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AICD H2 2019 Director Sentiment Index released: director sentiment is at a three year low

Key Takeout: Director sentiment has dropped to a three year low and over 60% of directors expect weakened economic conditions over the next 12 months.

Report Overview | AICD, Director Sentiment Index: Research Findings Second Half 2019

The Australian Institute of Company Directors (AICD) has released its latest biannual Director Sentiment Index. The report is a survey of AICD member opinions and future intentions on a range of issues including the economy, government policy and governance regulations. A high level overview of some of the key findings is below.

[Note: For a summary of the H1 2019 survey results see: Governance News 01/05/2019]

Some Key Points

- **'Awake at night' issues?** Consistent with previous surveys (H1 2018, H2 2018 and H1 2019), sustainability and long term growth prospects continue to be the main issue that keeps directors 'awake at night'. Other concerns include: global economic conditions; legal and regulatory compliance; cybercrime; and structural change/changing business models which are mentioned by at least one in five directors.

(Suggested) top priorities for the government?

- Energy policy, followed by climate change and infrastructure are the top three priorities for the Federal government to address in the short term. By comparison, in H1 2019 the top three priorities were climate change, energy policy and taxation. Taxation slipped to fourth place (behind infrastructure) in H2 2019.

- Consistent with H2 2018 and H1 2019, climate Change was ranked as the top long term priority for the federal government to address. This was followed by energy policy and infrastructure, a shift from H1 2019 when infrastructure and the ageing population were ranked as the next most important long term priorities.

Regulation

- 'Red tape' is expected to increase: Directors continue to feel pessimistic regarding the level of 'red-tape' in the next 12 months, with 42% expecting it to increase. The AICD comments that this is a 'significant improvement' on H1 2019 when 59% expected to see an increase in red tape over the coming year.

- Directors are slightly more willing (as compared with H1 2019) to continue on boards/accept new board appointments, though they continue to feel pessimistic about the impact of legislation on director liability. According to the survey:

    1. 50% of directors feel legislation on directors' liability has negatively impacted their willingness to accept new board appointments, a slight decrease on H1 2019 when 52% felt this was the case.

    2. 40% of directors feel it has negatively impacted their willingness continue on boards (down from 43% in H1 2019)

    3. 36% of directors feel it negatively impacts their business decision making, a slight increase on H1 2019 (when 35% of directors indicated this was the case, and on H2 2018 when 33% of directors felt 5this was the case).

- **Top three factors influencing director willingness to serve on a board?** 86% of directors believe that the contribution they make to the economy and society positively influences their willingness to serve on a board. The next most influential factors were: the time commitment required (23%) and the remuneration offered (for non-executive directors) 22%. Director liability (based on current legislation) was the most likely factor to negatively impact their willingness to serve on a board with 55% indicating that this was the case.

Economic outlook

- **Director confidence levels:** Overall, director confidence has fallen to a three year low. The overall sentiment in the second half of 2019 remains pessimistic at minus 21.1 down a further 4.3 points on the last survey. The AICD attributes this in the main to a fall in confidence about the economic outlook. Compared to the first half of 2019, directors expect a significant decrease in inflation, the cash interest rate and level of wages growth 37% of directors expect an increase in the unemployment rate in the next 12 months.

- **Outlook for the Australian economy:**

  - Compared to the first half of 2019, the assessment of the Australian economy is significantly more negative. 49% of directors perceive the economy as weak versus 11% as strong (as compared with 23% perceiving the economy to be strong in H1 2019, and 39% in H2 2018).

  - The outlook for the next 12 months is also more negative than the previous survey. 59% of directors expect the economy to be weak over the past twelve months (an increase on H1 2019 where 50% of directors expected the economy to be weak).

  - Outlook at state level: Compared to the previous survey, directors across all states and territories are less optimistic about the economic outlook in their own state/territory. Tasmanian directors are the most optimistic about the health of their state economic with 42% viewing it as either very strong (6%) or strong (36%). Next most optimistic were ACT directors (34%), NSW directors (28%) and Victorian directors (24%). QLD directors were the most pessimistic about the economic outlook for their state with 64% viewing it as either very weak (18%) or weak (46%).

- **Global outlook**: Directors are less optimistic about the health of major global economies over the next 12 months as compared with the first half of the year. Consistent with the previous survey, the European economy is viewed the least favourably with 69% viewing it as weak/very weak (as compared with 62% in H1 2019). The Asian and Chinese economies are viewed most favourably with 24% (in both cases) viewing it as strong/very strong.

  - **Health of the Asian economy:** The assessment of the health of the Asian economy at present remains positive with 28% of directors viewing it as either very strong (2%) or quite strong (26%). However, the outlook for the next twelve months is less positive with less than a quarter or directors (24%) viewing the economy as either very strong (2%) or strong (22%).

  - **Health of the Chinese economy**: The assessment of the health of the Chinese economy has declined compared to the first half of 2019. 30% of directors perceive the Chinese economy as currently strong (4% see it as very strong and 26% see it as quite strong). However, sentiment for the next 12 months is less positive with less than a quarter (24%) of directors rating it as strong.

  - **Health of the European economy**: The assessment of the European economy both at present and in the next 12 months is negative. 63% of directors perceive the European economy as weak (either very weak 8% or somewhat weak 55%). 69% expect it to remain weak in the next 12 months.

- **Health of the US economy**: The assessment of the US economy has declined compared to the first half of 2019. 27% of directors perceive the US economy as presently strong, 48% perceive it to be 'ok' and 25% view it as weak. Sentiment for the next 12 months is negative with 44% expecting it to be weak in the coming year.

- **Key economic challenge facing Australian business?** Consistent with the survey findings in H1 2019, the key economic challenge facing Australian business in H2 2019 was identified as global economic uncertainty (37% of directors indicated 5this as the case up from 27% in H1 2019). This was followed by low productivity growth (23% of directors indicated that this is the case, up from 20% in H1 2019) and China's outlook (21% of directors indicated this is the case down from 24% in H1 2019). Climate change was the fourth highest ranked economic challenge with 21% of directors indicating this is a key concern (down from 23% in H1 2019).

- **Business growth:** Directors continue to have a positive view regarding the growth of their business, with 43% of directors expecting their business to expand over the next 12 months.

- **Encouraging business to increase investment/capital expenditure?** 64% of directors state that an improved economic outlook would encourage their business to increase its level of investment/capital expenditure over the next year , followed by Australian economic policy certainty and enhanced focus on long term returns.

Culture

- **Cultural change remains a focus for the majority of boards:** 89% of directors said that their board is trying to effect change in culture within their organisation (as compared with 91% in H1 2019). 38% said that their board is making a 'substantial effort' to effect to effect change (up from 36% in H1 2019).

- **Australian boards have a risk-adverse decision making culture:** 70% of directors perceive there to be a risk averse decision making culture on Australian boards (unchanged from H1 2019). 34% of directors attribute this to excessive focus on compliance over performance (up from 30% in H1 2019), followed by pressure from shareholders for short terms returns (17%, down from 21% in H1 2019) and lack of genuine diversity in the board room (14% up from 13% in H1 2019).

Board diversity

Consistent with the results of the H1 2018, H2 2018 and H1 2019 surveys, skills diversity remains a priority for boards with 77% (up from 72% in H1 2019) indicating that their board is actively engaged on the issue. 58% of boards said their board is actively trying to increase board diversity (up from 52% of directors in H1 2019) and 40% said that they are actively trying to increase ethnic diversity.

About the survey: The survey was conducted with 1489 AICD members over the period 12-26 September 2019.

Too much red-tape is having an impact? Commenting on the results, AICD Managing Director and CEO Angus Armour said that 'The trend towards over regulation, particularly of listed companies, is having a real impact on the economy. Too much emphasis on compliance obligations is driving a risk-aversion in boardrooms and stifling the ability of boards to drive strategy and innovation.' Mr Armour added that 'to boost productivity and trigger the next phase of economic growth we need to strike the right balance between regulatory obligations and innovation settings.'

Time to consider a new approach to the economy? Citing falling director confidence and the fact that Australian economic growth has slowed to its weakest point since the Global Financial Crisis (GFC), Mr Armour said directors are calling for a new approach. 'With conventional monetary policy now reaching its limits we need to look at other options. Directors have identified increased infrastructure spend and further personal income tax cuts, perhaps by bringing forward already-planned tax measures, as options the Government should prioritise' he said.

[Source: AICD media release 25/10/2019; Director Sentiment Index: Research Findings Second Half 2019; [registration required] The Australian 25/10/2019]

Diversity

Don't know where to start? In response to industry feedback, WGEA has released a toolkit to help organisations improve gender equality efforts

In response to feedback from industry that in some cases, organisations 'don't know where to start' when it comes to progressing efforts to improve gender equality, the Workplace Gender Equality Agency (WGEA) has released a comprehensive gender equality strategy toolkit (GES Toolkit).

The GES Toolkit is in two parts:

1. a diagnostic tool — the Gender Equality Diagnostic Tool — to assist organisations to 'score' their current level of engagement with workplace gender equality; and

2. a strategy guide, which provides instructions and guidance on how best to develop and implement workplace gender equality strategies including suggested metrics for measuring/monitoring progress.

