that the new body, which he described as a 'long term sustainable solution' will replace the role of code monitoring bodies due to be established by industry associations under professional standards reforms.
- **A Code of Ethics will be applied by law from 1 January 2020**, and financial advisers will be expected to meet the code's high ethical standards. Australian Financial Services Licensees (AFSL holders) will also be required to take reasonable steps to ensure their representatives comply with the code. The Australian Securities and Investments Commission (ASIC) will be able to take action against licensees that fail to do so.

Mr Frydenberg added that ASIC is considering the steps it needs to take to ensure that licensees do not breach the law by not registering advisers with a code monitoring body and will provide an update shortly.

Mr Frydenberg said that the changes will not impact clients who seek access to redress through the Australian Financial Complaints Authority (AFCA).

Next steps?

Mr Frydenberg said that the Treasury will 'immediately' begin engaging with industry associations, consumer representatives and other stakeholders to consult on the new system and that roundtables will be held later this year to consider policy design and transition arrangements.

[Source: Treasurer Josh Frydenberg media release 11/10/2019]

Response

The Australian reports that financial advisers have criticised the government's decision to establish a single disciplinary body. The Stockbrokers and Financial Advisers Association reportedly said it was disappointed with the decision to move away from the code-monitoring model.

[Source: [registration required] The Australian 14/10/2019]

Related News: ASIC to provide relief from compliance scheme obligations

ASIC announced on 15 October that it will make a legislative instrument to provide relief to AFS licensees from financial adviser compliance scheme obligations following the government's announcement (see above).

ASIC said that it is taking action as, following the government's announcement, compliance scheme applicants withdrew their applications to ASIC for approval of their schemes with the result that the compliance scheme regime, 'will not be able to proceed at this time'.

ASIC will grant a three-year exemption to all AFS licensees from the obligation in the Corporations Act 2001 to ensure that their financial advisers are covered by a compliance scheme, and from the associated notification obligations.

ASIC notes that AFS licensees will still be required to take reasonable steps to ensure that their financial advisers comply with the code from 1 January 2020, and advisers will still be obliged to comply with the code from that date onwards. ASIC says that it may take enforcement action where it receives breach reports.

Next steps? ASIC says that licensees do not need to take any action at this time. ASIC will make a public announcement when the legislative instrument providing the exemption takes effect.

[Source: ASIC media release 15/10/2019]

ACCC investigation into interest rate pricing on residential mortgages announced

The Treasurer has directed the Australian Competition and Consumer Commission (ACCC) to undertake an 'immediate' inquiry into the supply of residential mortgages, including banks' refusal to pass on in full, recent interest rate cuts, to consumers.

Scope of the inquiry

- **Primarily focus on big banks?** The inquiry will inquire into the supply of residential mortgages including into home loans supplied by authorised deposit taking institutions, and non-bank lenders. The ministerial direction states that the inquiry should have 'particular regard to the activities of those with the largest shares of outstanding home loans by market value'. This appears to the source of assertions in media reports that the primary focus will be on the big four banks.
- **The focus will be on the period since January 2019 and the response by the banks to rate cuts** made during that period (which have resulted, according to media reports, in the cash rate being reduced by a total of 75 basis points)
- **The inquiry will have a wide range of focus and will cover a number of issues** including: 1) how banks make pricing decisions for residential mortgages (taking into account such factors as the bank's borrowing costs and their profit margins); 2) the extent to which the prices paid by new and existing customers differ (the 'loyalty tax'); and 3) whether there are impediments to consumers switching to cheaper home loans and if there are, what action could be taken to address it.
- **The ACCC says that it will consult closely with financial regulators** such as the Reserve Bank of Australia, the Australian Prudential Regulatory Authority (APRA), and the Australian Securities and Investments Commission (ASIC).
- **By holding an inquiry under Part VIIA of the Competition and Consumer Act (2010), the ACCC can use compulsory information-gathering powers** to gather information from financial institutions including their decision making documents.

Context

ACCC says that the inquiry will build on the Residential Mortgage Inquiry (the final report delivered 11 December 2018 is accessible on the ACCC website here) and the inquiry into foreign exchange services.

Timeline?

The ACCC will release a preliminary report by the end of March 2020, with a final report due 30 September 2020. According to media reports, the preliminary report is expected to deliver findings on pricing decisions related to rate cuts as well as the loyalty tax. The final report is expected to include findings into impediments to switching banks.

Announcing the inquiry, Treasurer Josh Frydenberg said that it supports the government's commitment to promoting competition and good consumer outcomes in the residential mortgage market. He added that the government has provide the ACCC with $13.2 million of dedicated funding to undertake regular inquiries into specific competition issues within the financial system.

ABA response

In a short statement in response to the announcement of the inquiry, the Australian Banking Association (ABA) said that 'Australia's banks stand ready to assist the ACCC in this inquiry. Banks are no stranger to public scrutiny and look forward to the opportunity to cast more light on mortgage pricing and the many important factors that influence the setting of interest rates'.

[Sources: ACCC media release 14/10/2019; ACCC home loan price inquiry: ACCC direction — home loan price inquiry 14/10/2019; Treasurer Josh Frydenberg media release 14/10/2019; ABA media release 14/10/2019; [registration required] The AFR 14/10/2019; [registration required] The Australian 14/10/2019]

House Economics Committee to scrutinise the smaller banks for the first time: Public hearing to be held on 29 November

The House Standing Committee on Economics will scrutinise the smaller banks — Macquarie, Bendigo and Adelaide Bank, Bank of Queensland, Suncorp, Citi — and the Australian Banking Association (ABA) at a public hearing in Canberra on 29 November 2019

Noting that it will be the first time the smaller banks have appeared before the inquiry, Chair of the committee, Mr Tim Wilson said 'the committee's scrutiny will include examining the banks' progress in implementing the recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.'

