Governance News

COVID-19 Special Edition

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Contents

Diversity

Losing momentum: MSCI data shows that the number of women being appointed to boards globally slowed considerably in 2020

MSCI has released its latest annual report tracking the representation of women on corporate boards/C-suites at MSCI ACWI Index firms.

Some interesting findings

- Fewer women were appointed to boards 2020: The headline finding is that the rate at which women are being appointed to boards globally slowed considerably in 2020 – the overall increase in female board representation was 0.6% (down from 2.1% in 2019).
- If this trend continues, it will take longer to reach board gender parity: As a result of this slow down, MSCI now projects, based on an average of the four-year trend from 2017 to 2020, that women will account for:
  - 30% of all directors at MSCI ACWI index companies by 2029
  - 50% of all directors at MSCI ACWI Index companies by 2045
  - If the 2019/2020 average rate of increase per year (0.6%) were to continue, these timeframes would blow out considerably. In this scenario, the 30% target would not be reached until 2036, and the 50% target would not be reached until 2069.
- All-male boards
  - Despite the decrease in the number of women being appointed to boards, the number of all-male boards declined overall from 18.6% in 2019 to 17% in 2020.
  - In developed markets in the Pacific, Japan saw a 'significant reduction' in the number of companies with all-male boards, from 33% in 2019 to 22% in 2020.
  - In Australia, only 1 of the 62 companies included in the survey had zero female board members.
  - Hong Kong is among the few markets that saw an increase in the number of all male boards from 32% in 2019 to 37% in 2020.

- **Majority female boards:** According to the report, there are 23 companies in the MSCI ACWI Index (or 0.8% of companies) with majority-female boards in 2020 (a fractional increase on the 22 in 2019).
- **Boards with three or more female directors:** 57.6% of MSCI World Index firms now have three or more women directors on their boards (up from 21.1% in 2019). European companies, many of which are subject to representation mandates are leading the way. 81.8% of these firms had reached the tipping point as of 2020 and accounted for all of the top 10 countries ranked by percentage of companies with three or more female directors.
- **Female CFOs:** The report highlights that the trend towards women holding a higher proportion of CFO positions in emerging market companies as compared with companies in developed markets continued in 2020. According to MSCI, 18.7% of the constituents of the MSCI Emerging Markets Index had a female CFO. In contrast, 12.1% of the constituents of MSCI World Index had a female CEO.
- **Female CEOs:** Globally, the number of female CEOs remains low – below 5% in all regions except the US where 5.7% of MSCI World (US) constituents have female CEOs.

[Source: [registration required] MSCI report: Women on Boards: 2020 Progress Report]

Nasdaq is pushing for the introduction of new minimum board diversity requirements and disclosure requirements for Nasdaq listed companies

Nasdaq has filed a proposal with the US Securities and Exchange Commission (SEC) to adopt new listing rules designed to both increase board diversity (in the broad sense) on listed company boards and to ensure greater transparency on the issue.

Subject to SEC's approval, the changes will mean that:

- **Listed companies will need to meet new minimum board composition requirements (on a comply or explain basis).** Most listed companies will need to have at least two diverse directors, including one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+. Foreign companies and smaller reporting companies will 'have additional flexibility in satisfying this requirement with two female directors'.
- **Proposed timing:**
  - All companies will be expected to have one diverse director within two years of the SEC's approval of the change.
  - Companies listed on the Nasdaq Global Select Market and Nasdaq Global Market will be expected to have two diverse directors within four years of the SEC's approval of the change.
  - Companies listed on the Nasdaq Capital Market will be expected to have two diverse directors within five years of the SEC's approval of the change.
- **New disclosure requirements:** Within one year of SEC's approval, all Nasdaq-listed companies will also need to publicly disclose board-level diversity statistics using a new standardised format (Nasdaq's proposed disclosure framework). Nasdaq comments that provided companies provide a 'public explanation of their reasons for not meeting the objectives' within the recommended timeframe, 'they will not be subject to de-listing'.

Assistance in sourcing diverse candidates

To assist companies in sourcing suitable candidates, Nasdaq announced that through a partnership with Equilar, Nasdaq-listed companies will be able to access the Equilar BoardEdge platform which will provide them with access to 'a larger community of highly-qualified, diverse, board-ready candidates to amplify director search efforts'.

Rationale for the proposal

The proposal outlines several justifications for proposed changes including (among others) that: a) numerous academic studies indicate that diverse boards are positively associated with both improved financial performance and higher corporate governance standards; b) intervention is required given the slow rate of progress towards diversification of boards; and c) the growing investor demand (eg from Vanguard, State Street Advisors, BlackRock, and the NYC Comptroller's Office) for more detailed, consistent, comparable and generally more useful information on board diversity.

The proposal also notes that discussions held with stakeholders indicated that there is 'consensus across every constituency in the inherent value of board diversity'.

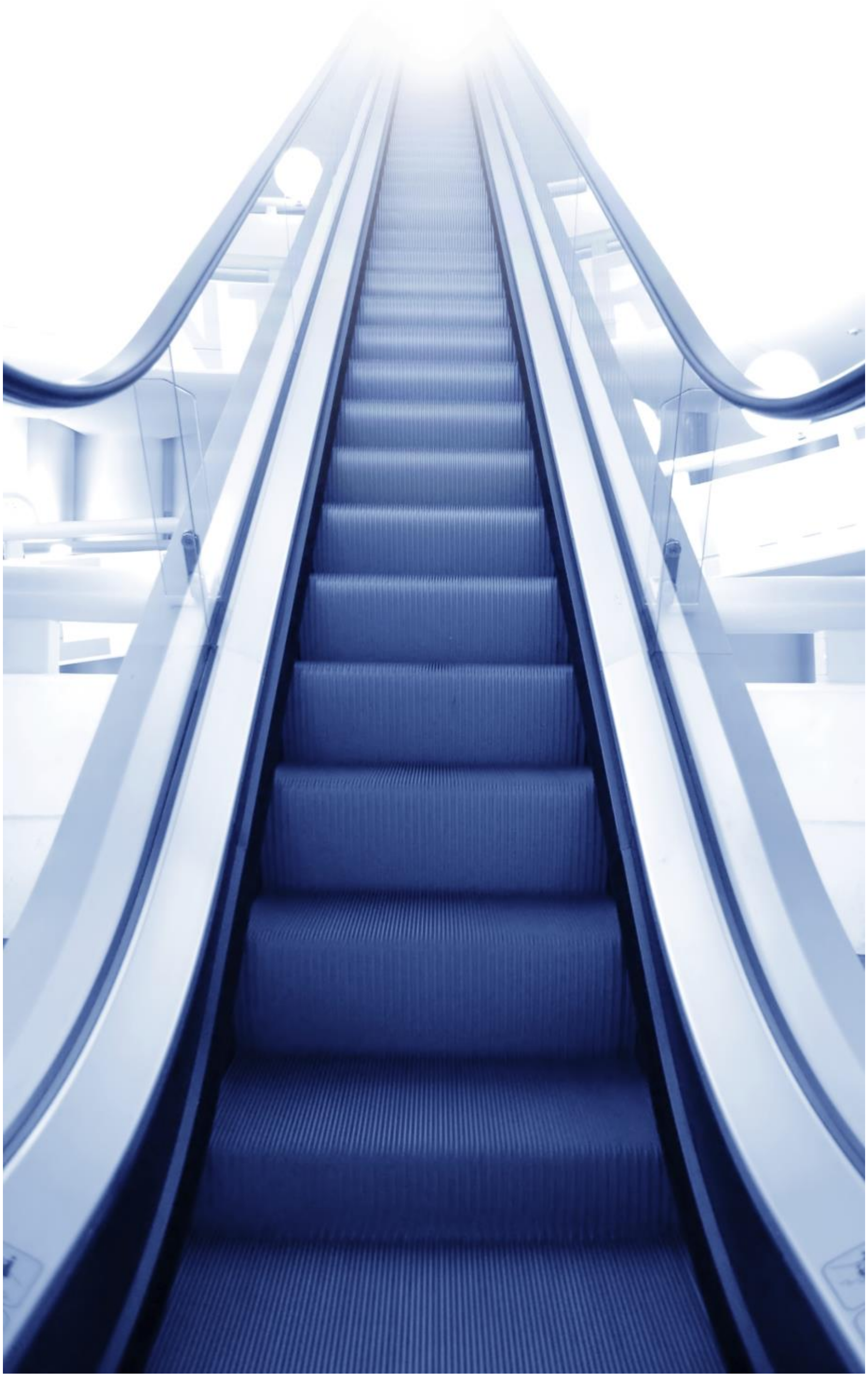
[Source: Nasdaq media release 01/12/2020; Proposal]

Progress toward financial parity: Financy's latest quarterly report shows the timeline to financial parity between men and women is unchanged at 32 years

The Q3 2020 Financy Women's Index tracks progress towards financial gender equality in Australia.