[Sources: WGEA media release 25/10/2019; Gender equality strategy guide; Gender equality diagnostic tool]

In Brief | Sometimes a blunt instrument (quotas) are necessary? Fortune reports that panellists at the Most Powerful Women Summit expressed support for Californian style gender quotas given the lack of progress on board (gender) diversity

[Source: Fortune 21/10/2019]

Remuneration

APRA's proposed changes to remuneration don't go far enough? Consumer groups' joint submission in response to APRA's consultation on proposed changes to executive remuneration called for APRA to go further

[Note: For context, consultation on a proposed new draft Prudential Standard (CPS 511) closed on 23 October. The Australian Prudential Regulation Authority (APRA) has said that it intends to publish a response to submissions and a final prudential standard in late 2019 or early 2020. For a summary of APRA's proposals see: Governance News 24/07/2019]For a summary of APRA's proposed changes see: Governance News 24/07/2019]

A joint submission to the Australian Prudential Regulation Authority's (APRA's) consultation on proposed changes to remuneration requirements for APRA-regulated entities argues that though the proposed changes are an 'important step forward', the changes need to go further in light of the seriousness of the issues identified by the Financial Services Royal Commission.

Among other things, the submission argues that APRA should:

- **prohibit ALL sales-based bonuses:** The submission acknowledges that APRA has mandated that 50% of variable bonuses for executives must be from non-financial metrics but argues that this measure does not go far enough. 'Allowing corporations to still devote half of their variable bonuses to financial metrics will not solve the systemic issues of financial markets' the submission states. The submission argues that APRA should 'go further' by prohibiting all sales-based bonuses. In addition, the submission argues that in light of issues identified by the Hayne Commission, 'balanced scorecards' — which are described as 'a wolf in sheep's clothing' — should be 'made public and in clear English'.

  According to The AFR, Choice policy adviser, Patrick Veyret said that the call to ban sales-based bonuses is focused primarily on executives and decision-makers in financial services entities, though rewarding staff at any level on the basis of the 'single minded pursuit of profit' has led to poor consumer outcomes.

- **ban boards from approving executive bonuses 'when a company has had a significant breach'**: The submission argues that boards are insufficiently incentivised to clawback or block bonuses where misconduct occurs and that to address this, 'APRA must provide clear guidelines that bonuses are not paid to executive if a company has had significant breach of the law'. Further, the submission argues that APRA should 'explicitly acknowledge that other important non-financial metrics be considered by boards when allocating bonuses to executives, including complaints to internal dispute resolution (IDR), external dispute resolution (EDR), and time spent handling complaints'. The submission suggests that the review of ASIC regulatory guide 165 Internal Dispute Resolution Guidance (RG 165) could provide improved data for regulatory oversight with respect to these issues.

[Note: Earlier in the year, the Australian Securities and Investments Commission consulted on proposed new Internal Dispute Resolution standards and reporting requirements to improve the way in which financial firms including APRA regulated superannuation funds, handle consumer and small business complaints. For an overview of ASIC's proposals see: Governance News 22/05/2019]

- **provide more guidance around non-financial metrics** 'that accurately capture when staff members provide safe and well-designed products'. More particularly, the submission argues APRA Prudential Standards should prescribe that financial institutions not rely on the Net Promoter Score (NPS) as a measure of good consumer outcomes. 'Any measure that seeks to capture good consumer outcomes must focus on the quality of product, service or advice provided to consumer, and must consider whether the service provided was in the suitable and fit for purpose. The NPS simply fails to achieve this' the submission argues.

- **mandate independent oversight and approval of remuneration systems:** The submission argues that APRA should 'specify in the Prudential Standards that independent oversight and approval of remuneration systems is required. This includes an independent assessment that non-financial metrics are not tied to sales targets, and actually promote good consumer outcomes. These assessments must be accountable and made public. This is an important step forward to guarantee improved standards in the industry'.

Push-back from industry against the proposed changes? According to The AFR, business leaders including Wesfarmers Chair Michael Chaney and HSBC Bank Australia Chair Graham Bradley have expressed criticism of the proposed 50% cap on the basis that it is too prescriptive. In addition, the AFR reports that retail and proxy investors have also criticised the draft standard. Likewise, The Australian reports that IAG Chair Elizabeth Bryan has questioned APRA's proposed approach as overly prescriptive and uncommercial.

[Sources: Joint submission by Consumer Action Law Centre, Choice, Financial Rights Legal Centre and Super Consumers Australia in response to APRA consultation on remuneration requirements for APRA regulated entities 23/10/2019; [registration required] The AFR 27/10/2019; [registration required] The Australian 26/10/2019]

The IOOF board has said it will consider scrapping short term incentives entirely as part of a broader review of executive remuneration

IOOF released its annual report on 28 October, ahead of the AGM which will be held on 28 November.

Among other things, the remuneration report flags that 2020 will see a number of changes to the way in which remuneration is designed including (among other changes):

- **Considering scrapping short term incentives entirely:** The report states that the Group Remuneration Committee is currently considering removing short term incentives for all KMP [key management personnel]'.
- **Changes to long term incentives:** IOOF expects long term incentives to change to a minimum four year vesting period with a range of financial and non-financial performance measures to be included in vesting conditions. IOOF states that it intends to increase the focus on non-financial performance metrics 'to encourage long-term decision making in the interest of the Group's clients, shareholders and other stakeholders'.

Zero STIs awarded: In addition, the report states that due to share price underperformance, 'no discretionary short term incentives' were awarded to any key management personnel or other senior management personnel for the 2019 year.

[Source: IOOF Annual Report;; [registration required] The AFR 28/10/2019]

Institutional Shareholders and Stewardship

Top Story | Focus on outcomes not policies: 2020 UK Stewardship Code released

Overview | UK Stewardship Code 2020

Key Takeouts

- Following consultation, the UK Financial Reporting Council (FRC) published a revised stewardship code: UK Stewardship Code 2020 (Code) and feedback statement. The Code was last revised in 2012.
- **Changes?** The FRC says that the '2020 Code sets a much higher standard and marks a substantial shift away from boilerplate policy statements, towards a focus on activities (what investors did) and outcomes (what was the result)'. In addition, the new Code has a strong focus on delivery, by signatories, of sustainable long term investment.
- **Six Key Changes** to note:

  1. Redefinition of stewardship: 'Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society'.
  2. Signatories are required to explain their organisation's purpose, investment beliefs, strategy and culture and how these enable them to practice stewardship. They are also expected to show how they are demonstrating this commitment through appropriate governance, resourcing and staff incentives

3. New outcomes focus: signatories are required to report annually on what they have done and what the outcome was, rather than on the generally policy.

4. Expectation that signatories consider environmental, social and governance (ESG) issues (including climate change) in their investment, monitoring, engagement and voting.

5. Signatories are now expected to explain how they have exercised stewardship across asset classes other than listed equity, such as fixed income, private equity and infrastructure, and in investments outside the UK.

6. Extension to asset owners and service providers (eg pension funds and insurance companies, and service providers)Redefinition of stewardship: 'Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society'.

- **Support for the changes?** The FRC says that there was 'strong support' for the key proposals including: a) a focus on reporting activities and outcomes; b) the inclusion of how signatories' purpose and culture support stewardship; c) the extension of scope to asset classes beyond UK listed equity; d) a code that sets expectations for different entities in the investment chain; and e) integration of ESG issues.

- **The Code remains voluntary** but the WSJ suggests that the requirement for asset managers to provide additional explanations if they don't follow the Code is likely to operate as an incentive to do so.

- **Timing?** The new Code takes effect on 1 January 2020. Signatories are required to report annually on their stewardship activity. To be included in the first list of signatories, organisations must submit a final report, in line with the FRC's reporting expectations, to the FRC by 31 March 2021.

Following consultation, the UK Financial Reporting Council has released a revised Stewardship Code (Code).

Announcing the release of the Code, the FRC said that it 'builds on the success of the previous Code, but sets a substantially higher standard, reflecting the changing expectations of investors and the significant developments in sustainable and responsible investment and stewardship since the Code was last revised in 2012'. The FRC's Chair, Simon Dingemans said the new Code 'marks a step-change in the expectations for investors, their advisors, and how they manage investments for their savers and pensioners'.

Some Key changes

Expanded focus/application

The 2012 was primarily directed to institutional investors (asset owners and asset managers) with equity holdings in UK listed companies. The revised 2020 Code is explicitly directed at asset owners and managers and at service providers with separate principles for each group.

Signatories are also now expected to explain how they have exercised stewardship across asset classes beyond listed equity, such as fixed income, private equity and infrastructure, and in investments outside the UK.

Reporting: Shift away from 'boilerplate' reporting — 'show me' don't tell me

Signatories to the 2012 Code were required to publish a statement (policy statement) describing how they applied each of the seven principles and where one or more principles were not applied, an explanation as to why. The 2012 Code provided that signatories were 'encouraged' to review policy statements annually and to update them where necessary to reflect changes in actual practice.

One of the recommendations made by the Kingman Review (Recommendation 42) was that a revised code 'should focus on outcomes and effectiveness, not on policy statements…If the Code remains simply a driver of boilerplate reporting, serious consideration should be given to its abolition.'