He added that 'given widespread misconduct in banking and financial services identified by the Hayne Royal Commission, it is important that the smaller banks and the Australian Banking Association are held accountable to ensure that they are making the crucial improvements needed to restore trust in the sector.'

[Source: House of Representatives Standing Committee on Economics media release 14/10/2019]

Ineffective (or not)? ASIC is seeking public views on school banking programs

ASIC Consultation | CP 323 School Banking Program Review

The Australian Securities and Investments Commission (ASIC) is seeking the public's view of school banking programs as part of its ongoing review of their use and impact in primary schools.

The purpose of the review is to: a) understand how school banking programs are implemented and how they are marketed to school communities; b) understand how students are engaging with the programs and the accounts established through these programs while they are at school and after they leave school; c) assess the benefits and risks of school banking programs; and d) develop principles for appropriate conduct and good practice in the implementation of school banking programs. In addition, ASIC says that it will consider the transparency of the implementation of the programs.

School banking programs are not directly regulated by ASIC

Though ASIC does not directly regulate school banking programs, it does regulate the deposit accounts which must be opened in order for a student to participate in the programs. 'The ADIs that issue these deposit accounts must comply with their Australian financial services (AFS) licence obligations under s912A of the Corporations Act 2001, including the requirement to provide financial services efficiently, honestly and fairly'.

ASIC's role in building financial capability

ASIC is the lead Australian Government agency for financial capability, consistent with its strategic priority and statutory objective to promote confident and informed consumers and investors.

Announcing the consultation ASIC Commissioner Sean Hughes said, 'Young people are engaging with money every day and they need to understand financial concepts and develop the skills to identify financial services that are right for them. Financial literacy is embedded in the Australian Curriculum, and needs to be – and there is a long history of school banking programs in Australian schools. It is important for ASIC to understand the range and extent of impacts that school banking programs can have on students, parents and school communities, as part of our responsibility to ensure the financial sector is delivering for all Australians, and especially for future generations of financial consumers.'

ASIC-commissioned research raises questions about the value of school banking programs

The consultation follows the results of an ASIC-commissioned report into attitudes to school banking which raised questions about the efficacy of school banking programs.

Among other things, the research found 'limited evidence among past students that school banking programs have a lasting impact on their saving behaviour'. The research also found that past-participants recall of the program is often limited to the 'ritual involved'.

In addition, the research found that school banking increases the chances of a participating student remaining with the bank that provided the program into adulthood. Findings also suggest that nonparticipating students were also likely to remain with the same bank they banked with as a child.

Nine questions

ASIC is seeking responses to nine consultation questions.

1. **Perceived benefits of school banking programs**: Do you consider there are or may be benefits to students opening and maintaining bank accounts through a school banking program?
2. **Perceived drawbacks of school banking programs:** Do you consider there are or may be drawbacks to students opening and maintaining bank accounts through a school banking program?
3. **Delivery of educational benefits not otherwise provided by the curriculum:** Financial literacy education is embedded in the Australian Curriculum. Do you believe that school banking programs provide beneficial educational opportunities not available through the curriculum?
4. **Concerns:** Do you have concerns about financial institutions marketing to young primary school students?
5. **Negative consequences of ceasing the programs:** Do you consider there are or may be negative consequences if financial institutions no longer offer bank accounts to students through school banking programs?
6. **Support for the programs:** Do you support financial institutions offering bank accounts to students through school programs?
7. **Suggested improvements:** Are there changes that could be made to how school banking programs operate, to improve students' understanding of money and the importance of saving (such as incorporating more digital elements)?
8. **Other information:** Is there any other information you would like to provide that may enable us to better understand how school banking programs operate and to provide high-level principles on the delivery of school banking programs
9. **Guidance for education authorities/schools:** If you are a school or an education authority, what policies or processes guide you when deciding whether to engage with school banking (or similar) programs?

Timing: The deadline for submissions is 31 October 2019. ASIC says that it expects that the review will be completed in early 2020.

[Sources: ASIC media release 30/09/2019; Consultation page; Consultation Paper 323 School Banking Program Review]

Response?

The SMH quotes consumer group Choice's consumer advocate, Jonathan Brown, as saying that ASIC's research confirms anecdotal evidence that the programs are of limited efficacy. 'We've heard from parents across the country who are fed up with their children being targeted as future customers…ASIC's new research shows that these bank marketing programs have little evidence they work [in improving financial literacy]' Mr Brown is quoted as saying.

Noting that the CBA's dollarmites program is the most widespread of the school banking programs (though Bendigo Bank has a similar program) the SMH quotes an unnamed CBA spokesperson as saying that the CBA has a 'strong and respected track record of providing quality financial education programs in Australia and is always looking at ways to improve our financial education programs…As we stated in October 2018 [when the ASIC review was first announced], we welcome ASIC's review into school banking programs in primary schools and have been working with the regulator to provide information on our financial education programs'.