Some interesting findings

- COVID-19: The report found that though COVID-19 disruption saw women lose their employment in higher numbers than their male counterparts - there was a 7% fall in female employment in the June quarter vs a 1% fall in male employment - data for the September quarter shows that the female employment growth rate is recovering at a faster rate than the male employment growth rate – there was a 3% recovery in female employment in the September quarter.
- There was also a (slight) narrowing of the gender gap in the underemployment rate which fell from 15% in the June quarter to 14% in the September quarter.
- Despite this, the timeframe for reaching economic gender equality is unchanged at 32 years, because of the gender gap in unpaid work. The gender gap in unpaid work remained stable at 34% (unchanged since September 2017).
- The gender pay gap is also virtually unchanged at 14% (up from 13.9% in the March quarter). The report predicts that the timeframe for closing the gap is 24 years.



[Source: Financy Women's index September 2020]

Institutional Investors and Stewardship

Investors are driving a 'tectonic shift': BlackRock data shows investors representing US$25 trillion in assets are planning to double their ESG assets over the next five years

Key Takeouts

- A global survey of investors conducted by BlackRock has identified that sustainable investment is set to accelerate over the next five years, with investors representing US$25 trillion in assets planning to double their ESG assets in that period.
- The key focus for investors remains climate risk with 88% of investors globally nominating this as they top area of focus
- COVID-19 has not slowed investment: During the period 1 January 2020 to 30 September 2020, $USD203 billion flowed into ESG funds (up from $USD166 billion in 2019).
- The quality of data remains a key barrier to adoption: Globally, 53% of respondents identified the quality of ESG data or the availability of ESG data as the primary barrier to adopting sustainable investing

BlackRock has released the results of a client survey, conducted in mid-2020, into the key drivers and barriers to sustainable investing. The report is based on responses from 425 in 27 countries representing as estimated US$25 trillion in assets under management.

Some Interesting Findings

- **Sustainable investing is now mainstream:** 54% of respondents globally consider sustainable investing to be 'fundamental to investment processes and outcomes'. There are regional differences in the value placed on sustainability. In the Americas, 40% of respondents view sustainability as very important, with a similar proportion

believing it unimportant. In contrast, in Europe, the Middle East and Africa (EMEA) 64% of respondents indicate that it as their top priority and 86% of respondents indicate that it is already/set to become central to their investment strategy.

- **COVID-19 has not slowed investment:** During the period 1 January 2020 to 30 September 2020, $USD203 billion flowed into ESG funds (up from $USD166 billion in 2019).
- **Sustainable investment is set to accelerate:** Globally, respondents plan to double their sustainable assets under management, on average, by 2025. The rate of growth is predicted to be highest in the EMEA region (47% growth) and slowest in North/South America (20%). The rate of growth in in the APAC region is predicted to be 22%.
- **Key drivers of adoption:** The survey identifies a variety of factors driving the adoption of sustainable investing. The top driver across all regions is the notion that 'it's the right thing to do' but there is variation in the priority accorded to other considerations across regions. In the Asia Pacific region, an equal number of respondents (46%) nominated 'the right thing to do' and 'mitigate investment risk' as the key drivers, followed by 'mandate from the board/management' (40%) and 'better risk adjusted returns' (35%).
- **Climate change is perceived as the most urgent issue** that investors wish to address with 88% of global respondents ranking environmental issues as their current top priority. Over the next 3-5 years, climate remains the key focus, but there is also a strong focus (58%) on social issues.
- **Sustainable development goals:** Respondents are increasingly looking to express their environmental investment objectives through the lens of the Sustainable Development Goals (SDGs). Globally, 66% of respondents align their investments with the SDGs or are looking to do so. This trend is most pronounced in EMEA, where 70% of respondents already align, or plan to align, their investments with the SDGs. Among the 17 Goals, respondents are looking to primarily focus on SDGs 13 (climate action: 51%) and 7 (affordable and clean energy:50%) and 6 (clean water and sanitation: 37%).
- **ESG integration is the most popular approach to sustainable investing:**
  - 75% of global respondents currently use, or would consider using, ESG integration to incorporate sustainability into their portfolios. The next most common approach was the use of exclusionary screens (65%).
  - 65% of global respondents prefer the use of exclusionary screens as a key mechanism in sustainable investing.
- **The quality of data remains a key barrier to adoption:** Globally, 53% of respondents identified the quality of ESG data or the availability of ESG data as the primary barrier to adopting sustainable investing.

Commenting on the findings, BlackRock Chief Client Officer Mark McCombe said

> 'The tectonic shift we identified earlier this year has really taken hold, as the convergence of political and regulatory pressures, technological advancements and client preferences have pushed sustainability into the mainstream of investing…The results of our survey show this sustainable transition is occurring all around the world.'
>
> [Sources: BlackRock media release 03/12/2020; date; BlackRock report: Sustainability goes mainstream 2020 Global Sustainable Investing Survey]

Corporate Social Responsibility and Sustainability

No conflict: Wesfarmers Chair says responsible business is, and has always been, good business

Key Takeouts

- **Purpose of listed companies:** Speaking at the Governance Institute's National conference, Wesfarmers Chair Michael Chaney said that the purpose of listed companies is to deliver strong shareholder returns over the long term and that doing this requires that they operate ethically and responsibly. As such, he considers there is no conflict between Milton Friedman's conception of the purpose of a company and that put forward by the business roundtable – maximising profits is at the heart of both approaches.

- **Effective boards are diverse (and experienced) boards:** Mr Chaney emphasised the importance of diverse skills/viewpoints in the boardroom. Effective boards need to be gender diverse and directors need to bring an independent mindset coupled with strong communication skills. They need to be able to pursue issues/challenge management constructively. He also emphasised the need for directors to be sufficiently experienced – either to have held a prior board role, or to have held a sufficiently senior executive role (eg CFO, CEO)

The keynote national address at the Governance Institute's National Conference was an interview with Wesfarmers Chair Michael Chaney conducted by AFR columnist Jennifer Hewitt.

The wide-ranging discussion touched on the increasing prominence of governance issues in the eyes of the community and the consequences of that shift; the role/purpose of listed companies; the role of the board vs management and board composition and effectiveness.

Some interesting points from the discussion

Governance is a mainstream concern

Mr Chaney observed that governance is no longer a theoretical or academic issue but is very much a 'mainstream' concern which is reported on in the press and followed by the community. This has led to members of governing bodies, and in particular to the leaders of public companies, being 'more under the microscope' than they have been previously. Generally speaking, Mr Chaney said, tolerance for error has been greatly reduced. Mr Chaney cited the increase in the number of class actions and new industrial manslaughter legislation as two examples of this reduced tolerance level. He added that increased insurance premiums also underscore the point.

Success isn't a straight line

Mr Chaney spoke about the fact that success is not always a straight line. He said that boards need to bring a long-term lens to strategy and not be daunted by criticism in the press when decisions made in line with that strategy result in short term losses.

Corporate Social Responsibility and Purpose

Commenting on the increasing investor focus on non-financial issues and the debate around the proper purpose of listed companies, Mr Chaney said that it is important for listed companies not to lose sight of the fact, and to ensure that their internal and external stakeholders understand, that their primary purpose is ultimately to provide strong financial returns to shareholders. Losing sight of this, he said risks muddying the waters and failing in this objective.

Mr Chaney stressed that objective is not in conflict with being a good corporate citizen and that in fact, responsible business practices are necessary for the delivery of strong financial returns. In support of this, he cited Wesfarmer's continuing success which he said have always been underpinned by responsible business practice.

As such, Mr Chaney rejected the idea that there is any conflict between Milton Friedman's conception of the purpose of listed companies and responsible business practice.

Commenting briefly on the Business Roundtable's Statement on Corporate Purpose (you can find our summary here), Mr Chaney labelled it a 'cynical exercise' that purports to shift the definition of the purpose of listed companies, without in fact entailing any meaningful change – profit maximisation, he pointed out, is still included in the statement.

In support of this view, Mr Chaney cited a report that found that most of the signatories to the statement, did so without board sign off. Mr Chaney agreed with the authors of the report, that this indicates that the statement was never meant to herald a fundamental shift in thinking or approach.

[Note: The reference to the report appears to be a reference to an article published on Harvard Law School Forum on Corporate Governance entitled: Was the Business Roundtable Statement on Corporate Purpose Mostly for Show? – (1) Evidence from Lack of Board Approval and posted by Lucian Bebchuk and Roberto Tallarita (Harvard Law School). The article can be accessed here.]