[Note: For a summary of the Kingman Review recommendations — Independent Review of the Financial Reporting Council (FRC) led by Sir John Kingman (Kingman Review) — see: Governance News 16/01/2019]

The 2020 Code requires signatories to report annually on stewardship activities and its outcomes (every principle has reporting requirements under the headings activity and outcome). The FRC explains that under the 2020 Code 'signatories reports are required to "show" what has actually been done in the previous year, and what the outcome was, including their engagement with the assets they invest in, their voting records and how they have protected and enhanced the value of their investments' rather than just their general policy'.

As such, The FRC said that the changes directly addresses the issues raised by the Kingman review.

Focus on supporting long-term, sustainable value and new requirement to factor ESG issues into investment decisions

The 2020 Code has a strong focus on establishing 'a clear benchmark for stewardship as the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society'.

In addition, signatories are expected to take environmental, social and governance factors, including climate change, into account and to ensure their investment decisions are aligned with the needs of their clients.

Further detail: An overall shift in scope

The 2012 Code included seven principles. Namely:

1. Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities
2. Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. Institutional investors should monitor their investee companies
4. Institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.
5. Institutional investors should be willing to act collectively with other investors where appropriate.
6. Institutional investors should have a clear policy on voting and disclosure of voting activity
7. Institutional investors should report periodically on their stewardship and voting activities.

The 2020 Code includes two sets of principles, one set for asset owners/asset managers (12 Principles) and a separate set (6 Principles) for service providers (eg investment consultants, proxy advisors, and data and research providers). The principles themselves have been substantially changed.

Overview of the new requirements: 12 principles/reporting requirements for asset owners

- ***Principle 1 Signatories' purpose, investment beliefs, strategy, and culture enable stewardship that creates longterm value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society:*** Signatories are required to explain both the purpose of the organisation and to give an outline of its culture, values, business model and strategy as well as their investment beliefs, ie what factors they consider important for desired investment outcomes and why. In addition, the Code requires signatories to explain the actions they have taken to ensure their investment beliefs, strategy and culture enable effective stewardship. Ultimately, signatories' disclosure should make clear how their purpose and investment beliefs have guided their stewardship, investment strategy and decision-making and include an assessment of how effective they have been in serving the best interests of clients and beneficiaries.

- ***Principle 2 Signatories' governance, resources and incentives support stewardship:*** Signatories should explain how: 1) their governance structures and processes have enabled oversight and accountability for effective stewardship within their organisation and the rationale for their chosen approach; and 2) they have appropriately resourced stewardship activities including a) their chosen organisational and workforce structures; b) their seniority, experience, qualifications, training and diversity; c) their investment in systems, processes, research and analysis; d) the extent to which service providers were used and the services they provided; and e) performance management or reward programs have incentivised the workforce to integrate stewardship and investment decision making. Signatories should disclose both how effective their chosen governance structures and processes have been in supporting stewardship and how they may be improved.

- **Principle 3 Signatories manage conflicts of interest to put the best interests of clients and beneficiaries first:** Signatories should both: a) disclose their conflicts policy and how this has been applied to stewardship; and b) explain how they have identified and managed any instances of actual or potential conflicts related to stewardship. Disclosure should include examples of how they have addressed actual or potential conflicts.

- ***Principle 4 Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system:*** Signatories should explain: a) how they have identified and responded to market-wide and systemic risk(s), as appropriate; b) how they have worked with other stakeholders to promote continued improvement of the functioning of financial markets; c) the role they played in any relevant industry initiatives in which they have participated, the extent of their contribution and an assessment of their effectiveness, with examples; and d) how they have aligned their investments accordingly. Disclosure should include an assessment of their effectiveness in identifying and responding to market-wide and systemic risks and promoting well-functioning financial markets.

- ***Principle 5 Signatories review their policies, assure their processes and assess the effectiveness of their activities:*** Signatories should explain: a) how they have reviewed their policies to ensure they enable effective stewardship; b) what internal or external assurance they have received in relation to stewardship (undertaken directly or on their behalf) and the rationale for their chosen approach; and c) how they have ensured their stewardship reporting is fair, balanced and understandable. In addition, the Code requires signatories to explain how their review and assurance has led to the continuous improvement of stewardship policies and processes. The Code says that internal assurance may be by given by senior staff, a designated body, board, committee, or internal audit and external assurance by an independent third party.

- ***Principle 6 Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them:*** Signatories should explain either:

a) how they have evaluated the effectiveness of their chosen methods to understand the needs of clients and/or beneficiaries; and how they have taken account of the views of beneficiaries where sought, and what actions they have taken as a result; OR

b) how they have taken account of the views of clients and what actions they have taken as a result; and where their managers have not followed their stewardship and investment policies, and the reason for this; OR

c) where they have not managed assets in alignment with their clients' stewardship and investment policies, and the reason for this.

- ***Principle 7 Signatories systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities:*** The revised Code requires that signatories explain how information gathered through stewardship has informed acquisition, monitoring and exit decisions, either directly or on their behalf, and with reference to how they have best served clients and/or beneficiaries.

- ***Principle 8 Signatories monitor and hold to account managers and/or service providers:*** Signatories should explain: a) how the services have been delivered to meet their needs; OR the action they have taken where signatories' expectations of their managers and/or service providers have not been met. The revised Code gives as an example (among others) that asset managers monitoring data and research providers should ensure the quality and accuracy of their products and services.

- ***Principle 9 Signatories engage with issuers to maintain or enhance the value of assets:*** Signatories should describe the outcomes of engagement that is ongoing or has concluded in the preceding 12 months, undertaken directly or by others on their behalf. The Code includes a number of examples including (among others): how outcomes of engagement have informed investment decisions (buy, sell, hold); and how outcomes of engagement have informed escalation.

- ***Principle 10 Signatories, where necessary, participate in collaborative engagement to influence issuers directly or by others on their behalf:*** Signatories should describe the outcomes of collaborative engagement. For example: a) any action or change(s) made by the issuer(s); b) how outcomes of engagement have informed investment decisions (buy, sell, hold); and c) whether their stated objectives have been met.

- ***Principle 11 Signatories, where necessary, escalate stewardship activities to influence issuers:*** Signatories should describe the outcomes of escalation either undertaken directly or by others on their behalf. Including (for example): any action or change(s) made by the issuer(s); any action or change(s) made by the issuer(s); any action or change(s) made by the issuer(s); and any changes in engagement approach.

- ***Principle 12 Signatories actively exercise their rights and responsibilities:*** For listed equity assets, signatories should provide examples of the outcomes of resolutions they have voted on over the past 12 months.

Overview of the new requirements: Six principles/reporting requirements for service providers

The six principles (and accompanying reporting requirements) for service providers are as follows.

- ***Principle 1 Signatories' purpose, strategy and culture enable them to promote effective stewardship:*** The Code requires signatories to disclose an assessment of how effective they have been in serving the best interests of clients.

- ***Principle 2 Signatories' governance, workforce, resources and incentives enable them to promote effective stewardship:*** Signatories should disclose both: a) how effective their chosen governance structures and processes have been in supporting their clients stewardship; and b) how they may be improved.

- ***Principle 3 Signatories identify and manage conflicts of interest and put the best interests of clients first:*** The Code requires that signatories disclose examples of how they have addressed actual or potential conflicts. The Code states that conflicts may arise from (but are not limited to): ownership structure, business relationships, cross directorships and client interests diverging from each other.

- ***Principle 4 Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system:*** The Code requires signatories to disclose the extent of their contribution and an assessment of their effectiveness in identifying and responding to systemic risks and promoting well-functioning financial markets.

- ***Principle 5 Signatories support clients' integration of stewardship and investment, taking into account, material environmental, social and governance issues, and communicating what activities they have undertaken:*** The Code requires signatories to explain: a) how they have taken account of clients' views and feedback in the provision of their services; and b) the effectiveness of their chosen methods for communicating with clients and understanding their needs, and how they evaluated their effectiveness.

- ***Principle 6 Signatories review their policies and assure their processes:*** The Code requires that signatories explain how the feedback from their review and assurance has led to continuous improvement of stewardship practices.

Broad support for the changes?

The feedback statement released with the 2020 Code, states that there was overall 'strong support' for the key proposals including: a) a focus on reporting activities and outcomes; b) the inclusion of how signatories' purpose and culture support stewardship; c) the extension of scope to asset classes beyond UK listed equity; d) a code that sets expectations for different entities in the investment chain; and e) integration of ESG issues.

[Note: The full text of the feedback statement is available here]

Why sign up?

The Code remains voluntary. The FRC's CEO, Sir Jon Thompson encouraged 'institutional investors, asset managers and their service providers to sign up to the new Code and demonstrate that they are operating across their businesses to these high standards of Stewardship.'

He added that the FRC 'will be holding signatories to account by regular review of adoption of the new Code and the quality of the reporting against its principles. Asset owners and beneficiaries will then be able to see if those investing on their behalf are doing so in accordance with their needs and views. They will also be able to see the impact of their managers decisions, particularly in relation to environmental, social and governance issues, including climate change.'

May meet other requirements? The FRC notes that 'signatories may choose to use their Report to meet the requirements of the Code and disclose information to meet other stewardship-related UK regulatory requirements or stewardship Codes.' The WSJ suggests that this may act as an incentive to reporting against the Code.

[Note: Pages 30-32 of the Code outlines the regulations/rules that signatories may satisfy by reporting against the Code.]