[Sources: The SMH 30/09/2019; [registration required] The Australian 30/09/2019]

APRA has proposed new measures to strengthen capital protection for bank depositors

In a consultation paper released on 15 October, the Australian Prudential Regulation Authority (APRA) proposed changes to Prudential Standard APS111 Capital Adequacy: Measurement of Capital (APS 111) which establishes the criteria for ADI's regulatory capital requirements. The regulator says that the revisions are aimed at ensuring that 'Australian deposit holders continue to be protected when the major banks hold significant investments in subsidiaries'.

A markup of the proposed changes to APS 111 is available on the APRA website here.

Proposals

- increasing the capital ADIs must hold to offset concentrated exposures to foreign or domestic banking or insurance subsidiaries;
- reducing the capital ADIs must hold to offset smaller exposures to banking or insurance subsidiaries;
- incorporating into the prudential standard various rulings and technical information APRA has published since APS 111 was last substantially updated in 2013; and
- aligning APS 111 with updated guidance from the Basel Committee on Banking Supervision.

APRA says that the effect of these proposals will be to 'increase the amount of equity required to support investments in large subsidiaries and reduce that for small subsidiaries'. As such, the proposed changes are aimed at balancing the benefits of revenue diversification that banks can achieve by owning subsidiary operations against the potential concentration risk that arises as these investments increase in size.

APRA says that the proposed changes are 'in part shaped' by the Reserve Bank of New Zealand proposal for New Zealand's banks to materially lift their regulatory capital as this would impact Australia's major banks as owners of New Zealand's four largest banks. In a statement announcing the consultation, APRA says that it held discussions with the RBNZ regarding its proposed revisions to APS 111.

APRA Deputy Chair John Lonsdale commented that the 'proposed measures seek to support the resilience of the major banks' Australian operations. In relation to New Zealand, there are a number of options available to the banks. If they decide to fund any higher capital requirements by retaining local profits, they are unlikely to require additional capital domestically. Both APRA and the RBNZ will continue to maintain an open dialogue as we work to strengthen the resilience of our respective financial systems and protect the interests of depositors in each country'.

Timeline: APRA intends to finalise changes to APS 111 after the consultation period closes on 31 January 2020. The updated prudential standard is expected to come into force from 1 January 2021.

[Sources: APRA media release 15/10/2019; Discussion paper - Revisions to APS 111 Capital Adequacy: Measurement of Capital; Mark up: draft changes to Prudential Standard APS 111]

In Brief | APRA is supportive of increased competition in the banking market (and therefore of challenger banks) but will not compromise standards says APRA General Manager, Regulatory Affairs and Licensing Melisande Waterford. 'Put simply: we want to encourage innovation; to welcome new entrants into the industry; to support competition. But we don't want to lower our standards and create risks for deposit-holders in order to do so….It's worth reminding ourselves that the statutory obligation to obtain a licence before commencing banking business is intended by design to act as a barrier to entry. There's a very good reason why only people with a pilot's licence are allowed to fly an aeroplane. And there's an equally good reason why no-one is allowed to simply set themselves up as a bank and start taking deposits. We believe that taking deposits is a weighty responsibility, and we are unapologetic about setting high standards for people who wish to do so' she said

[Source: APRA General Manager, Regulatory Affairs and Licensing Melisande Waterford - Speech to the Future Banking Forum 2019 09/10/2019; [registration required] The AFR 09/10/2019; BrokerNews 10/10/2019]

In Brief | The Reserve Bank of New Zealand has affirmed its climate strategy through the investment of US $100 million of green bonds. The investment was made via the Bank for International Settlements' USD Green Bond Investment Pool (BISIP G1) and funded from its foreign reserves portfolio

[Source: Reserve Bank of New Zealand media release 27/09/2019]

Accounting and Audit

United Kingdom | The FRC has released a revised and strengthened 'going concern' auditing standard

Following consultation, the UK Financial Reporting Council (FRC) has issued a revised going concern standard in response to recent enforcement cases and what it described as 'well-publicised corporate failures' in which auditor reports failed to highlight concerns about the prospects of entities which collapsed shortly after.

[Note: The response to the consultation is available on the FRC website here]

Revised standard

The revised standard (ISA UK 570 Going Concern) follows concerns about the quality and rigour of audit and increases the work auditors are required to do when assessing whether an entity is a going concern. The new standard requires UK auditors to follow 'significantly stronger requirements than those required by current international standards'.

More particularly, the revised standard requires:

- more work on the part of the auditor to more robustly challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence, evaluate the risk of management bias, and make greater use of the viability statement
- improved transparency with a new reporting requirement for the auditor of public interest entities, listed and large private companies to provide a clear, positive conclusion on whether management's assessment is appropriate, and to set out the work they have done in this respect
- a stand back requirement to consider all of the evidence obtained, whether corroborative or contradictory, when the auditor draws their conclusions on going concern

[Sources: FRC media release 30/09/2019; New standard: ISA (UK) 570 Going Concern (revised September 2019)]

In Brief | The Financial Reporting Council (FRC) has commenced an investigation into the audit by EY of the financial statements of Thomas Cook Group Plc (Thomas Cook) for the year ended 30 September 2018. Thomas Cook went into compulsory liquidation on 25 September. Reportedly, if EY is found to

have provided unsatisfactory auditing it could face a fine of up to £10m, with the potential for both disciplinary hearings and the banning of at-fault accountants

[Sources: FRC media release 01/10/2019; Accountancy Age 01/10/2019; [registration required] The FT 25/09/2019]