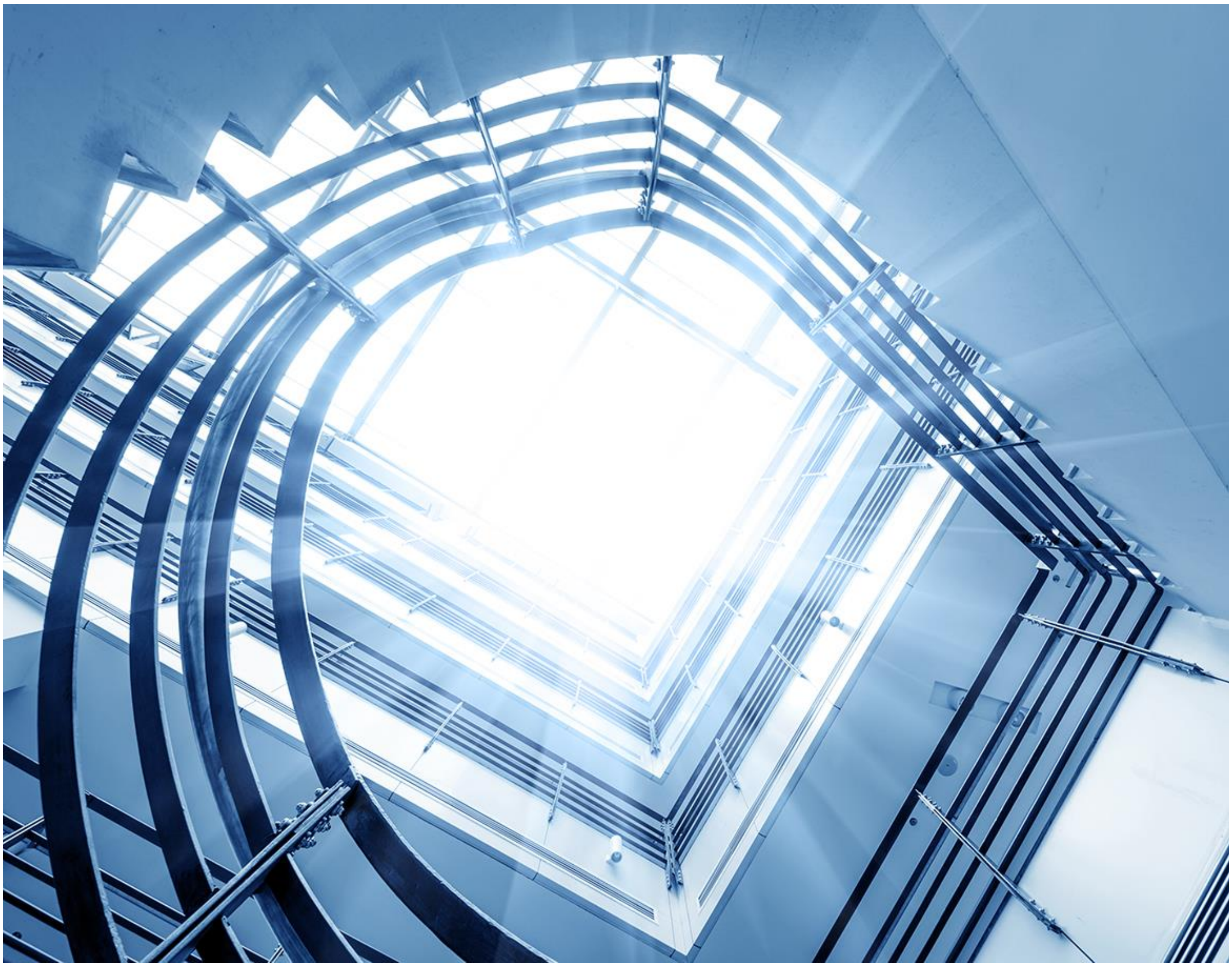
Asked whether the increased focus on ESG by companies is window-dressing, only intended to alleviate pressure from activists on companies, Mr Chaney reiterated that ESG issues will always and should always be important because they underpin the ability of the company to deliver strong financial returns over the long term.

Paying dividends vs investing – a false dichotomy

Mr Chaney rejected the idea being put forward by some politicians/commentators that companies are (wrongly) electing to pay dividends instead of ploughing profits into investments on the basis that the two decisions – to invest and/or to pay dividends – have nothing to do with each other. He said,

> 'They are presenting it as a matter of whether you pay out dividends or make investments. This is quite incorrect…I have sat on company boards for over 30 years, and with rare exceptions like the global financial crisis of 2008 I don't recall ever making a dividend declaration decision while thinking about the effect on investment'.

Mr Chaney pointed instead to Australia's system of dividend imputation as the driver behind companies paying out a higher proportion of their profits in dividends as compared with their overseas counterparts.



Key drivers of change in governance in 2020

Asked to nominate the key drivers of change in governance this year, Mr Chaney said that COVID-19 has underscored the importance of having a strong balance sheet in order to be able to weather unexpected crises.

Mr Chaney also pointed to the rapid shift to virtual meetings, observing that meetings have increased in frequency in 2020. His view is that companies will return to less frequent physical meetings when the COVID-19 health crisis abates.

Establishing a strong board

Asked to comment on how companies can ensure their board is effective and/or establish a strong board, Mr Chaney emphasised the importance of diversity of skills/perspective in the boardroom. He said that:

- there should be gender diversity
- directors need to have an independent mindset and the ability to pursue issues/challenge management in a constructive (rather than combative) way
- directors need to be sufficiently senior and experienced (either to have sufficiently senior executive experience or prior board experience) to be able to provide effective support/guidance to the CEO

Mr Chaney also suggested that a measure of tolerance for mistakes and avoiding 'knee-jerk' reactions when things go wrong are important.

The division of responsibility between management and the board

Commenting briefly on the line between management vs board responsibility and accountability, Mr Chaney said that there is a widespread misconception in the community that boards can be across the detail at all levels of an organisation when this is not the case. Though boards need to understandenough about the business to be able to effectively challenge management, they cannot know everything.

Mr Chaney said that following the Hayne Commission there is broad acceptance that boards need to challenge management more robustly than was the case in the past, but that ultimately boards need to trust the CEO and trust management to execute their roles. Where management fails to deliver, management (not boards), he said should be held accountable.

Remuneration – use of non-financial metrics

Asked for his views on the use of non-financial metrics in the context of executive remuneration, Mr Chaney said that Wesfarmers have always used a mix of financial and non-financialperformance measures – 60% financial and 40% non-financial metrics.

Mr Chaney said that though sometimes perceived as 'soft' measures, non-financial metrics can in fact be very effective in incentivising long-term value creation by ensuring priority is given to longer-term projects.

Managing #MeToo risk

Asked for his views on how companies should manage personal relationships in the workplace, Mr Chaney said it is a matter of ensuring that conflicts of interests arising from the workplace relationships are managed effectively. A company's Code of Conduct should address how conflicts should be managed, ensure that relationships are disclosed and that necessary actions are taken.

Government's policy agenda

Asked to comment on the government's current policy agenda, and more particularly on whether the government's approach to industrial relations (IR) and tax reform goes far enough, Mr Chaney said that 'it's never enough' – his hope is that changes to IR will improve productivity and streamline what are extremely complex requirements.

[Source: Notes from the National keynote and fireside chat Day 1 of the Governance Institute Conference – discussion between Michael Chaney, AO Chair of Wesfarmers and Jennifer Hewett, National Affairs Columnist Australian Financial Review 7/12/2020]

Financial Services

Hurdles at every stage: The ACCC's home loan price inquiry final report makes four recommendations to address the barriers standing in the way of borrowers switching to a cheaper deal

Key Takeouts

- The Australian Competition and Consumer Commission's final home loan price inquiry report is focused on identifying the impediments to borrowers switching to alternative lenders to secure a better deal.
- A headline finding is that borrowers face significant barriers at every stage of the switching process – including lack of engagement, a lack of clear, readily available and readily comparable pricing information and a complex and often lengthy discharge process.
- The report includes four recommendations to address these barriers. Broadly, the report recommends that:
  - all lenders be required to provide an annual 'prompt' to borrowers to consider how their deal compares (recommendation 1)
  - the introduction of a new standard discharge authority form that all lenders will be required to use (recommendation 2) and the introduction of a ten day time limit on completing the discharge process (recommendation 3) to streamline the discharge process
  - the ACCC continue to monitor competition and pricing issues in the home loan market for the next five years reporting annually to the Treasurer (recommendation 4).
- On the issue of pricing, the ACCC concluded that 'further regulatory intervention is not required at this stage' but cautioned that if the regulator's ongoing monitoring activities (recommendation 4) identify that progress toward increased pricing transparency has stalled/consumer harm is occurring, it will 'consider making recommendations' to the government to address consumer harms.
- The Treasurer has said that the government will consider the proposed recommendations and respond in due course.