Transition arrangements

The FRC says that it will accept applications to the UK Stewardship Code 2012 until 31 December 2019. Organisations will remain signatories to the UK Stewardship Code until the first list of signatories to the 2020 Code is published.

To be included in the first list of signatories, organisations must submit a final report to the FRC, meeting the FRC's reporting expectations, by 31 March 2021.

[Note: As part of its broader response to the Financial Services Royal Commission, The Australian Council of Superannuation Investors (ACSI) released a policy paper outlining two proposals to strengthen investment stewardship in line with global best practice and in line with growing ESG expectations. ACSI called for two changes: 1) explicit regulatory recognition (by APRA) of the importance of ESG issues in the formulation of investment strategies; and 2) a review of the regulatory framework for stewardship (including consideration of: the appropriate minimum standards and reporting, the regulatory framework and a stewardship code for institutional investors). For a summary of ACSI's proposals see: Governance News 08/05/2019]

[Note: The Australian Council of Superannuation Investors (ACSI) has released The Australian Asset Owner Stewardship Code (the Code) on 17 May 2018. The voluntary Code is open to all asset owners (including super funds, endowments and sovereign wealth funds), not just ACSI members. For a summary see: Governance News 18/05/2019.]

[Source: FRC media release 24/10/2019; 2020 UK Stewardship Code: changes; Full text: 2020 UK Stewardship Code; FRC feedback statement; [registration required] The WSJ 23/10/2019; The Guardian 24/10/2019; Reuters 24/10/2019; The Times 24/10/2019; CityAM 24/10/2019; FN London 24/10/2019; Pensions&Investments 24/10/2019]

A steer on how board decisions or actions will be viewed by long term investors: ACSI 2019 Governance Guidelines released

Following consultation with members/stakeholders, The Australian Council of Superannuation Investors (ACSI) has released its latest edition of its Governance Guidelines (9th ed).

The guidelines set out ACSI's approach to company engagement and voting advice with respect to: director responsibilities; board composition and process; remuneration; voting rights and company meetings; managing ESG risks and opportunities; financial integrity and capital structure and shareholder rights.

ACSI says that the guidelines 'provide a steer to companies on how board decisions or actions will be viewed by long-term investors' and more particularly, are intended to 'promote robust governance practices including how companies manage ESG risks and opportunities'.

Key change? Strong focus on management of ESG risk

Announcing the release of the revised guidelines ACSI CEO Louise Davidson underlined ACSI's focus on strong risk management, including management of ESG risk: 'One principle underpins everything we do. We are focussed on financially material ESG risks and opportunities over the long-term, to protect and enhance the retirement savings that are entrusted to our members'.

Other changes

The ninth edition of the Guidelines, maintains the existing format but provides expanded guidance on a number of contemporary issues including themes and recommendations from the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, which ACSI considers to be relevant for all entities. Other updates, ACSI says, have been made in response to issues observed across the market or through engagement with companies.

Changes focus on the following themes.

- **Accountability:** Section 1 has been updated to reinforce the importance of the board demonstrating accountability. Citing Commissioner Hayne's comments in support, ACSI emphasises that directors 'must not blindly follow the advice of experts and should critically assess all matters put before them'. The guidance includes a list of director responsibilities (p8) which includes among other things: a) setting the company's risk appetite and seeking assurance that management is operating within that risk appetite, including in respect of ESG risks; b) setting the company's risk appetite and seeking assurance that management is operating within that risk appetite, including in respect of ESG risks; and c) setting the company's risk appetite and seeking assurance that management is operating within that risk appetite, including in respect of ESG risks. When assessing director election or reelection proposals ACSI says that it will take into consideration a range of factors relating to the performance and accountability of the candidate in addition to overall board composition. These factors include (among others): evidence of the exercise of independent judgement; length of director tenure; and any 'relevant publicly known conduct of the directors'.

- **Risk management (with a strong focus on ESG risk):** ACSI have added focus on ensuring ESG risks (eg climate change, workforce and human rights, corporate culture and tax practice) are incorporated into risk frameworks, including risk appetite, and updates to highlight the board's role in ensuring management is operating within the risk profile (sections 1.1 and 5.1). ACSI says that it expects that every company has a 'processes for identifying ESG issues relevant to its operations' and cites a number of 'leading frameworks' that companies could use in the identification of material ESG issues for management/reporting eg Global Reporting Initiative's Sustainability Reporting Standards; International Integrated Reporting Council's (IIRC) International <IR> framework for integrated corporate reporting and the Sustainable Development Goals (among others).

- **Culture:** ACSI have updated the Guidelines to reflect the importance of corporate culture, including highlighting that companies should articulate and disclose their values to underpin their desired culture, and form a basis to demonstrate alignment between expected and actual behaviour. ACSI also emphasise the board's role in overseeing the company's culture (sections 1.2 and 5.5).

- **Diversity:** ACSI expects companies to set a time frame within which they will achieve gender balance (40:40:20) on their boards (section 2.2). ACSI states that 'our preference is for companies to reform their board's composition in line with the target on a voluntary basis. Our members are also taking action by voting against the election of directors in companies that have made no progress to improve board gender diversity'.

- **Remuneration:** Section 3.1 of the guidance sets out ACSI's expectations with respect to remuneration. Though the guidance expresses no preference for one pay structure over another, ACSI says that it does expect remuneration arrangements to be 'explained fully and fairly', to be 'reasonable overall and implemented appropriately'. ACSI also questions whether short incentives paid for performance 'at target' is at risk. ACSI says that it expects companies to explain the rationale for their choice of remuneration practice and explain how short term incentive is at risk. 'We expect to see fluctuation in pay out from year to year, in particular in respect of payment for true outperformance. There should also be genuine potential for zero outcomes, (including for the 'at target' component) where performance indicates that this is appropriate' ACSI states. The guidance includes a table setting out the factors ACSI will consider when assessing remuneration arrangements at p19-20 as well as a table setting out the remuneration practices ACSI will generally oppose (p20) eg incentive pay (including options) for non-executive directors and the payment of incentives for making acquisitions rather than as a measure of the value delivered to shareholder over time (among others).

[Source: ACSI media release 11/10/2019; 2019 Governance Guidelines]

Regulators

In Brief | We could do better (from an 'efficiency' point of view)? In his address to the Lord Mayor's city banquet UK FCA CEO Andrew Bailey said, among other things, that part of the criticism levelled at the regulator is justified and that in consequence, the FCA is looking to improve efficiency (primarily by investing in data analytics)

[Sources: Speech by FCA CEO Andrew Bailey, delivered at the Lord Mayor's City Banquet at Mansion House 24/10/2019; [registration required] The FT 25/10/2019]

Financial Services

Top Story | Where is the line between general and personal financial product advice? has succeeded on appeal

Casenote | Australian Securities and Investment Commission v Westpac Securities Administration Limited [2019] FCAFC 187

Key Takeouts

- This is a significant and important decision for the financial services industry. It dramatically changes the characterisation of general and personal financial product advice and will significantly impact the way licensee interact with clients. As a result of this decision, financial institutions will need to review:
  - their distribution models and channels;
  - the scope of their licences and activities;
  - marketing materials, online calculators and other tool; and
  - the types of information gathered from clients.

The MinterEllison insights at the conclusion of this case note outline the legal and practical implications for the industry.

- The case largely concerns the question of what constitutes 'personal', as opposed to 'general' financial product advice under the Corporations Act. This is important because providers of personal advice are required to act in the best interests of the customer and comply with additional disclosure requirements if only general advice is given, the primary obligations on the provider of the advice are fewer.
- In allowing ASIC's appeal, the Court found that superannuation switching marketing campaigns run by two Westpac subsidiaries, aimed at convincing customers to consolidate their superannuation accounts into a single Westpac-related account, did involve giving 'personal advice' within the meaning of s766B(3) of the Corporations Act 2001 (Cth).
- Flowing from the finding that personal financial product advice was provided, the Court found that Westpac failed to comply with other sections of the Corporations Act, including (s961B) (best interests obligation).
- The Court also agreed with the primary judge's view that Westpac failed to comply with and s912A(1)(a) (obligation to 'do all things necessary to ensure that the financial services covered by their licences were provided honestly, efficiently and fairly'), and in doing so lent weight to the emerging

view that holders of an Australian Financial Service Licence (AFSL) are subject to an objective duty to act 'fairly'.

- **Next steps?** The Court allowed ASIC's appeal with costs, and dismissed the cross-appeal with costs. The parties are to agree on the declarations and orders to be made by Court. In the absence of agreement, the parties are to make submissions and the Court will decide on the declarations and orders.

- In a statement welcoming the decision ASIC said that it provides 'clarity and certainty concerning the difference between general and personal advice for consumers and financial services providers'.

- In a short statement acknowledging the decision, Westpac said it is 'considering the decision'.

Overview of the decision

On 28 October, the Federal Court handed down its decision in Australian Securities and Investment Commission v Westpac Securities Administration Limited [2019] FCAFC 187.

The Court was unanimous in allowing the Australian Securities and Investments Commission's appeal with costs, and dismissing the cross-appeal with costs. Their Honours, Allsop CJ, Jagot and O'Bryan JJ each provided separate reasons for their decision.