In Brief | Strong public support for a stronger regulator? The UK Financial Reporting Council (FRC) has released the results of research conducted by BritainThinks, into public views on the regulation of corporate reporting, corporate governance and audit by the FRC and how this could be improved

[Source: FRC media release 02/10/2019]

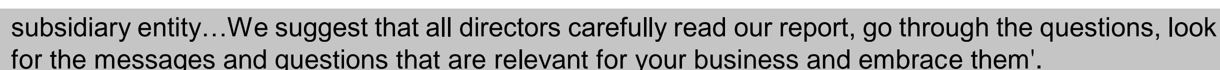
Risk Management

A 'useful roadmap' for improving director and officer oversight of non-financial risk? ASIC Corporate Governance Taskforce report released

Report Overview | ASIC Report 631: Corporate Governance Taskforce — Director and officer oversight of non-financial risk report

Key Takeouts

- The report identifies what ASIC describes as 'important shortcomings' with respect to management of non-financial risk in corporate governance practices in the large listed entities.
- The report should be read alongside other relevant reports: ASIC says that the observations and insights in the report are intended to sit alongside market guidance, industry-specific requirements and other relevant reports such as: 1) the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations; 2) APRA's Prudential Standards; 3) the APRA CBA Inquiry Report; 4) the APRA Information Paper: Self-assessments of governance, accountability and culture; 5) the Financial Services Royal Commission's Final Report.
- The report made four key findings: 1) board oversight of non-financial risk is 'immature' and less developed than ASIC hoped to find – 'all too often, management was operating outside of board approved risk appetites' due to insufficient board oversight; 2) reporting against risk appetite often did not effectively communicate the company's risk position (ie risk appetite statements were not utilised well — the quality and content of the statements is only 'developing' with the articulation of risk and metrics 'nowhere near as mature or effective as those for financial risk'; 3) reporting to boards on non-financial risk is ineffective (because material information about non-financial risk is often buried in voluminous and dense reports); and 4) ASIC considers that board risk committees are underutilised with the time spent/frequency of meetings 'modest'.
- Responsibility for oversight lies with boards: ASIC Chair James Shipton emphasised that 'boards must recognise that they are accountable for mitigating all risks – financial and non-financial – facing a company'.
- A separate independent report prepared by Kiel Advisory Group was commissioned by ASIC to supplement the work of the broader review. The report identifies mindsets and behaviours common to all the boards reviewed that were helpful to the oversight of non-financial risk as well as those that presented 'challenges'. ASIC suggests this may be useful for boards in identifying their own behavioural style to enable them to maximise the effectiveness of that style.
- ASIC has confirmed that it does not propose to put behavioural experts in every boardroom on an ongoing basis.
- Broader application: ASIC Chair James Shipton called on all boards generally, not just those in the financial services sector, to review governance practices and accountability structures in light of the findings. The report includes a series of questions that ASIC asks boards to consider. Though drafted with large and listed companies in mind, ASIC suggests that they have broader application, serving as 'guidance for boards of any company large or small, listed or unlisted, for profit or not, or a holding or



subsidiary entity…We suggest that all directors carefully read our report, go through the questions, look for the messages and questions that are relevant for your business and embrace them'.

The Australian Securities and Investment Commission (ASIC) has released the Corporate Governance Taskforce's report into the corporate governance practices of Australia's large listed companies.

The report outlines ASIC's observations on director and officer oversight of non-financial risk, considers how directors and officers of large and complex financial services companies are discharging their duties in relation to oversight and monitoring of non-financial risk, and highlights ways that governance practices could be improved.

The report is based on direct review of seven large financial institutions — AMP Limited; Australia New Zealand Banking Group Limited (ANZ); Commonwealth Bank of Australia (CBA); Insurance Australia Group Limited (IAG); IOOF Holdings Limited; National Australia Bank Limited (NAB); and Westpac Banking Corporation — 60 interviews with directors and officers, an extensive documentation review, and external resources.

Identifying problems before they become breaches

In a speech launching the report, ASIC Chair James Shipton said that the Corporate Governance Taskforce is one of two new principal supervisory initiatives underway aimed at improving the practices of regulated entities and addressing the 'root causes of problems before they cause significant harm'.

Mr Shipton explained that ASIC chose to focus on director and officer oversight of non-financial risk because of ASIC's responsibility to regulate the duties of directors and officers under the Corporations Law. The report is aimed primarily, he said at 'assisting directors adhere to their important obligations, discharge their profound responsibilities and ultimately for boards to be more effective. What clearly emerged from our work is that where there were deficiencies in process and governance, we nevertheless see that there are concrete and achievable steps that can be taken by boards and management to fix or mitigate them. Indeed, some of the companies we studied have already made good progress in doing so.'

Focus of the review was on compliance risk

ASIC says that it adapted the definition of non-financial risk used by the Australian Prudential Regulation Authority (APRA) in its prudential review of the CBA, to cover more than just prudential institutions.

The definition used includes: 1) operational risk – the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events and includes legal risk but excludes strategic and reputational risk; 2) compliance risk – the risk of legal or regulatory sanctions, material financial loss, or loss to reputation an organisation may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organisation standards and codes of conduct applicable to its activities; and 3) conduct risk – the risk of inappropriate, unethical or unlawful behaviour on the part of an organisation's management or employees.

ASIC's primary focus was on compliance risk as the primary risk through which director and officer oversight of non-financial risk was observed. ASIC observes non-financial risks, 'although called non-financial, may lead to very significant financial loss if they are not well managed'.