Following the release of the interim report in April, the Australian Competition and Consumer Commission (ACCC) Home Loan Price Inquiry final report was released by the government on 5 December. The report is focused on identifying any impediments to borrowers switching lenders and/or home loan products.

The headline conclusion is that borrowers would make significant savings if they either switched to a better deal or approached their lender and requested a better deal, but that they face significant impediments to doing so. These impediments include:

- a lack of borrower engagement to look for a better deal
- a lack of readily accessible and clear pricing information (making sourcing a new deal less than straightforward)
- a complex, opaque and frequently lengthy discharge processes.

Four recommendations to make switching to a better deal easier and faster for borrowers

The four recommendations in the report are aimed at addressing these impediments.

The ACCC comments that there are a number of reforms in train that are expected to assist borrowers in switching between lenders/home loan products including the Consumer Data Right and that the recommendations are aimed at addressing the impediments that the ACCC considers are likely to persist despite the changes.

FINAL REPORT RECOMMENDATION	RATIONALE FOR THE RECOMMENDATION
Recommendation 1: An annual prompt for variable rate borrowers The ACCC recommends the introduction of a new requirements for lenders to provide borrowers with variable rate loans originated three or more years ago with an annual prompt. The ACCC recommends that this prompt should: ▪ be provided directly to borrowers ▪ 'communicate the potential benefits of switching in a compelling and personalised way, including a comparison between the borrower's current interest rate and the average interest rate paid for new loans similar to the borrower's loan' ▪ outline the next steps for borrowers to look for a better home loan offer.	▪ The report found that lack of borrower engagement in the home loan market is a 'significant barrier' to switching to a better deal, despite the fact that borrowers with older home loans are generally paying much more than borrowers with newer loans. ▪ The ACCC identified two main reasons for the lack of engagement: a) the fact that many borrowers assume that switching won't save them enough to warrant the bother of doing so; and b) that once borrowers have secured a loan, they are not compelled to consider switching loans unless they experience a major change in circumstances. ▪ Recommendation 1 is intended to address these issues by: providing borrowers with encouragement to see if they would benefit by switching; giving them a benchmark against which to assess their existing loan/other offers; and giving them a clear idea about how to go about the task of looking for a better offer.
Recommendation 2: The introduction of a new standardised discharge authority form The ACCC recommends that all lenders be required to use a standardised discharge authority form – that is, lenders should be required to use an 'identical standard form template' (rather than continue to design their own forms). The ACCC recommends that the form should be: ▪ easy to access, fill out and submit ▪ only request details from the borrower that are necessary for their discharge request to be processed. There should be consultation on the design and implementation of the form.	▪ The report found that borrowers are less likely to start and/or complete a switch if the process of doing so is difficult or confusing, even where switching would save them money. The report identifies the discharge process as a particular pain point for borrowers. ▪ Recommendations 2 and 3 are intended to facilitate switching by making the discharge process simpler and more certain as well as faster for borrowers.
Recommendation 3: The introduction of a ten day time limit to complete the discharge process The ACCC recommends that all lenders should have a maximum of ten business days to complete the discharge process. The report recommends that this time limit should cover the period from when the borrower (or a third party acting on their behalf) submits the Discharge Authority form to when the existing lender is ready to begin the settlement process. The report comments that though stakeholder consultation indicated that the ten day timeframe is appropriate, further consultation will be needed to confirm this. Likewise, consultation will also be needed to confirm the 'specific definition' of the start and end points in the	

FINAL REPORT RECOMMENDATION	RATIONALE FOR THE RECOMMENDATION
discharge process, and any exemptions to the time-limit 'to account for circumstances in which the existing lender cannot meet the time limit due to factors outside their control'.	
Recommendation 4: Continued monitoring of competition and prices in the home loan market (but no regulatory intervention at this stage) The ACCC recommends that it should continue to inquire into/monitor competition and pricing in the home loan market reporting annually to the Treasurer over the next five year period. The first report would be delivered by 30 September 2022. The ACCC recommends that this inquiry should focus on the ten largest lenders in the home loan market and widen to consider other lenders or groups of lenders (including non-ADIs) 'as competition issues are identified that involve or impact those lenders.' The ACCC recommends that the inquiry should consider: ▪ the difference between prices paid on new and existing home loans ▪ the difference between the prices advertised for home loans and the prices borrowers actually pay ▪ the prices charged by, and pricing decisions of, lenders ▪ the impact of current and future government initiatives and regulatory interventions, including the Consumer Data Right and the recommendations in the Home loan price inquiry final report, on home loan prices, including interest rates, fees and charges ▪ other emerging issues and lender practices that impede competition or outcomes for consumers that arise during the inquiry period.	The ACCC considers that ongoing monitoring of prices and competition in the home loan market is required in order to enable the regulator to: ▪ 'provide transparency' to the government and to consumers on lenders' pricing practices ▪ monitor the impact of government initiatives and regulatory reform (eg the Consumer Data Right and the implementation of the recommendations in the report) ▪ identify issues that impede price competition ▪ make recommendations to remedy any issues identified (as appropriate).

Pricing practices

On the issue of pricing, the ACCC noted the competitive pressures to improve price transparency and the positive shift being made by industry to do so. Ultimately, the report concludes that 'further regulatory intervention is not required at this stage'. The regulator cautions that if progress were to stall, the regulator will 'consider making recommendations' to the government to address resulting consumer harms.

Government's initial response

In a statement announcing the release of the report, Treasurer Josh Frydenberg said that the government will 'consider the report and respond in due course'.

Commenting briefly on the findings, Mr Frydenberg said that they 'underscore the government's continued commitment to a number of major reforms to increase competition across the banking industry' such as the roll out of the Consumer Data Right which will enable consumers to more easily compare/switch between products/lenders and credit reforms which will 'remove unnecessary barriers to accessing credit'.

[Source: Treasurer Josh Frydenberg media release 07/12/2020; ACCC media release 05/12/2020; Home loan price inquiry final report]

APS 120 compliance: APRA is conducting thematic reviews of securitisation practices

Context

- Australian Prudential Regulation Authority (APRA) prudential standard APS 120 Securitisation (APS 120) is intended to ensure that an authorised deposit-taking institution (ADI) 'adopts prudent practices to manage the risks associated with securitisation and to ensure sufficient regulatory capital is held against the associated credit risk'.
- APS 120 requires ADIs 'to be clearly separate from their securitisations and to permanently (except in limited pre-defined circumstances) transfer credit risk to the securitisation investors'.
- A key requirement under this standard is that ADIs must 'not provide implicit support to a securitisation'.
- The standard states that where APRA considers that an ADI is providing implicit support to a securitisation, APRA may: a) require the ADI to hold additional regulatory capital; b) require the ADI to publicly disclose the implicit support; c) 'impose limits (both quantitative and qualitative) on the extent to which additional exposures may be securitised by the ADI, the extent to which additional securitisation exposures are acquired by the ADI or the extent to which additional services are provided by the ADI'.

APRA considers that some lenders are providing 'implicit support'

The Australian Prudential Regulation Authority (APRA) has written to ADIs notifying them that it has identified an issue with some (unnamed) ADIs providing 'implicit support' by 'repurchasing residential mortgage loans that were subject to repayment deferral from their securitisations', contrary to the requirements in APS 120

APRA has directed the lenders involved to:

- publicly disclose their repurchases as part of upcoming Pillar 3 reporting requirements
- arrange for a third party review of their APS 120 compliance and take steps to address the findings of the review prior to 'further securitisation issuance'.

Securitisation thematic reviews

APRA states that in addition to this, it has also identified other APS 120 compliance issues within the ADIs and that based on this, and following engagement with industry stakeholders, it has commenced a 'program of securitisation thematic reviews. The program is expected to continue 'into 2021'.

APRA has flagged that depending on the findings, the scope of the reviews may be expanded.

Deficiencies already identified

APRA states that the reviews have already identified the following issues:

- 'little or no procedures or controls to challenge or provide oversight of ongoing securitisation operations, such as approving repurchases;
- requirements for ADIs to repurchase loans from their securitisations under certain circumstances, in breach of APS 120 paragraph 18; and
- considering capitalising interest to be a further advance and insufficiently considering the provision of implicit support and the guidance in Prudential Practice Guide APG 120 Securitisation for the purposes of APS 120, Attachment A, paragraph 6.
- Self-identification and timely reporting by ADIs to APRA of non-compliance will be favourably considered by APRA when determining the appropriate actions'.