Context

At first instance, the Federal Court found that marketing campaigns implemented in 2014 and 2015 by Westpac subsidiaries (BT Funds Management Ltd (BTFM) and Westpac Securities Administration Limited (WSAL) (Westpac)) aimed at encouraging their customers to consolidate their external superannuation accounts into existing Westpac-related accounts (collectively, the BT accounts) involved the provision of general product advice, but that Westpac's conduct had breached section 912A(1)(a) of the Corporations Act 2001 (Cth) (the Act).

Section 912A(1)(a) states that holders of a AFSL must 'do all things necessary to ensure that the financial services covered by their licences were provided honestly, efficiently and fairly'.

However, the primary Judge held that ASIC failed to make out its case that Westpac provided 'personal advice' and that in consequence, ASIC failed to demonstrate alleged contraventions of ss 912A(1)(b), 946A and 961B of the Act. ASIC subsequently appealed the decision.

[Note: For a brief summary of the primary decision see: Governance News 16/01/2019].

Key Questions

When does marketing cross the line into financial product advice, and then into 'personal advice'?

The appeal was largely concerned with the questions of whether Westpac's conduct (the marketing campaigns – primarily phone calls made by callers on behalf of Westpac to Westpac customers) involved:

- the provision of financial product advice within the meaning of s 766B(1); and

- if so, whether the advice was 'personal advice' within the meaning of s 766B(3) or 'general advice' within the meaning of s 766B(4) of the Act.

Ultimately, their Honours each held that Westpac's conduct (the marketing campaigns) did involve the giving of financial product advice, that this was personal advice, and that flowing from this, the conduct also contravened various provisions of the Corporations Act 2001 (Cth).

Separately, their Honours each separately agreed with the primary Judge, that the conduct did constitute a breach of s912A(1)(a).

Westpac's conduct did constitute financial product advice

Their Honours each agreed with the primary Judge in concluding that Westpac's communications (primarily a sample of 14 calls to customers) involved the provision of financial product advice and was not simply marketing or advertising.

In reaching this conclusion, Allsop CJ, Jagot and O'Bryan JJ each rejected Westpac's argument that the whole of the communication needs to bear the character of advice for the statutory definition (s766B(1)) to be satisfied.

Justice Jagot states 'Contrary to Westpac's case, not every statement of fact, sales message or expression of enthusiasm which a financial product issuer makes about its own financial products will involve financial product advice. More is required in the form of a recommendation or statement of opinion. In the present case Westpac's communications, in my view, fall well on the side of the line of financial product advice in distinction from mere marketing'.

This is because, 'The clear message conveyed by the callers in each call was that Westpac was calling to help the customer by providing them with a service that would be in the customer's interest to accept. No reasonable customer would have expected that when Westpac said it was calling to help the customer, in fact, it was doing nothing more than helping itself to the customer's superannuation irrespective of the customer's best interests. Accordingly, the primary judge's conclusion at [260] that each customer received a recommendation that that they should rollover their external accounts into their BT account is unassailable'.

Both Chief Justice Allsop and Justice O'Bryan reached similar conclusions.

Chief Justice Allsop also emphasised in his reasons that because the 'callers took the customers to the point of decision making over the phone in a call' having been given 'helpful recommendations and statements of opinion (even of a general character)' for example, that the customer could potentially save on fees and that combining accounts made sense from a management point of view or would enhance manageability, the communications 'can plainly be seen as a form of advice'.

Westpac's conduct did involve the provision of 'personal advice' within the meaning of s 766B(3) of the Act

The primary judge held that 'financial product advice' was not 'personal advice' within the meaning of s 766B(3)(a) of the Act because the advice was not given in circumstances where: a) Westpac (through the callers) considered any/all of the customer's objectives, financial situation or needs; and b) a reasonable person might expect Westpac (through the callers) to have considered the customer's objectives, financial situation or needs.

It followed from that conclusion that the financial product advice given by Westpac (through the callers) was general advice within the meaning of s 766B(4).

Their Honours each rejected this characterisation of the advice as 'general advice', each instead separately concluding that the advice was 'personal advice'.

No imperative that the clients' objectives, financial situation and needs be considered in their totality

Their Honours each separately rejected Westpac's contention that s766B(3) requires consideration of all of the clients 'objectives, financial situation and needs', 'as a whole'.

Justice O'Bryan held that s 766B(3) requires only that 'the provider [of the advice] has considered to some extent one or more of the recipient's objectives, financial situation or needs; the paragraph does not require that the provider has considered any of them "as a whole" on the basis that doing so would defeat the purpose of s 961B'.

'On Westpac's construction, if the provider did not have complete information about one or more of the client's objectives, financial situation or needs, any advice given would not be personal advice and the obligation under s 961B would never arise. Such a construction would defeat the very purpose of s 961B'.

Justice Jagot makes a similar observation stating that 'If the legislature had intended that personal advice would be given only if the provider of the advice had considered the whole of one or more of the person's objectives, financial situation and needs then there would be no need for the legislation to expressly contemplate that information relating to the client's relevant circumstances may be incomplete for any category. Further, as ASIC submitted, it would lead to a perverse outcome if the client is protected by the personal advice provisions where the provider undertakes a detailed consideration of their personal circumstances but stops short of considering the whole of their circumstances…the legislature could not have intended that the personal advice protections are engaged when only some needs but all objectives are considered or vice versa but are not engaged if nearly all needs and nearly all objectives are considered'.

Section 766B(3) should be considered in the context of the Act, and in the context of the communication as a whole

Their Honours each make clear that s766B(3) should be read in both the broader context the Act and in the context of the communication as a whole.

Justice Jagot comments that 'The parties were in dispute about the meaning of "considered", "in circumstances where" and "one or more of the person's objectives, financial situation and needs" as they appear in s 766B(3). I do not consider that the phrases…are capable of being given meaning outside of the full context in which they appear'. Justice Jagot also rejected the approach of the primary judge in looking at the principles of administrative law to give meaning to the word 'considered' and stated that 'considered' in this context should be given its ordinary meaning, being 'to pay attention or regard to; to view or think about with attention or scrutiny'.

Likewise, Chief Justice Allsop comments that 'Care must be taken not to over-complicate these questions, in particular by breaking up the questions of meaning into parts of a section or sub-section to be treated separately'.

The question, Chief Justice Allsop says 'is one of the practical application of the statute to the context in question to see whether an express or implied "recommendation" (that is, a commending something by favourable representation or presentation as worthy of confidence or acceptance or as advisable or expedient) or "statement of opinion" (that is, a judgment or belief or view or estimation) was made. The two concepts are, of course, related. The opinion may be the basis of the recommendation; and the recommendation may carry with it an implied opinion.'

More than marketing?

A 'reasonable person standing in the shoes of the customers might expect the callers to have considered one or more of the person's objectives, financial situation and needs' given the context

In this case, Chief Justice Allsop held that though the marketing campaign was 'carefully calculated' to convince customers to consolidate their superannuation accounts into a Westpac-related superannuation account by giving no more than general advice (ie marketing/advertising a service), it was nevertheless personal advice.

'…the decision to consolidate superannuation funds into one chosen fund is not a decision suitable for marketing or general advice. It is a decision that requires attention to the personal circumstances of a customer and the features of the multiple funds held by the customer. Westpac attempted, assiduously, to get the customer to make a decision to move funds to BT without giving personal financial product advice as defined in the legislation. It failed. It gave personal advice, because when the telephone exchanges are considered as a whole and in their context, including importantly the "closing" on the telephone by getting the decision made during the call, there was an implied recommendation in each call that the customer should accept the service to move accounts funds into his or her BT account carrying with it an implied statement of opinion that this step would meet and fulfil the concerns and objectives the customer had enunciated on the call in answer to deliberate questions by the callers about paying too much in fees and enhancing manageability'.

Likewise, Justice O'Bryan found that the way in which the call was framed and the context, meant that the advice to switch accounts involved personal advice. 'Notwithstanding the general advice warning that was given at the outset of the call; notwithstanding no fees were charged for the offer of help; and notwithstanding that it was apparent that the callers did not have information about the customer's external superannuation accounts, in my view a reasonable person standing in the shoes of the customers might expect the callers to have considered one or more of the person's objectives, financial situation and needs…By its conduct, Westpac engendered a circumstance in which it conveyed an implicit recommendation to its customers to consolidate their external superannuation accounts into their BT account, and engendered a circumstance in which customers might rely and act on that recommendation because they might expect Westpac to have considered one or more of their personal circumstances in making that recommendation' he writes.

This does not mean that all marketing is 'personal advice'

In finding that the advice was 'personal advice' Chief Justice Allsop said that 'The dichotomy which Westpac seeks to establish in this case between advertising and marketing on the one hand and advice on the other hand is unhelpful. It is true that all advertising and marketing is intended to influence the listener to acquire the provider's products but that advertising and marketing is not necessarily advice. The rub in the present case is that while Westpac may have perceived what it was doing as a marketing campaign in the interests of Westpac, its campaign consisted of making calls to existing Westpac customers on the basis that the purpose of the call was to help the customer in respect of the customer's superannuation. The reasonable customer would not expect that in such a serious context, the customer's superannuation, and given the existing relationship between them, Westpac would present itself as helping the customer if, in reality, it was doing nothing more than helping itself. As the primary judge found at [47], while the customer would assume that Westpac was making the call to the customer self-interestedly, the customer would also assume that Westpac was making the call in the customer's interest.'

Both Jagot and O'Bryan JJ reached similar conclusions.