Four Key Findings

Broadly speaking, the report makes four key findings.

1. Board oversight of non-financial risk is 'immature' and less developed than ASIC hoped to find

ASIC observed that 'all too often, management was operating outside of board approved risk appetites' in relation to compliance risk, and non-financial risk more generally, for extended periods. 'For several companies, it was the norm – not the exception – to operate outside risk appetite for non-financial risk. This is in stark contrast to the position for financial risk' ASIC observes.

2. Reporting against risk appetite often did not effectively communicate the company's risk position

The Taskforce considered how risk appetite statements (RASs) are being used as a tool to assist boards in overseeing and monitoring non-financial risk. Overall, the report concludes that:

- risk appetite and accompanying metrics for non-financial risk were immature compared to those for financial risk. ASIC Chair James Shipton observed that 'too often the metrics for non-financial risk only covered particular and discrete issues so they would be unlikely to provide boards with a representative picture of where the company sat in respect to non-financial risk more broadly' and further that there is 'significant reliance' on 'lag indicators' such as past compliance, which he said are not necessarily accurate in predicting emerging risk
- management is operating outside board-approved risk appetites for non-financial risk for months or years at a time, without, Mr Shipton observed 'any serious attempt by boards to rein them in. Boards were not actively holding management nor themselves to account for prolonged failures to operate within the risk parameters the board itself had determined.'
- metrics designed to measure risk often failed to provide a representative sample to the board of the level of risk exposure, and did not allow accurate benchmarking to the board's stated appetite
- board engagement with the RAS was not always evident

3. Reporting to boards on non-financial risk is ineffective

Likewise, the report found that that information flows from management to the board and from board committees to full boards are less than optimal largely because material information about non-financial risk is often buried in voluminous and dense reports. More particularly, the report found:

- material information about non-financial risk was often buried in dense, voluminous board packs – boards did not own or control the information flows from management to the board to ensure material information was brought to their attention. 'The average pack provided to the board risk committees in the companies we studied was 300 pages long!' Mr Shipton observed.
- management reporting often did not identify a clear hierarchy or prioritisation for non-financial risks
- care needed to be taken to ensure undocumented board sessions and informal meetings between directors didn't create asymmetric information at board level
- information flows between board committees and full boards were sometimes informal and ad hoc.

4. ASIC considers that board risk committees are underutilised with the time spent/frequency of meetings 'modest'.

The operation of Business Risk Committees was found to be ineffective. More particularly, the report found that:

- There was little evidence in minutes of directors actively engaging with the substance of proposals submitted by management or information reported to them, in terms of offering alternative viewpoints or driving action by management. While the report states that minutes are not the sole source of evidence of the extent of directors' stewardship, it nevertheless flags that the minutes reviewed do not support an argument that directors were exercising active stewardship.
- The timing and frequency of BRC meetings was generally modest considering they are the board's 'workhorses' in relation to risk
- Material risk issues were often escalated in an informal and unstructured manner outside regular committee meetings.
- There is a trend toward full board attendance at BRC meetings (instead of a subset of board members). However, directors were rarely made formal members of the committee, creating the risk of disenfranchising board members through lost voting rights, and entrenching reduced information flows to the full board.
- Mr Shipton questions 'why the board risk committee isn't being used more effectively to triage and prioritise non-financial risks and, particularly to consider the root causes of key risks'.

Minutes: What approach should entities take? The Report appears to endorse the recent joint statement on minutes issued by the Australian Institute of Company Directors and the Governance Institute (see:

Governance News 07/08/2019) stating that 'Boards should review this joint statement against their own minute-taking practices, including for closed sessions, to ask themselves: Do our minutes adequately capture key discussion points, reasons for decisions and significant issues raised with management?'

(Some) 'green shoots'?

Though the report finds that overall, more needs to be done to improve oversight/management of non-financial risk it does identify some positive examples of 'better practice in the oversight of risk'. These include: the use of management level non-financial risk committees to raise the visibility of risks and go on to assist the board in their oversight of them; and the minutes of key issues by board committees that are automatically referred to other committees (ensuring that the transfer of this important risk information in complex companies is not solely reliant on cross committee membership).

A 'useful roadmap' to better practice? Suggested questions for all boards to consider

ASIC says that the observations in the report have relevance for all boards. 'We recognise that companies outside the financial services sector often face different and unique non-financial risks; however, it is wrong to suggest that only the boards of financial services companies should make non-financial risks a priority. The observations and insights in this report can be applied across sectors. We urge the boards of all large ASX-listed companies to read this report and ask themselves the questions posed throughout'.

Launching the report, Mr Shipton characterised it as a 'very useful roadmap' for improving oversight of non-financial risk.

[Note: The questions referenced above are listed in Appendix 1 at p53 of the report which is available on the ASIC website here.]

Behavioural review: ASIC-commissioned report, Influence of board mindsets and behaviours on effective non-financial risk oversight

Attached to the report is a separate report, commissioned by ASIC and carried out by Kiel Advisory Group, into how behaviour and behavioural dynamics between boards can influence oversight of non-financial risk.

Based on mindsets and behaviours observed to be common to all the boards reviewed that were helpful (or which presented challenges) to the oversight of non-financial risk, the report identifies and describes the characteristics of four different 'archetypes or models' of behaviour.