APRA expects full compliance with APS 120

APRA recommends that ADIs 'comply with the letter and intent of APS 120 and ensure controls and procedures are in place to maintain compliance. This applies to the documentation and ongoing management of the securitisation'.

The letter also outlines the actions APRA may take if compliance issues are identified. These include:

- requiring the ADI to publicly disclose their non-compliance
- imposing additional capital requirements on the ADI

- directing the ADI to engage an APRA-approved independent third party to review their APS 120 compliance
- requiring ADIs to seek APRA's pre-approval of further securitisation issuance.

[Source: Letter to ADIs 07/12/2020]

APRA is consulting on proposed changes to the ADI capital risk framework

The Australian Prudential Regulation Authority (APRA) is consulting on proposed changes to the authorised deposit-taking institution (ADI) capital framework. The proposals incorporate APRA's response to previous consultations.

The changes are primarily aimed at achieving two core objectives:

- delivering 'unquestionably strong' capital ratios, in line with the recommendation of the Financial System Inquiry recommendation (APRA comments that 'as ADIs are already meeting the 'unquestionably strong' benchmarks, APRA is not seeking to further increase the overall level of capital in the banking system')
- ensuring alignment with internationally agreed Basel III requirements

In addition, the proposed changes are also expected to deliver a number of other benefits including increased flexibility, comparability and transparency.

The consultation package includes:

- a discussion paper outlining APRA's proposed changes
- a response to submissions paper providing detailed responses to technical issues arising through previous consultations
- proposed updates to three standards: Prudential Standard APS 110 Capital Adequacy (in markup); Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk (in markup); and Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk.

Some key proposals

APRA's proposed adjustments to the capital framework include:

- implementing more risk-sensitive risk weights: APRA is proposing a more risk-sensitive approach for determining the capital requirement for different types of mortgages and separately the introduction of reduced risk weights for small business lending (to provide additionall incentives to lend to small businesses)
- requiring ADIs to hold a larger share of their required capital as regulatory buffers (which can be drawn down in times of stress) to enhance the flexibility of the risk capital framework
- increasing the transparency of the framework by requiring all ADIs to disclose their capital ratios on a common basis, and making it easier to reconcile the Australian framework with international standards
- introducing a simplified framework and reduced compliance requirements for smaller ADIs (ADIs with less than $20 billion dollars in total assets) which will lighten their regulatory burden. .

Chapter 2 of the discussion paper provides an overview of the proposed capital framework. The table at pages 7-8 of the provides a comparison of the key proposals being put forward and current requirements.

Proposed timing

- The deadline for submissions on the proposed changes is 1 April 2021.
- The standards are expected to be finalised by 'late 2021'.
- It's proposed that the new framework will be implemented from 1 January 2023.

[Sources: APRA media release 08/12/2020; discussion paper; response to submissions paper; draft Prudential Standard APS 110 Capital Adequacy (in mark-up); draft Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk (in mark-up); draft Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk.]

Responsible lending reforms: APRA is consulting on two (potential) revisions to new Prudential Standard APS 220 Credit Risk Management

The Australian Prudential Regulation Authority (APRA) has written to authorised deposit-taking institutions (ADIs) seeking feedback on potential amendments to APS 220 Credit Risk Management that APRA considers will be necessary will be necessary if the government's proposed credit reform package is passed into legislation (you can find a summary of the proposed changes here).

The letter states that 'APRA is not planning material revisions to its credit-related prudential standards or guidance' but, is proposing to make two changes.

- **Amendment to paragraph 41:** APRA is proposing to add a sentence to the end of paragraph 41 of APS 220 stating that 'For exposures to individuals, an ADI must assess the individual's capacity to repay credit without substantial hardship'. The requirement is similar to the government's proposed requirements for non-ADI lenders. APRA says that it considers the amendment to be consistent with existing APRA requirements and that it is not expected to 'impose additional burden on ADIs.'
- **Timing of implementation**: Currently the implementation date for APS 220 is 1 January 2022 (delayed one year because of COVID-19). APRA proposes to bring this forward, to align with the government's proposed consumer credit reforms (if they commence ahead of the scheduled implementation date for APS 220). APRA considers that the earlier implementation date 'is unlikely to create material additional regulatory burden for ADIs' given that industry has been aware of the details of APS 220 since late 2019 and that most ADIs are likely to already be compliant with the new requirements. . APRA states that it will not implement the new APS 220 any earlier than 1 April 2021.

The proposed changes to APS 220 are contingent on the passage of the government's consumer credit reform package – if the reform package is not passed into legislation, the proposed changes will be unnecessary and will not be implemented.

The deadline for submissions is 29 January 2021.

Other changes?

- APRA is currently consulting on a draft Reporting Standard ARS 220.0 Credit Risk Management (ARS 220.0). APRA states that the proposed changes to APS 220 will have no impact on the timelines for ARS 220.
- APRA intends to finalise Prudential Practice Guide APG 220 Credit Risk Management (APG 220) in Q1 2021.
- Depending on the outcome of the government's reform package, APRA may also consult on revisions to APG 223 Residential Mortgage Lending (APG 223) 'around' Q1 2021. If this occurs, APRA expects that the revisions will not be material.

[Source: APRA Letter to ADIs 09/12/2020]

Being prepared for increasingly regular 'black swan' events: APRA Chair Wayne Byres reflects on the importance of building resilience as well as strength

The key theme of Australian Prudential Regulation Authority (APRA) Chair Wayne Byres' recent address to 2020 Forum of the Risk Management Association, was resilience, and the need to ensure that the financial system is not only objectively strong, but also resilient and able to absorb the shocks of unexpected events.

Some Key Points

- **Not helpful to think about 'black swans' as rare events:** Mr Byres questioned the utility of characterising the unexpected events of recent times as rare 'black swan' events. Instead he suggested that given the regularity with which 'black swan' events occur, there is a need for business and for regulators to ensure that they are always prepared for the unexpected. Mr Byres said that this realisation has led to 'a subtle but important shift in regulatory thinking' from focusing primarily on building the strength of the financial system, to now also focusing on ensuring the resilience of the system. Mr Byres observed,

  …'it is possible to be strong, but not resilient. Your car windscreen is a great example – without doubt it is a very strong piece of glass, but one small crack and it is irreparably damaged and ultimately needs to be replaced. That is obviously not the way we want the financial system to be. We want a system that is able to absorb shocks, even from so-called "black swan" events, and have the means to restore itself to full health.

- **Opportunities to improve the resilience of the financial system;** Mr Byres identified: capital frameworks, liquidity, credit risk, operational and cyber-risks, people and climate as areas where improvement is needed.
- **Capital:** Mr Byres said that Australia went into 2020 with financial firms that were 'soundly capitalised' and this has 'served its purpose well'. However, the crisis has also identified a number of areas where the system could be more resilient including:
  - the buffer framework – how it can be adjusted to make it easier to use capital buffers without unintended consequences
  - the role/impact of Additional Tier 1 (AT1) instruments - whether they are capable of providing the loss absorbing capacity they are intended to achieve).

  Mr Byres said that APRA's next package of bank capital reforms will include a 'redesign of the buffer framework' and that APRA is monitoring the broader international debate about the role/impact of AT1 instruments.

  [Note: Following Mr Byres' speech, APRA launched a consultation on proposed changes to the capital risk framework. This is covered in a separate post above.]

  Mr Byres commented that outside regulation, there is an opportunity for business to take steps to improve their own resilience/test their own resilience through regular stress tests and capital planning.

- **Liquidity:** Mr Byres said that the pandemic has also highlighted liquidity as another area where adjustments would be helpful. He observed that despite the actions taken by the Reserve Bank, individual firms and funds faced challenges as a result of COVID-19 and ultimately, the behavioural assumptions underpinning existing management and prudential regulation 'did not hold up'. He commented,

  'The Liquidity Coverage Ratio, for example, is built on assumptions of likely stressed outflows over a one-month time horizon. But what about when those assumed stress flows prove inadequate? And what about liquidity needs sitting just beyond the one-month window? Both are issues on which we need to reflect on and consider whether – without seeking to raise requirements – we can adjust the framework to make the system more resilient to liquidity stress'.