The emphasis on 'closing' was a key factor

Chief Justice Allsop observed that 'Westpac could have avoided this conclusion and result by the callers by ensuring that the customers had the opportunity to consider their own positions and, having done so, later communicate an acceptance, if they wished'.

Consequences of the findings that the conduct constituted personal advice: Other contraventions of the Act

Having found that the conduct did constitute personal advice, their Honours each held that Westpac also contravened s 961B(1) (the duty to act in the best interests of the client) and in consequence also breached ss 961K(1), 912A(1)(b) and (c).

In addition, their Honours also agreed with the primary judge that Westpac's conduct contravened s 912A(1)(a).

Contravention of s912A(1)(a): One duty or three?

The case also includes discussion of the interpretation of s912A(1)(a): the requirement that financial services licensees must 'do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly'.

Chief Justice Allsop acknowledged that the Courts have held s912A(1)(a) to be 'compendious as a single, composite concept, rather than containing three discrete behavioural norms', referencing the decision in Story v National Companies and Securities Commission (1988) 13 NSWLR 661, but cast doubt over this decision and the various cases that have followed it. The Chief Justice was careful to 'reserve for an occasion where the matter was fully argued' whether the phrase is compendious, but in doing so lent weight to the emerging view in the industry that s912A(1)(a) imposes three concurrent but separate obligations imposed on AFSL holders, including an obligation to act 'fairly'.

'Fair' to be given its ordinary meaning

Observing that the word 'fair' as used in s 912A(1)(a) has not received detailed judicial consideration, Justice O'Bryan commented that 'it seems to me that there is no reason why it cannot carry its ordinary meaning which includes an absence of injustice, even-handedness and reasonableness…It seems to me that the concepts of efficiently, honestly and fairly are not inherently in conflict with each other and that the ordinary meaning of the words used in s 912A(1)(a) is to impose three concurrent obligations on the financial services licensee: to ensure that the financial services are provided efficiently, and are provided honestly, and are provided fairly'. Likewise, Chief Justice Allsop cites the Macquarie Dictionary definition of fairness in his reasons.

Form over substance

In his reasons, Chief Justice Allsop observed that 'the provision is part of the statute’s legislative policy to require social and commercial norms or standards of behaviour to be adhered to' and as such, emphasis 'must be given to substance over form and the essential over the inessential in a process of characterisation by reference to the stated norm'.

Conclusions on s912A(1)(a)

In this case, their Honours each separately agreed with the primary Judge, that the conduct did constitute a breach of s 912A.

Chief Justice Allsop commented that 'It could hardly be seen to be fair, or to be providing financial product advice fairly, or efficiently, honestly and fairly, to set out for one's own interests to seek to influence a customer to make a decision on advice of a general character when such decision can only prudently be made having regard to information personal to the customer…There was a degree of calculated sharpness about the practice adopted in the QM Framework [quality monitoring framework]'.

His Honour goes on to say that 'The QM Framework courted the risk of personal advice being given; and it was. I do not intend to be either flippant, or disrespectful, but the perceived importance of the "closing" being over the phone might be seen as not wanting to let the customer out of the showroom or shop. This is not ensuring that financial services covered by its licence were provided efficiently, honestly and fairly. There was a contravention of s 912A(1)(a).'

Justice Jagot commented along similar lines that 'on the primary judge's approach to the facts (that is, that Westpac did not give personal advice) it can nevertheless be said that Westpac was guilty of what would colloquially be described as systemic sharp practice about what must have been one of their clients' major financial concerns, their superannuation. The fact that Westpac provided training to its staff to avoid giving personal advice does not alter this conclusion'.

Justice O'Bryan likewise held that it the conduct was 'was inherently likely to result in financial advice being given to customers in a manner that was unfair to those customers, contrary to the requirement in s 912A(1)(a)'.

Failure to act in the best interests of the client: s961B

Their Honours also each concluded that flowing from the finding that Westpac acted in a manner that was unfair to customers, the conduct also constituted a failure to act in the best interests of the client (in breach of s961B).

Justice O'Bryan said that 'The facts found by the primary judge compel a conclusion that the callers contravened s 961B(1) and Westpac thereby contravened s 961B(1). Westpac, through its representatives, failed to act in any of the ways referred to in paragraphs (b) to (g) of s 961B(2). The callers failed to obtain the most basic information that would have been required in order to act in the best interests of the customers'.

Chief Justice Allsop held that 'The whole approach of Westpac was to obtain an advantage for itself without engaging with the personal circumstances of the customers so as to avoid the consequences of the responsibilities of providing personal advice'.

Regulatory context

ASIC has said that is it targeting 'potential misconduct and harms to consumers that may arise from the industry's shift towards "general advice' models"

ASIC has identified 'fairness' and 'address(ing) poor financial advice outcomes' as a key area of focus. More particularly, ASIC's latest Corporate Plan states that the regulator will support measures to improve professional of financial advisers and 'target the potential misconduct and harms to consumers that may arise from the industry's shift towards 'general advice' models'.

ASIC has also flagged plans to review regulatory guide 146: Training of Financial Product Advisers (RG 146) over 2019-2020 to assess what training standards apply to individuals providing general advice, or personal advice on basic banking products, general insurance and consumer credit insurance, to retail clients.

MinterEllison Insights

Legal implications

- The decision establishes a threshold for what constitutes 'personal' as opposed to 'general' financial product advice which is lower than what many within the industry had adopted.
- It is clear there is a risk that any financial product advice provided after gathering information about a client's financial situation, objectives or needs may constitute personal advice and that information on one of these factors alone may be sufficient.
- The element of 'consideration' of the factors relevant to the client does not require a detailed analysis to be established, nor does consideration necessarily have to occur at the same time as the recommendation is provided.
- It is also clear that the overall impression created through customer interactions and any pre-existing relationship with the provider are relevant considerations in respect whether a reasonable person would expect the advice provider to have taken the client's financial situation, objectives and needs into account.
- The posing of questions to the client which illicit information about their financial situation, objectives and needs will also contribute to the overall impression of the advice provided.
- The 'reasonable person' for the purposes of assessing whether there is an expectation of personal financial situation, objectives and needs being considered is likely to be a reasonable person in the circumstances of the relevant client.

Efficiency, honesty and fairness

- The decision lends significant weight to the emerging view that the general obligation under s912A(1)(a) to act 'efficiently, honestly and fairly' imposes three concurrent but separate obligations, contradicting previous caselaw on this point (see for example Young J in Story v National Companies and Securities Commission (1988) 13 NSWLR 661).
- Given that the Court effectively held that acting in its own self-interest as unfair, this raises the question of whether licensee will effectively be held to act in the best interests of their clients irrespective of whether persona advice is provided.

Practical implications

- The decision significantly impacts on the way licensees interact with clients and potentially signals the end of direct telephone-based product campaigns when considered in combination with the proposals to further reforms the ant-hawking regime.
- Licensees will need to consider whether general advice and 'no advice' distribution models (both directly and via third parties) remain appropriate and sustainable in light of the decision.
- For general advice and 'no advice' distribution models that are retained, the overall impression created through the sequence of customer interactions should be scrutinised to determine whether there is a risk personal advice will be provided. Close examination of the customer information gathered will be critical to this step.

- Licensees with advice authorisations restricted to general advice will need to reconsider the scope of their activities and the suitably of a limited licence in this regard.

- Marketing materials, telephone call scripts, representative training and digital tools should be assessed in isolation and as a complete customer experience.

- Compliance with the general obligation of acting efficiently, honestly and fairly must be imbedded in all aspects of the licensee's business given there is likely to be an increase in ASIC relying on breaches of the obligation as the basis for regulatory and enforcement action.

- Implementation of the upcoming design and distribution reforms should be mindful of the decision in determining target markets and setting distribution conditions.

- Licensees currently undergoing remediation projects will need to consider the impact of the decision on remediation methodologies, strategies and compensation provisions. For remediation projects dating back prior to the introduction of the FOFA best interest duty, licensees will need to consider whether a different methodology should apply depending on when the advice was provided.

[Sources: Australian Securities and Investment Commission v Westpac Securities Administration Limited [2019] FCAFC 187; [registration required] The AFR 28/10/2019; 28/10/2019; 29/10/2019; Financial Standard 28/10/2019; Independent Financial Adviser 28/10/2019]

ASIC has imposed additional licence conditions on the Australian financial services (AFS) licence of IOOF Investment Services Ltd (IISL) as part of an application by IISL to vary its licence

What happened? IOOF Investment Services Ltd (IISL) sought a variation to its Australian Financial Services (AFS) licence from the Australian Securities and Investments Commission (ASIC) in order to facilitate the transfer of managed investment schemes, investor directed portfolio services (IDPS) and advice activities from IOOF Investment Management Ltd (IIML) to IISL.

In granting the licence variation, ASIC says that it decided to impose additional conditions relating to the governance, structure and compliance arrangements of IISL. IISL agreed to the imposition of the additional licence conditions.

Why are the additional conditions being imposed? ASIC says that its decision to impose additional licence conditions took into account: 1) concerns highlighted by the Financial Services Royal Commission about the real and continuing possibility of conflicts of interests in IOOF Group's business structure; 2) ASIC's past supervisory experience of the entities; and 3) material supplied by IISL as part of its licence variation application.