Commenting on this, Mr Shipton said that 'There is no right or wrong type of archetype or behaviour. Different dynamics in the board environment will produce different strengths and weaknesses. The challenge is to be conscious of those dynamics, and the different models, and to work to amplify the good aspects and avoid the bad.' He added that ASIC considers the report to be a 'helpful resource for boards in identifying their own behavioural style so that they can maximise the effectiveness of that style' and will supplement a 'growing trend behavioural experts being engaged in internal board effectiveness reviews'.

Mr Shipton made clear that there is no plan to insert behavioural experts into boardrooms on an ongoing basis. 'And to debunk any myths, we don't propose to put behavioural experts in every boardroom on an ongoing basis. Nevertheless, we do feel such inputs into a report like this has been very beneficial, and, most importantly will be helpful to you as directors' he said.

[Sources: Speech by ASIC Chair James Shipton at the Australian Institute of Company Directors, Essential Director Update, Launch of ASIC's report on director and officer oversight of non-financial risk *02/10/2019*; *ASIC report 631*; *Executive Summary*; *Kiel Advisory Group report: Influence of board mindsets and behaviours on effective non-financial risk oversight; [registration required] The AFR 02/10/2019; 02/10/2019; Mortgage Business 08/10/2019]*

APRA Chair Wayne Byres has underlined APRA's focus on transforming governance, culture, remuneration and accountability (GCRA) in financial institutions

Key Takeouts

- **Stronger (and more prescriptive) standards are needed:** As APRA looks to strengthen its prudential framework, and increase its effectiveness, 'it is inevitable they will become at least in places, more prescriptive'.

- **Proposed changes to remuneration standard — come up with something better?** The proposed changes to APRA's remuneration standard are an example of APRA's new approach. Commenting that most groups have found 'something to seriously dislike' about the proposed changes, Mr Byres 'challenged' those engaging in the debate to provide the regulator with an alternative, given the 'status quo' is unacceptable. Mr Byres went on to say that change could be achieved either through change in industry practice or through more prescriptive APRA standards, noting that though a shift in industry practice (without more prescriptive standards was preferable) 'the evidence suggests that 'change in industry practice' will be very difficult, if not impossible, without some form of regulatory backing'.
- **Other proposed changes to standards?** Mr Byres flagged industry should expect revisions to CPS 510, CPS 520, CPS 220 and the extension of the BEAR regime (along the same lines as the proposed changes to the remuneration standard).
- **'Sharpened supervisory practice':** APRA is considering requiring companies to make annual GCRA declarations, perform periodic self-assessments and submit to independent CBA-style inquiries.
- **Increased transparency:** APRA says that its intent is to 'actively share' its findings and insights in relation to GCRA with the industry and the wider public, at the very lease 'we foresee routinely making public reports on all thematic reviews and the risk governance self-assessments (including identifying the institutions that are demonstrating better or poorer practice), insights from our risk culture deep dives and, wherever possible, reports from Prudential inquiries and similar investigations'.

The focus of Australian Prudential Regulation Authority (APRA) Chair Wayne Byres' speech to the Australian Banking Association National Economic Series was on outlining APRA's four-year plan with respect to transforming governance, culture, remuneration and accountability in financial institutions.

Some Key Points

Achievement of APRA's goal involves three components: 1) strengthening the prudential framework; 2) sharpening supervision of GCRA; and 3) increased transparency (sharing insights/findings with industry and the broader community).

Ultimate responsibility rests with the board

Mr Byres emphasised that notwithstanding APRA's 'increasing intensity of GCRA supervision, APRA's supervisory philosophy remains firmly founded on the premise that the ultimate responsibility for the prudent management of a financial institution rests with its board and management. That is not changing. However, the intensity of our oversight, and our preparedness to compel rectification action, is certainly increasing. This is essential for both strengthening the resilience of financial institutions and restoring community trust in the financial system as a whole'.

Strengthening the prudential framework

Mr Byres said that to date, APRA's principles based standards have 'not been as effective as they need to be in promoting robust governance, healthy corporate cultures, appropriate remuneration outcomes, and clear accountability' and that in consequence, as the standards are reviewed 'it is inevitable they will become at least in places, more prescriptive'.

Proposed changes to the remuneration requirements

Mr Byres cited APRA's proposed new remuneration requirements as an example of the regulator's new approach, noting that APRA has had 'no shortage of feedback' on the changes. Commenting that most groups have found 'something to seriously dislike', Mr Byres 'challenged' those engaging in the debate to provide the regulator with an alternative 'that isn't just the status quo' which is unacceptable. Mr Byres went on to say that change could be achieved either through change in industry practice or through more prescriptive APRA standards, and that change is industry practice was preferable but observed that 'the evidence suggests that 'change in industry practice' will be very difficult, if not impossible, without some form of regulatory backing'.