- **Credit risk:** Mr Byres said that despite the scale of the economic shock caused by COVID-19, stronger credit practices combined with government intervention and other measures have meant that credit losses that otherwise may have been expected have been delayed or in some cases, entirely avoided – though it is as yet unclear, what the full impact will be. Given this, he considers that a cautious approach is warranted. Mr Byres said that for credit risk managers, the key issue is 'what yet is to come'. For example, he suggested that they should consider whether/the extent to which: remote working arrangements will persist/how this impacts the value of office space (among other examples). Mr Byres commented that though the scope of the changes that may persist post-pandemic is as yet uncertain, it is certain that there will be change and that this needs to be reflected in risk modelling, portfolio limits and underwriting practices. In saying this, Mr Byres emphasised the importance of collective action in ensuring the continued flow of credit and the dangers inherent if industry responds by becoming overly risk-averse. Mr Byres comments, that should this occur, 'we will all end up worse off and make the system less resilient if we all seek to avoid risk altogether'.
- **Operational and cyber risks**: On the issue of cybersecurity, Mr Byres said that overall, business has demonstrated a level of resilience when faced with the need to adapt rapidly to the changed environment, but that it is imperative now that any short cuts/compromises made in order to ensure business continuity are not allowed to persist/are addressed. Mr Byres observed, 'A truly resilient system should not need compromises in operational and cyber security controls to be able to continue to provide its services in the face of a crisis. That should be our collective goal'. Mr Byres said that to make the system resilient to future shocks, it's necessary to learn the lessons from the current crisis and ensure they are built into contingency planning. Mr Byres said that APRA will be updating its prudential standards in this area.
- **People:** Mr Byres said that risk managers also need to be cognisant of the people-related risks associated with the COVID-19 pandemic and their potential impact on organisational performance, operational controls and risk culture.
- **Climate**: Commenting briefly on climate-related risks, Mr Byres reiterated that an understanding of climate-risk is essential for a resilient financial system. He said,

  'Whether it is insurers underwriting weather events and physical risks, a bank lending to finance business development, or superannuation trustees investing for long-term return, climate-related risks need to be factored into decision-making and risk management'.

  [Source: APRA Chair Wayne Byres - Speech to the 2020 Forum of the Risk Management Association 03/12/2020]

Removal of the BNPL no-surcharge rule is looking unlikely (at least for the present)? RBA Governor Philip Lowe has outlined the board's preliminary views on possible changes to payments systems regulation

In a speech to the Australian Payments Network Reserve Bank of Australia (RBA) Governor Philip Lowe spoke about key issues emerging as a result of the rapid change and innovation taking place in the payments sector and outlined the Payments System Board's preliminary views from its Review of Retail Payments Regulation.

Current and emerging challenges

- **Two key challenges:** Generally speaking, Mr Lowe said that Australians enjoy an efficient and dynamic payments system. However, the RBA would like to see improvement in two areas: 1) the RBA would like to see progress on moving to electronic invoicing and the ability to link e-invoices to payments; and 2) the RBA would like to see improvements to the speed, cost and transparency of cross-border retail payments and international money transfers.
- **New issues:** Technology focussed businesses are driving rapid change in the structure of the payments system and this has given rise to new issues including the following.
  - **Regulation of digital wallets:** In Australia and many other countries, large technology companies - Google, Apple, Facebook and Amazon - are increasingly incorporating payments functionality into their service offerings eg Apple Pay and Google Pay. Mr Lowe observed that this raises competition issues around the involvement of the big tech companies in payments at all and also specific issues around digital wallets. These include: a) new competition issues; b) questions concerning the value of information/data being collected and

how technology companies should approach this; and c) questions around charging transaction fees. Another issue raised by both digital wallets and the big techs is the issue consumer protections and more particularly what protections apply to funds held within any new payment systems, and outside the formal banking sector. Mr Lowe went on to welcome the government's acceptance of the Council of Financial Regulators' proposed reforms of regulatory arrangements for stored-value facilities under which the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) will be the primary regulators.

– Regulation of stablecoins: Mr Lowe observed that internationally Facebook's announcement that it is developing a global stablecoin has raised concerns from governments/regulators on a range of issues including consumer protection, financial stability, money laundering and privacy. From the Australian perspective, Mr Lowe said that if Diem (Facebook's stablecoin) poses bank-like risks, 'it will be subject to bank like regulatory requirements' but that it 'remains to be seen how this and other similar initiatives progress'.

Update on the Review of Retail Payments Regulation

Mr Lowe said that the Payments System Board has been resumed work (which was halted because of COVID-19) on its periodic Review of Retail Payments Regulation in Australia and outlined the Payments System Board's preliminary views on three issues:

- buy now pay later (BNPL) no surcharge rules.
- interchange fee regulation
- dual-network debit cards and least-cost routing

In doing so, Mr Lowe emphasised that no final conclusions have yet been reached and that further discussion with industry participants on these issues will occur over the next few months. He said that should the review conclude that changes to the standards are necessary, the RBA will consult on the proposed changes by mid-2021.

Buy now pay later no-surcharge rules

- Mr Lowe said that the board's preliminary view is that intervention to remove the no-surcharge rule is unwarranted at present. He said,

  > 'The Board's preliminary view is that the BNPL operators in Australia have not yet reached the point where it is clear that the costs arising from the no-surcharge rule outweigh the potential benefits in terms of innovation. So consistent with its philosophy of only regulating when it is clear that doing so is in the public interest, the Board is unlikely to conclude that the BNPL operators should be required to remove their no-surcharge rules right now'.

- Mr Lowe went on to say that the Board expects that 'over time a public policy case is likely to emerge for the removal of the no-surcharge rules in at least some BNPL arrangements'.
- Were this to occur, the Board's preference would be 'to reach a voluntary agreement with the relevant provider' (as occurred in the case of American Express and PayPal). Should this not prove to be workable, the Bank would discuss the best way forward with the government.
- The bank will continue to monitor the issue, and as part of this work, Bank staff will be discussing possible criteria or thresholds for determining when no-surcharge rules should no longer be allowed with industry participants.
- Mr Lowe observed that the current Treasury review of the regulatory architecture 'provides an opportunity to look holistically at this issue and whether the existing legislation and regulatory provisions could be amended to better reflect our modern and dynamic payments ecosystems'.

Interchange fee regulation

- Mr Lowe said that the board's preliminary view is that generally, these fees should be as low as possible and that the 'direction of change in these fees over the medium term should be down and not up' because 'once a payment system is well established these fees increase the cost of payments for merchants and they can distort payment choices'.
- Having said this, Mr Lowe said that the board does not 'see a strong case for a significant revision of the interchange framework in Australia' at present given that: a) the existing standards 'appear to be working well and frequent regulatory change can carry costs' and b) the average level of interchange rates in Australia is 'quite low by international standards'. Mr Lowe observed that credit card interchange fees are also lower than in most other

countries with the exception that Europe has lower interchange fees. Mr Lowe said that board is 'watching the European experience closely and expects that, over time, a stronger case will emerge for lower credit card interchange fees in Australia'.

- Mr Lowe said that the RBA is considering lowering the 15 cent cap on the fees that can be applied to any particular category within a scheme's schedule of debit card interchange fees to address the issue of interchange fees on transactions automatically being set at the 15 cent cap. Mr Lowe said that the RBA will be seeking further information from industry on the issue over the coming months.

Dual-network debit cards and least-cost routing

- Mr Lowe said that the Board's view is that 'merchants should have the freedom and the capability to route debit card transactions through the lower-cost network' and that the board sees a 'strong case for all larger issuers of debit cards to issue cards with two networks on them'.
- Mr Lowe said that the board expects that 'in the point-of-sale or "device-present" environment all acquirers should provide merchants with the ability to implement least-cost routing for contactless transactions, possibly on an opt-out basis'.
- Mr Lowe said that it is 'not yet clear' how least cost routing should operate in the online or 'device-not-present' environment and that this is something the Bank's staff will explore over the coming months.

[Sources: Reserve Bank of Australia Governor Philip Lowe, Address to the Australian Payments Network: Innovation and Regulation in the Australian Payments System, 07/12/2020]

ASIC is consulting on proposed updates to remediation guidance: Regulatory Guide 256 Client review and remediation

The Australian Securities and Investments Commission (ASIC) has commenced the first phase of a two stage consultation on proposed updates to Regulatory Guide 256 Client review and remediation conducted by advice licensees (RG 256). The deadline for submissions is 26 February 2021.

Broadly, ASIC the proposals outlined in Consultation Paper 335 Consumer Remediation: Update to RG 256 (CP 335) seek to: a) clarify that the guidance is intended to have broad application to AFS licensees, ACL licensees and to the trustees of regulated superannuation funds (excluding SMSFs) regardless of their size; b) provide guidance on when it may be appropriate to initiate a remediation (including when there has been no breach of formal/compliance obligations); c) scrap the existing seven year review period; d) provide guidance around the use of assumptions in the context of remediation and when they should be used; e) provide updated guidance on the calculation of interest; contacting customers and returning money to customers.