What are the conditions?

ASIC says that the additional conditions require:

- that IISL has a majority of independent directors with a breadth of skills and background relevant to the operation of managed investment schemes and IDPS platforms

- the establishment of an 'adequately resourced' Office of the Responsible Entity (ORE) that reports directly to the IISL board, with responsibility for: a) oversight of IISL's compliance with its AFS licence obligations; b) ensuring IISL's managed investment schemes are operated in the best interests of their members; and c) overseeing the quality and pricing of services provided to IISL by all service providers (including related companies)

- the appointment of an independent expert, approved by ASIC, to report on their assessment of the implementation of the additional licence conditions.

ASIC is ready and willing to impose additional conditions 'to address governance weaknesses': ASIC Commissioner Danielle Press said that 'ASIC is serious about improving the quality of governance and conflicts management across the funds management sector and ensuring that investors' best interests are the highest priority of fund managers'. Ms Press added that ASIC 'will use its licensing power, including through the imposition of tailored licence conditions to address governance weaknesses, the risk of poor conduct or vulnerabilities to conflicts of interest in a licensee's business model.'

IOOF response

In a statement, IOOF said that in working through the application process, it has already commenced implementing the conditions 'and is supportive of the stronger governance which will be in place for IISL'.

IOOF CEO Renato Mota said, 'This stronger governance framework for IISL is in line with our ambition of establishing higher standards of governance for ourselves and the industry. As we accelerate our focus on governance, together with the proposed acquisition of ANZ's P&I business, we are confident we are building better outcomes for all our stakeholders and the communities we serve.'

[Sources: ASIC media release 28/10/2019; IOOF media release 28/10/2019; [registration requierd] The Australian 28/10/2019]

Financial Executive Accountability Regime (FEAR) or maybe Financial Services Executive Accountability Regime (FSEAR) on the way? The AFR reports that Treasury/ASIC are jointly developing a consultation paper and draft legislation to extend the BEAR to other financial services institutions

The AFR reports that Treasury, with the input of the Australian Securities and Investments Commission (ASIC), is developing a consultation paper and draft legislation to extend the Banking Executive Accountability Regime (BEAR) to the financial services sector, though reportedly, the precise scope of the regime is at this stage unclear.

According to The AFR the government is looking to limit the scheme to large companies considered to be crucial to financial stability — superannuation funds, insurers, (possibly private health insurers), the Australian Securities Exchange, AMP and possibly other large companies playing a 'crucial role in the financial system' — whereas ASIC has been interested in a slightly wider application. According to The AFR, small financial services licence holders, such as financial advice firms and mortgage brokers, are will be exempted. Reportedly the consultation paper, consulting on the scope of the scheme, will be released by the end of the year.

The AFR adds that finance industry insiders are referring to the new BEAR as the 'FEAR' - the Financial Executive Accountability Regime - although the AFR reports that the government is 'leaning towards' the acronym 'FSEAR' (the Financial Services Executive Accountability Regime).

[Note: Possible scope of the regime: The government's February response to the royal commission's final report (response to recommendations 6.6-6.8) said that the government would 'extend the BEAR to all APRA regulated entities, including insurers and superannuation RSEs. Further, the Government will introduce a similar regime for non-prudentially regulated financial firms focused on conduct…The new ASIC-administered accountability regime will apply to AFSL and ACL holders, market operators, and clearing and settlement facilities. Like the BEAR, individuals with specified functions (including senior executives) will be registered and have explicit obligations related to the conduct of the entity. Financial entities will also have an obligation to deal with APRA and ASIC (as the case may be) in an open, constructive and co-operative way'. For discussion expert insights into the possible impact of the Financial Services Royal Commission recommendations from a BEAR perspective, see: FSRC Final Report: BEAR Regime 08/02/2019]

[Note: Timing: The government's latest implementation roadmap (for implementing the recommendations of the Financial Services Royal Commission) states that the government intends to consult on and introduce legislation to extend the BEAR (implement recommendations Recommendation 3.9 – Extending the Banking Executive Accountability Regime (BEAR) to RSE licensees; Recommendation 4.12 – Extending the BEAR to APRA-regulated insurers; Recommendation 6.6 – Joint administration of the BEAR; Recommendation 6.7 – Statutory amendments to facilitate co-regulation; Recommendation 6.8 – Extending the BEAR to all APRA-regulated financial services institutions; and Additional commitment – extension of the executive accountability regime to non-prudentially regulated financial entities to be administered by ASIC. 3.) by the end of 2020. For a summary of the government's implementation schedule see: Governance News 21/08/2019.]

[Source: [registration required] The AFR 29/10/2019]

Inquiry calls on fintechs and regtechs for feedback: The Select Committee on Financial Technology and Regulatory Technology has released an issues paper seeking feedback from fintechs and regtechs on key issues impacting the competitiveness of the sector including (among other things) regulation of the sector eg the extension of the CDR to the superannuation sector

Key Takeouts

- The Select Committee on Financial Technology and Regulatory Technology has released an issues paper seeking feedback from fintechs and regtechs on key issues impacting the competitiveness of the sector including (among other things) regulation of the sector eg the extension of the CDR to the superannuation sector
- The committee is due to report back by October 2020, and is accepting submissions until the end of this year.

Context

On 11 September 2019, the Senate resolved to establish a Select Committee on Financial Technology and Regulatory Technology. The committee will inquire and report on the following matters:

- the size and scope of the opportunity for Australian consumers and business arising from financial technology (FinTech) and regulatory technology (RegTech);
- barriers to the uptake of new technologies in the financial sector;
- the progress of FinTech facilitation reform and the benchmarking of comparable global regimes;
- current RegTech practices and the opportunities for the RegTech industry to strengthen compliance but also reduce costs;
- the effectiveness of current initiatives in promoting a positive environment for FinTech and RegTech start-ups; and
- any related matters.

The committee is to present its final report on or before the first sitting day in October 2020.

Issues Paper released

On 23 October, the Committee released an issues paper to assist submitters to respond to the inquiry.

Section 1 is a consideration of issues that 'determine our competitive position as a nation that seeks to attract global capital' including: 1) capital and funding (eg schemes available to attract private equity funding); 2) tax issues (eg tax treatment for early stage innovation companies and investment vehicles); 3) access to skills and talent; 4) fostering a 'local FinTech culture' to foster innovation; regulation (eg how the Consumer Data

Right (CDR) could be extended to superannuation); 5) ways in which AML/CTF laws could be strengthened (eg stronger know your customer checks and streamlined reporting); and 6) accessing government property data.

Section 2 of the paper seeks feedback on a number of specific questions around these issues.

With respect to the extension of CDR to the superannuation sector, the paper asks stakeholders to consider how quickly the CDR should be rolled out (after implementation in complete in the banking sector) and what specific considerations need to be given to the implementation in the superannuation context.

Watershed moment? InnovationAus reports that the issues paper has been welcomed as a 'watershed moment' for industry group FinTech Australia, given most of the topics raised echo the organisation's own policy agenda. FinTech Australia general-manager Rebecca Schot-Guppy is quoted as commenting: 'In our eyes, it is a first step towards a national FinTech agenda. As a result, we support this inquiry, this issues paper and the points that have been raised'

FSC response to the idea of expanding the CDR to superannuation? The AFR quotes Financial Services Council (FDSC) CEO Sally Loane as saying that the extension of the CDR to superannuation 'is worth examining' and that the FSC 'welcomes this opportunity to work with government to ensure financial services regulation is fit for purpose, encourages consumer-focused innovation, and ultimately improves consumer outcomes'.

[Sources: Senate select committee on financial technology and regulatory technology media release 23/10/2019; Senate select committee on financial technology and regulatory technology: Issues Paper; InnovationAus 23/10/2019; [registration required] The AFR 23/10/2019]

In Brief | ASIC Commissioner Cathie Armour provided an overview of ASIC's activities to support fintech at the China Financial Summit. Among other things, the Commissioner underlined ASIC's 'deliberate "open mind" approach'. Ms Armour said that ASIC 'cannot afford to be disinterested in fintech and regtech. Our approach includes learning from industry input, from international case studies, and close collaboration and knowledge sharing with domestic and international regulators' given the increasingly important role financial technology will play into the future

[Source: Speech by ASIC Commissioner Cathie Armour at the China Financial Summit 2019, An Australian regulator's view on financial technology 23/10/2019]

In Brief | ASIC, the Financial Services Council, Association of Superannuation Funds of Australia and Treasury are due to appear at the Senate inquiry hearing into Treasury Laws Amendment (Recovering Unpaid Superannuation) Bill 2019 on 30 October

[Source: Treasury Laws Amendment (Recovering Unpaid Superannuation) Bill 2019 [Provisions] Public Hearing 30/10/2019]

In Brief | APRA is consulting on proposed revisions to the capital treatment of eligible mortgages covered by the government's first home loan deposit scheme. The deadline for submissions is 11 November 2019

[Source: Consultation on the capital treatment of mortgages under the First Home Loan Deposit Scheme]

In Brief | Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019, received royal assent on 28 October after passing both houses on 14 October

[Source: Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019]

Accounting and Audit

In Brief | The largest UK accountancy firms have increased their share of the UK audit market with 100% of FTSE 100 companies now audited by the Big Four according to an FRC report

[Sources: FRC media release 28/10/2019; Key Facts and Trends in the Accountancy Profession 2019 (Issued on 25 October 2019)]

In Brief | Whistleblowers allege accounting irregularities at Infosys? The FT reports that whistleblowers (purporting to be Infosys employees) have alleged accounting issues at Infosys, which has led to India's securities regulator seeking information from the company about the complaints. Infosys is also reportedly facing a US SEC investigation and a US class action lawsuit

[Source: [registration requied] The FT 25/10/2019]

Risk Management

A Guide to ethical decision making in the boardroom: Ethics in the boardroom AICD/Ethics Centre Guide released

In partnership with The Ethics Centre, the Australian Institute of Company Directors (AICD) has released a guide to ethical decision making in the boardroom. The Guide includes examples of ethical issues that are embedded in board decisions, as well as advice and practical tools to support ethical decision-making in the boardroom. It is intended to support directors in considering ethical issues as they discharge their duties.