[Note: APRA is currently consulting on plans to strengthen prudential requirements for remuneration across all APRA-regulated entities in the banking, insurance and superannuation industries and issued a proposed draft prudential standard on remuneration (CPS 511) and discussion paper in July. Submissions close on 23

October 2019. APRA has said it intends to release the final prudential standard (CPS 511) before the end of 2019, with a view to it taking effect in 2021 following transitional arrangements. For a summary of the proposed changes see: Governance News 24/07/2019]

Other areas where the prudential framework will be strengthened

- **CPS 510 and CPS 520**: Mr Byres said that APRA plans to update CPS 510 Governance and CPS 520 Fit and Proper to take account of recent experience and international developments. With respect to CPS 510, Mr Byres said that APRA will look to more clearly articulate its expectations of effective board oversight, and empowering supervisors to better identify and act upon boards that are ineffective. Mr Byres emphasised that in 'rethinking CPS 510, our goal will be to not add materially to an already long list of responsibilities and duties [for boards], but rather to consider how we can best equip and enable boards to perform existing roles well'.
- **CPS 220:** Mr Byres said that APRA plans to update CPS 220 Risk Management to ensure it remains fit for purpose. Areas for review include: 1) the effectiveness of board obligations in relation to risk culture; 2) the relative emphasis on financial and non-financial risks; and 3) the need to strengthen requirements in relation to compliance and audit functions.
- **Extension of the BEAR:** In addition, Mr Byres said that the extension of the Banking Executive Accountability Regime (BEAR) beyond the ADI sector and to conduct-related matters as well will result in 'a major strengthening of the regulatory framework'. Mr Byres said that APRA is a strong supporter of this initiative and that it will work closely with Treasury and with the Australian Securities and Investments Commission (ASIC) to deliver on what he described as the government's 'ambitious timetable' for this roll-out.

'Sharpening' supervisory practices: consideration

Mr Byres outlined a 'range of initiatives' designed to 'sharpen' APRA's supervisory practices.

These include the following.

- **Expanding the GCRA team within APRA:** Mr Byres said that APRA will use additional funding to bolster the resources devoted to GCRA-related activities by expanding the central team focused on this area to 'at least 20' and appointing a senior executive at General Manager level to head it. This senior executive will have sole responsibility for 'driving our agenda forward' in this area.
- **New tools being developed:** APRA is developing 'improved and new tools' to assist in identifying, assessing and dealing with shortcomings in GCRA practices. For example, the PAIRS model 'is being completely overhauled' with the objective (among other things) of ensuring GCRA issues are given sufficient weight within overall risk assessments. APRA expects to roll out the new model in the first half of 2020.
- **APRA will also make use of new types of reviews and investigations to examine GCRA practices**. For example, APRA 'envisage making greater use of' GCRA declarations and self-assessments in the supervision framework, building on the existing framework of risk management declarations. This may involve: 1) annual GCRA declarations, along the lines of the declarations provided for risk management under CPS 220 Risk Management; 2) periodic GCRA self-assessments; and 3) independent reviews, to supplement the annual declarations. Mr Byres said that the exact specifications will need to be consulted on as part of the process of strengthening the prudential framework. There will need to be scope to tailor requirements to the nature, size and complexity of regulated entities. He added that 'we agree with the panel that conducted the Capability Review that embedding self-assessments in a structured way into APRA's supervisory processes will lead to a positive and sustained uplift in GCRA practices by all financial institutions. It will also rightly put the onus on institutions to keep these issues under constant review, rather than relying on APRA to identify and call out issues through its own supervision activities'.
- **APRA will continue its supervisory reviews**, to assess GCRA practices within regulated institutions. These will be supported by the development of new supervisory guidance to enable supervisors to better assess, in a more structured manner, GCRA issues with a focus on assessing not only the adequacy of policies and frameworks but also the effectiveness of outcomes. APRA is planning an active program of thematic reviews, led by its central team examining topics including: 1) the role and effectiveness of board

committees; 2) processes undertaken to assess board effectiveness; and 3) the alignment of remuneration outcomes with risk outcomes.

- **CBA style prudential inquiries?** Mr Byres said that where particular concerns are identified at individual institutions, more intensive examination will occur through 'deep dive' reviews of specific areas, possibly drawing on external expertise to assist. Where there is 'material concern about potential widespread deficiencies in GCRA practices, APRA can employ either a Prudential Inquiry, as was conducted for CBA in 2017/18, or a more formal investigation under the relevant industry Act' he said.
- **Partnering with experts** will be an important part of APRA's approach. Some of APRA's increased funding will be deployed to engage external experts, from other regulators, academia and the private sector, both domestically and internationally. Being able to draw on this type of expertise on an 'as needs' basis to assist with reviews and inquiries of individual institutions, and to help plan, challenge and review the findings from our thematic work, is likely to be more effective and efficient than seeking to develop an entirely in-house capability.
- **Utilising technology: Mr Byres emphasised that '**not all expertise need be human. We intend to make use of technology, such as natural language processing, to help target our scarce resources'. For example, Mr Byres said that APRA plans to explore industry surveys, akin to that conducted by the UK Banking Standards Board, to measure and monitor changes in standards of behaviour, competence and culture across the industry. Data analytics capabilities would be deployed to interrogate the responses, and to provide evidence of the extent to which positive changes are (or are not) occurring.

Sharing insights: 'our intent is to actively share our findings and insights in relation to GCRA with the industry and the wider public'

Mr Byres said that APRA agrees with the findings of the recent Capability Review that increased transparency and communication are important tools for driving sound prudential outcomes. In line with this, he said that APRA's goals are to: 1) inform – by explaining APRA's overall supervisory approach, methodology, views and outcomes; 2) influence – by conveying key messages that help to deter poor behaviour, promote better practice and maintain confidence in the Australian financial system; and 3) drive accountability – by holding entities and individuals to account.