Broader application

Currently, the guidance in RG 256 is focused on advice licensees providing personal advice.

ASIC proposes that the updated guidance will clarify that the guidance has broader application to all: Australian financial services (AFS) licensees; Australian credit licensees; and trustees of regulated superannuation funds (excluding self-managed superannuation funds); approved deposit funds or pooled superannuation trusts (RSEs) and retirement savings account (RSA) providers (superannuation trustees) (collectively licensees).

ASIC emphasises that this is consistent with licensees' existing obligations (including the obligation to provide financial services efficiently, honestly and fairly). Paragraphs 6-10 of the guidance fleshes out these obligations in detail.

ASIC intends that the updated guidance will apply to all licensees regardless of their size on the basis that it will be sufficiently flexible to be scalable according to the circumstances.

When to initiate remediation: A proposed two tiered approach

ASIC is proposing to provide guidance that initiating a remediation should not (necessarily) be limited to circumstances in which a formal legal or compliance breach has been established.

Rather, ASIC is proposing a 'two tiered' approach which will mean that guidance:

- 'must be initiated when a licensee has engaged in a misconduct, error or compliance failure that has caused one or more consumers to have suffered potential or actual loss, detriment or disadvantage (loss) as a result' (Tier 1); and
- that licensees 'should also turn their mind' to whether a remediation is also justified where consumers have suffered a loss due to conduct/behaviour/omission by a licensee that is in breach of community expectations/values or other standards (eg industry code of conduct) (Tier 2).

ASIC considers that this is 'consistent with licensee obligation and community expectations' and comments that it is already being applied by some licensees. ASIC states,

> 'We have seen some licensees adopt a remediation approach that is not limited to establishing a legal or compliance breach only—it also takes into account what their consumers and the broader community would expect in terms of 'righting wrongs'. Some licensees are also no longer waiting for consumer harm to become a systemic issue, and instead are initiating a remediation when they identify a single instance of loss'.

Review period for remediation: ASIC proposes to scrap the seven year minimum period

ASIC is also proposing scrap the current seven year review period in the current guidance and replace it with guidance that the relevant review period for a remediation should 'start on the date a licensee reasonably suspects a failure first caused loss to a consumer'.

ASIC comments that based on its observations, and as identified by the Hayne Commission, remediation issues often go back more than seven years by the time they are uncovered and that the proposed change will help guard against unfair consumer outcomes and ensure licensees take responsibility for the consequences of their actions. ASIC states,

> 'Taking responsibility for the consequences of a licensee's actions is a part of holding a financial services or credit licence…We think this responsibility should extend in principle to each consumer who has suffered loss and that the remediation period should not be anchored to a seven-year timeframe'.

ASIC also observes that the change should not impose an unjustifiably heavy burden on licensees given the advances in data management capabilities and IT systems in the four years since the guidance was first issued which should mean it's easier for licensees to retain and access client information.

Having said this, ASIC acknowledges that smaller licensees may not have the same data management capability as larger licenses and that the proposed shift in approach may present logistical challenges for some licensees in accessing files or consumer information in some circumstances eg where a third party provider is involved or where an adviser has left the firm.

ASIC has requested feedback on the proposal including information about any 'practical problems' that stakeholders can see and whether there are 'any other matters that we should consider to help us provide appropriately scalable guidance'.

The use of assumptions

ASIC observes that because the current guidance does not directly address what assumptions can be used in the context of a remediation and when they may be deployed, ASIC regularly receives requests for guidance on the issue.

To address this gap, ASIC is proposing to provide guidance that 'overall, licensees should only use assumptions in a remediation if they are 'beneficial assumptions'. ASIC also proposes to provide guidance on the factors that should be considered when determining whether it is appropriate to rely on assumptions.

What is a 'beneficial assumption'?

ASIC proposes to provide guidance that when applying assumptions, licensees should take into account the following considerations:

- whether the assumption aims to return all affected consumers as closely as possible to the position they would have otherwise been in (this may include giving a consumer the benefit of the doubt);
- whether the assumption is evidence-based and well documented

- the adequacy of the monitoring mechanisms in place 'to ensure assumption continues to achieve the goal of returning consumers as closely as possible to the position they would have otherwise been in throughout the remediation'.

ASIC further comments that an assumption that benefits all affected consumers on average may not necessarily meet a licensee's obligations. This will depend on the nature of the distribution of the losses caused. That is, while it may be appropriate to where there is a normal distribution and a low standard of deviation, it 'will fall dramatically short' where there is an unusual/skewed distribution or high standard of deviation.

Using 'beneficial assumptions'

ASIC proposes to provide guidance that:

- In the context of determining which consumers should be included in the remediation (making 'scoping assumptions'), any assumptions made should 'benefit consumers by preferencing inclusivity rather than exclusivity (ie the assumptions widen the net to capture more consumers rather than less)'.
- In the context of calculating the amount of actual or potential loss (making refund assumptions), assumptions should 'err on the side of overcompensation, rather than under compensation; and not be used to justify limiting or preventing a consumer's right to challenge a remediation outcome through internal dispute resolution (IDR) systems or to make a complaint to the Australian Financial Complaints Authority (AFCA)'. ASIC clarifies that this should not be read to mean that licensees are expected to overcompensate, but rather that where they opt to apply assumptions to save costs/time or to account for absent records, the assumptions applied 'should equate to actual loss or err towards overcompensation rather than risk returning less than what consumers are owed'.

ASIC comments that 'remediations that employ these types of beneficial assumptions in this way are usually more efficient, timely and generally lead to fair consumer outcomes'.

It may be appropriate to use beneficial assumptions to increase efficiency

- ASIC proposes to provide guidance that it may be appropriate to apply assumptions to increase the efficiency of a remediation, even where a licensee has good quality records. Case studies 3–4 at p25 are real examples of situations in which ASIC has seen licensees using beneficial assumptions to increase efficiency.
- ASIC stresses that using assumptions to increase efficiency may not always be appropriate, and that before relying on assumptions, licensees should first consider whether the remediation is properly resourced.

Absent records

- ASIC proposes to provide guidance that where a licensee has not kept records (and in consequence is unsure about whether a consumer has suffered a loss), the licensee should make beneficial assumptions in the consumer's favour if there is evidence to suggest the consumer has been/may have been impacted.
- ASIC considers that though it may be reasonable to ask a consumer for information in some cases, it's important that a consumer not be disadvantaged if they are unable to 'fill in the gaps' in a licensee's records.
- Though ASIC 'will not generally expect' a licensee to apply beneficial assumptions for the purposes of compensation if it is not reasonably possible to identify the potentially affected consumer, ASIC does expect licensees to 'think creatively about where they may be able to source data from across their organisation, or from service providers or consultants, and what that data could tell them about their consumers, and how it may inform assumptions'. The consultation paper includes two real examples of licensees using beneficial assumptions to account for absent records (p22).

Calculating foregone returns or interest – a proposed three step framework

ASIC proposes to update its current guidance on calculating foregone returns or interest by setting out a new three-step framework for licensees requiring:

- licensees to first attempt to calculate actual foregone returns or interest rates (without the use of any assumptions)
- where this is either not appropriate, not possible or not reasonable practical, licensees would need to consider whether beneficial refund assumptions can be made (if an evidence-base supports it)

- in the absence of an evidence base to support a beneficial assumption, licensees would need to apply 'a fair and reasonable rate that compounds daily and is:(i) reasonably high;(ii) relatively stable; and (iii) objectively set by an independent body'.

Identifying and automatically paying consumers

ASIC proposes to provide guidance that

- licensees should apply best endeavours to find and automatically transfer funds into consumers back accounts as this is most effective way of ensuring that the funds reach consumers
- given the very low and declining use of cheques and the low rate at which cheques are cashed, cheques should generally only be issued as a last resort

ASIC also proposes to scrap the existing $20 low-value compensation threshold in the existing guidance on the basis that it is not necessarily appropriate in all circumstances and does 'not align with some of the positive industry practices that we have seen'.

Instead, ASIC proposes to provide guidance that: a) the starting position should be to return all consumers as closely as possible to the position they would have otherwise been in regardless of value; b) it is up to licensees to decide how they will treat their unresponsive or lost consumers, and if applying a compensation threshold, what low value is fair and appropriate in line with their obligations; and c) if applicable, the reasons for the decision to apply a low value threshold should be well documented and appropriately justified.