In his foreword to the Guide, Executive Director of the Ethics Centre, Dr Simon Longstaff writes that 'acknowledging and addressing the ethical dimension of a sensitive issue can be challenging. However, boards that fail to take account of such matters are not effectively fulfilling their governance responsibilities'.

Four Ethical lenses

The guide invites directors to view decisions through four ethical lenses in order to identify the range of ethical issues that can be embedded in a decision that comes before the board.

1. **general influences:** The broadest lens focuses the board on issues that affect the organisation as a participant in society as a whole (eg modern slavery in supply chains, climate change and workforce automation). For example, boards might ask: what aspects of the organisation's strategic environment are relevant to the decision? How do we wish to position the organisation?

2. **the board's collective culture and character:** The culture and character of the board should reflect the purpose, values and principles (the ethical framework) of the organisation. For example, boards might ask: Does the board as a whole have a culture that enables and supports ethical considerations, including calling on the organisation's ethical framework? To what extent is the decision before the board clearly linked to the organisation's purpose, values and principles? What impact will the board's decision have on the culture of the organisation?

3. **interpersonal relationships and reasoning:** How the personal relationships between board members/the dynamics of the boardroom influence decisions and the role of the Chair in maintaining 'coherence' while ensuring there is room for diversity of views. For example, directors/the Chair might ask: Have I considered how group dynamics impact on board discussions, including how my own default decision-making style fits in? Is there too comfortable a drift towards agreement? Or is there an active effort to promote and manage diversity, and recognise and encourage differences of perspective?

4. **Directors' self-awareness:** this lens invites directors to be aware of their own motivations, biases and ethical reasoning styles as 'ethical actors(s)'. Boards/individual directors might ask (for example): Is each director aware of their personal ethical position and how it might differ to that of the organisation?

Suggested five step board decision making model

The paper also sets out a 'reliable and replicable process for decision making' developed by the ethics centre, which offers boards 'a clear and simple basis for addressing the ethical dimension of any decision'.

The suggested process has five steps. These are as follows.

[Note: The five steps are summarised in a table at p29 of the report]

1. **Frame:** The first step is to define and understand the precise nature of the issue to be decided.

2. **Shape**: Develop options that could resolve the issue. Some options will have been developed by management and others by directors.

3. **Evaluate:** apply a matrix of values (the appendix to the paper provides a framework for creating a matrix at p30 and discussion following) and principles to evaluate the options

4. **Refine:** Identify and eliminate weaknesses in the proposed course of action: a) play 'devil's advocate' by taking up the option that has fared best in the matrix in order to identify its major areas of weakness; b) adjust the proposal as necessary; and c) put the proposal to some final tests eg how would I feel if this was done to a loved one?'

5. **Act:** Give effect to the decision, provide reasons for the decision, monitor the outcomes, and reflect on what can be learned/applied in future.

[Sources: AICD media release 18/10/2019; Ethics in the Boardroom: A decision making guide for Directors October 2019]

In Brief | The ACCC has instituted proceedings in the Federal Court against Google LLC and Google Australia Pty Ltd alleging they engaged in misleading conduct and made false or misleading representations to consumers about the personal location data Google collects, keeps and uses

[Sources: ACCC media release 29/10/2019; Concise Statement_ACCC v Google Australia Pty Ltd & Anor_ 29.10.19]

Corporate Misconduct and Liability

The Full Court of the Federal Court has reimposed penalty orders in proceedings against former Prime Trust directors

Context: On 13 December 2018, the High Court of Australia (Keifel CJ, Bell, Gageler, Keane and Edelman JJ) handed down its decision in Australian Securities & Investments Commission v Lewski [2018] HCA 63 (Prime Trust case).

The High Court unanimously allowed, in part, four appeals from a decision of the Full Federal Court reinstating declarations made by the primary judge Murphy J in the Federal Court that four former directors of Australian Property Custodian Holdings Pty Ltd (APCHL) (the responsible entity of the Prime Retirement and Aged Care Property Trust), Mr Lewski, Dr Wooldridge, Mr Butler and Mr Jaques each contravened the Corporations Act 2001 (Cth) (Corporations Act).

The matter was remitted to the Federal Court to reassess the penalties and disqualification periods for each of the four directors, together with ASIC's cross appeals about the adequacy of the original penalties.

[Note: For a summary of the decision in Australian Securities & Investments Commission v Lewski [2018] HCA 63 see: Governance News 17/12/2019]

Penalties reinstates by the Full Federal Court

The Full Court of the Federal Court has made disqualification and pecuniary penalty orders against William Lewski, Mark Butler, Kim Jaques and Michael Wooldridge, former directors of Australian Property Custodian Holdings Limited (APCHL).

The Australian Securities and Investments Commission said that the effect of the orders is to reinstate the original pecuniary penalties and periods of disqualification imposed by the trial judge, Justice Murphy in 2014.

Penalties?

ASIC said that the reinstated penalties are as follows:

- Mr Lewski – disqualified from managing a company for 13 years 134 days (original period 15 years, less time already served) and fined $230,000
- Mr Butler – disqualified from managing a company for 2 years 134 days (original period 4 years, less time already served) and fined $20,000
- Mr Jaques – disqualified from managing a company for 2 years 134 days (original period 4 years, less time already served) and fined $20,000
- Dr Wooldridge — disqualified from managing a company for a further 263 days (original period 2 years and 3 months, less time already served) and fined $20,000.

Costs: The Full Court ordered that the four directors pay ASIC's costs of, and incidental to each of their appeals to the Full Federal Court in 2015 (with the exception of the costs of those appeals that the High Court ordered that ASIC should pay).

Leave to manage four corporations: ASIC says that Dr Wooldridge has applied to the Federal Court for leave to manage four corporations. This matter is listed for hearing on 31 October 2019 before Anderson J.

[Sources: ASIC media release 25/10/2019; Sealed orders of Justice Middleton - Michael Wooldridge - 23 October 2019; Sealed orders of the Full Court - Michael Wooldridge - 11 October 2019; Sealed orders of the Full Court - William Lewski - 11 October 2019; Sealed orders of the Full Court - Mark Butler - 11 October 2019; Sealed orders of the Full Court - Kim Jaques - 11 October 2019]

Other News

Status update: legislative package giving effect to the proposed cash payment limit

Status update primary legislation

The Currency (Restrictions on the Use of Cash) Bill 2019 passed the House of Representatives on 24 October. The Bill proposes to introduces offence for entities that make or accept cash payments of $10,000 or more from 1 January 2020. The Bill was referred to the Senate Economics Legislation Committee for report by 07/02/2020. Submissions to inquiry close on 15 November.

Draft rules

Treasury has released draft rules to support the Currency (Restrictions of the Use of Cash) Bill 2019.

The draft rules specify the types of transactions that are exempt from the cash payment limit and prescribe how to work out the value in Australian currency of an amount of foreign currency or digital currency for the purposes of the cash payment limit.

The explanatory statement accompanying the draft Rules provides that broadly speaking, the payments not subject to the cash payment limit are:

- payments related to personal or private transactions (other than transactions involving real property);
- payments that must be reported by an entity under anti-money laundering and counter-terrorism legislation, provided, broadly, the entity with a reporting obligation complies (or is reasonably expected to comply) with their obligations under that legislation;
- payments made or accepted by a public official in the course of their duties where it is necessary for the payment to be made in cash for the performance of those duties and payments made or accepted by Australian government agencies where the payment is foreign currency produced for a foreign government;
- payments that only equal or exceed the cash payment limit because the payment is part of a transaction involving collecting, holding or delivering cash and this is undertaken in the course of an enterprise of collecting or delivering cash (i.e., providing cash-in-transit services);
- payments that only equal or exceed the cash payment limit because payment is or includes an amount of digital currency; and
- payments that occur in exceptional situations where no alternative method of payment could reasonably be used.

Treasury states that the draft rules take into consideration the consultation on draft legislation for the cash payment limit that was held from 26 July 2019 to 12 August 2019.

Proposed timeline: The proposed commencement date is 1 January 2020 – the day when the offences in the Act also commence.

[Sources: Treasury media release 25/10/2019; [DRAFT] Currency (Restrictions on the Use of Cash) Rules 2019; Explanatory Statement — Currency (Restrictions on the Use of Cash) Rules 2019; Factsheet – addressing the myths about the cash payment limit; The Currency (Restrictions on the Use of Cash) Bill 2019; ABC 25/10/2019]