Mr Byres said that APRA is 'actively looking to expand the range of material we publish about key areas of supervisory focus (not just in relation to GCRA), and the associated findings' as is evidenced by APRA's recent communications with respect to enforcement actions. 'Our intent is to actively share our findings and insights in relation to GCRA with the industry and the wider public. We will also be examining sorts of information institutions themselves should routinely make public. We are still reviewing all of the options available to us, and of course will need to consult on any new requirements we impose. But at the very least we foresee routinely making public reports on all thematic reviews and the risk governance self-assessments (including identifying the institutions that are demonstrating better or poorer practice), insights from our risk culture deep dives, and, wherever possible, reports from Prudential Inquiries and similar investigations. As we flesh out the specifics of the regulatory and supervisory framework for GCRA, we will see what else can be added to the list' he said.

What does success look like?

In closing, Mr Byres said that the development of APRA's GCRA capabilities is being significantly accelerated and that success will entail: 1) stronger governance frameworks and processes, providing robust oversight of organisational activities; 2) organisational cultures that acknowledge the need for risks (of all types) to be prudently managed, and to deliver outcomes that balance the interests of all stakeholders; 3) remuneration arrangements that reflect a holistic assessment of performance and risk management; and 4) clear accountability (individually and collectively) for outcomes achieved.

[Sources: APRA Chair Wayne Byres' speech to the Australian Banking Association National Economic series: An ambitious agenda 09/10/2019; [registration required] The AFR 09/10/2019; [registration required] The Australian 09/10/2019]

An independent survey of Lloyds' culture has reportedly identified a culture of sexual harassment

The BBC reports that an independent (self-commissioned) survey of the culture at Lloyd's of London, has identified a number of issues. The survey, carried about by the Banking Standards Board, was open to all 45,000 people who work at the marketplace, not just its 800 direct staff, and around 6,000 people participated.

Findings reportedly include:

- 8% of workers reported having seen harassment in the past 12 months
- 22% had seen people in the organisation "turn a blind eye" to inappropriate behaviour
- 25% said they had observed excessive consumption of alcohol at the marketplace during the past year
- One in five said that they did not believe they had equal opportunities at Lloyd's, regardless of gender

Responding to the findings, Lloyd's has said it will take action to address the 'negative actions and behaviours that have for too long gone unspoken and with impunity'. Reportedly these include: a) launching a gender balance plan with 'measurable and achievable targets; b) publishing new standards of business conduct; and c) establishing an advisory group to drive 'cultural transformation'.

[Source: BBC 24/09/2019]

In Brief | The US Equal Employment Opportunity Commission (EEOC) has reportedly found 'reasonable cause' that seven US employers excluded women, older workers or both from seeing their job listings on Facebook through the use of targeted advertising (excluding them) in violation of the Civil Rights Act and the Age Discrimination in Employment Act. The companies will reportedly face court proceedings (if they do not negotiate a settlement with the EEOC)

[Source: Bizwomen 26/09/2019]

Insolvency and Restructuring

The Small Business Ombudsman has announced an inquiry into the insolvency system to be chaired by Senator John Williams, ARITA has reportedly dismissed the inquiry as a 'media stunt'

The Australian Small Business and Family Enterprise Ombudsman (ASBFEO), Kate Carnell has announced an inquiry into the insolvency system, to investigate if current insolvency practices achieve the best possible outcome for small and family businesses in financial trouble.

Announcing the inquiry, Ms Carnell said 'Unfortunately the Banking Royal Commission wasn't asked to look at the role of insolvency practitioners and that was a missed opportunity. We know there is a very low success rate in restructuring Australian businesses under external administration and the impact of the insolvency process is often devastating for the small business owner. Few small businesses that enter formal insolvency administration are able to navigate their way through the process to reach a restructuring agreement. The latest data reveals more than 8,000 businesses entered external administration in 2018/19. Of those, small and family businesses in rural and regional Australia have been among the hardest hit.'

Scope of the inquiry

The inquiry will examine: a) the existing insolvency system through the experience of small business; b) the degree of transparency of the governance, processes and costs of practitioners including legal advisers, valuers, investigating accountants, administrators, receivers and liquidators; c) how the insolvency of a small or family business may lead to bankruptcy for the owners; and d) how the framework impacts the practices and fees of insolvency practitioners.

Reference group established

ASBFEO has established a reference group, chaired by former Senator John Williams, to act as a forum for input and discussion on the challenges faced by small and family businesses facing insolvency. The statement notes that Mr Williams took a lead role in the 2010 Senate Inquiry into the regulation, registration and remuneration of liquidators.

Survey issued: Small and family businesses that have faced financial difficulties and restructured or wound up their business are invited to share their stories by completing a survey available via the ABSFEO website. (The survey is available on the ABSFEO site here).

Timing: An interim report will be released in December with a final report to be handed down in February 2020.

Response to the inquiry

The ABC quotes the Australian Restructuring Insolvency and Turnaround Association (ARITA) CEO John Winter as dismissing the inquiry as a media stunt. 'Given that the chair of the Carnell inquiry, the former senator Wacka Williams, was involved in numerous insolvency-related senate inquiries and failed to drive any positive change to our insolvency regime, we hardly see any value in his role here…The very pretext of the inquiry — seeking to turnaround failed small business — is unfortunately very naive. By the time the vast majority small business reach a decision to appoint an insolvency practitioner, they are generally well beyond saving' Mr Winter is quoted as saying.

Reportedly Mr Winter said ARITA plans to form its own Financial Recovery Law Reform Commission, to be led by an eminent group of commissioners it would appoint to conduct a root and branch review of the insolvency regime.

[Sources: ASBFEO media release 10/10/2019; Mirage News 10/10/2019; ABC 10/10/2019]