Remediation money that cannot be returned to consumers

ASIC proposes to provide guidance that where funds cannot, despite best endeavours, be repaid to consumers the licensee 'must not profit from the failure' and the funds should:

- be sent to a relevant state or federal unclaimed money regime where feasible; and
- if not feasible available; and 'as a last resort' the funds should be paid to a charity or not-for-profit organisation registered with the Australian Charities and Not-for Profits Commission.

ASIC proposes that if consumer seeks a remediation payment after the licensee has disbursed funds through a residual remediation payment, the consumer should be paid the compensation they are owe, regardless of additional costs.

Settlement deeds

ASIC proposes to provide guidance clarifying when/if using settlement deeds and relying on implied consent may or may not be appropriate as part of a remediation.

[Sources: ASIC Consultation paper: CP 335 Consumer remediation: Update to RG 256; ASIC media release 03/12/2020]

Superannuation: ASIC sounds a warning on the design and disclosure of default insurance

The Australian Securities and Investments Commission (ASIC) has released the findings of a review into the process by which MySuper members are defaulted into high-risk occupational categories for the purposes of life insurance held through their MySuper products.

The findings are based on a sample of 21 trustees over the course of 2019 and 2020. The trustees in the sample all used a high-risk occupational default and were also considered by ASIC to be more likely to have a membership including a 'broad based mix of occupations' including 'white collar' occupations.

The review considered:

- the assumptions being made about members when setting their occupational default and how trustees determined that the default was appropriate for their membership
- the quality of the information being provided to members about the occupational categories
- bearing in mind the fact that the cost of insurance for the highest risk occuptational category is higher than for other categories, and substantially higher than the lowest risk occupational cateory, the ease with which

members could update their occupational category to ensure they are paying the most appropriate insurance premiums.

Key findings: issues with the design and disclosure of occupational defaults

- Trustees often had limited data about members' occupations and in consequence trustees needed to apply assumptions in order to allocate members into a default occupational category. ASIC found that there was 'significant variation in the sophistication of trustees' assumptions and in the factors they took into consideration' in determining the appropriate default category.
- Disclosure by 'some funds' was 'poor' including disclosure around the cost of premiums for different occupational categories. ASIC comments that in 15 cases, generic labels (eg 'standard' or 'general') were used to describe the most expensive category. ASIC comments that 'most trustees' using this approach have since updated their websites/product disclosure statements to provide members with 'clearer information' about their occupational default categories.
- Overall, the process for members to update their occupational categories was neither 'readily apparent' or 'accessible'.

ASIC's expectations

ASIC cautions that failure to ensure that insurance premiums charged to members are based on 'appropriate statistical assumptions' may be a contravention of trustees' legal obligations.

ASIC suggests that trustees should take steps to ensure default settings are based on 'appropriate statistical assumptions' by making an effort to obtain 'better' occupational data about individuals and cohorts.

ASIC Commissioner Danielle Press said,

> 'Better occupation data about members will assist trustees in designing fair and reasonable default insurance, and good, clear disclosure can empower their members to make better informed decisions about their insurance arrangements'.

ASIC considers that outcomes for members with default insurance could also be improved by:

- ensuring that its easy for members to amend their profile so that premiums are charged based on accurate information.
- ensuring that members have access to clear, readily accessible and easily understandable information. Trustees should ensure that:
  - default labels clearly communicate the level of risk being covered
  - disclosures include a clear statement of: 'a member's occupational category; the meaning of the category; the cost of the insurance in that category; whether the member may be eligible for an alternative category that is less expensive or provides a greater level of cover'.

Value for money

ASIC states that this review is part of a broader program of work aimed at improving trustee practices around default insurance in superannuation.

As part of this work, ASIC says that it will 'soon communicate about measuring the value for money delivered to members'.

[Sources: ASIC media release 03/12/2020]

COVID-19: Funds have now paid out $35.5 billion under the government's early release of superannuation scheme

The Australian Prudential Regulation Authority (APRA) has released industry-level and fund-level data on the early release of superannuation scheme for applications received during the period 20 April (inception of the scheme) to 29 November 2020.

- Total payments made since the inception of the scheme have taken an average of 3.3 business days to process, with 95% of payments made within five business days.

- Over the week to 29 November, superannuation funds received 22,000 applications (up from 20,000 in the week to 22 November)
- Of the applications received in the week to 22 November, 15,000 were initial applications bringing the total number of initial applications received to date to 3.4 million since inception of the scheme.
- 7,000 applications were repeat applications, bringing the total number of repeat applications to 1.4 million since the inception of the scheme.
- Over the week to 29 November funds made payments to 21,000 members worth $150 million $146 million (up from $146 million in the previous week).
- Funds have made approximately 4.6 million payments since inception worth a total of $35.5 billion paid since inception.
- The average payment made over the period since inception is $7,649 overall and $8,305 when considering repeat applications only.

[Source: APRA media release 07/12/2020]

In Brief | Early release of superannuation scheme: APRA's analysis of data, collected through the pandemic data collection, on the impact of the early release of superannuation scheme concludes that funds have a high level of operational resilience (including in relation to heightened fraud risk and service provider disruptions), cash holdings remain relatively high and members with lower account balances had the highest take-up rate of ERS withdrawals

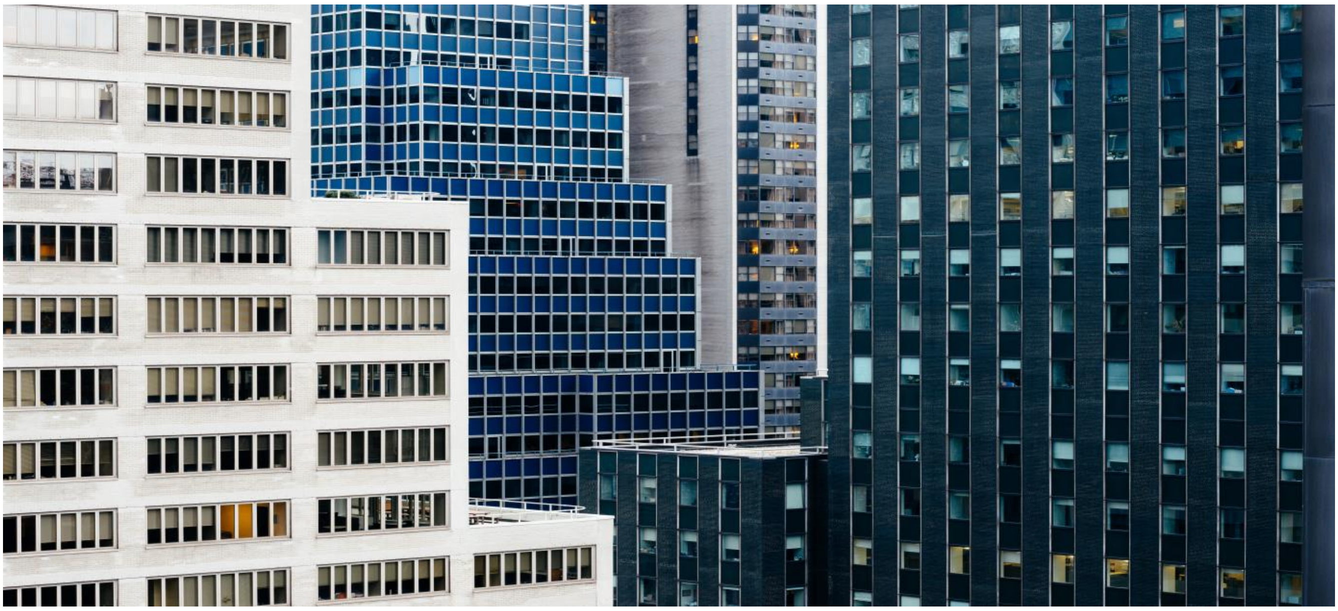
[Source: APRA Insight Issue Four – 2020, The superannuation Early Release Scheme: Insights from APRA's Pandemic Data Collection]

In Brief | No 'special status': ASIC has released an article by ASIC's Superannuation Senior Executive Leader Jane Eccleston clarifying what intra fund advice is, and confirming ASIC's expectations of intra fund advice providers

[Source: ASIC article, Clarifying intra-fund advice 04/12/2020]

In Brief | ASIC has deferred the first reporting date for superannuation funds to disclose their portfolio holdings to 31 December 2021 to allow additional time for the government to make the necessary regulations

[Source: ASIC media release 08/12/2020]



Risk Management

Key takeaways from an expert panel discussion on the three lines of defence model

In a panel discussion at the Governance Institute 2020 Conference, entitled Rethinking the three lines of defence approach, an expert panel - Luciennce Layton, Chief Risk Officer for Crestone Holdings Limited, David Tattam, Chief or Research, Knowledge and Consulting at The Protecht Group; Adriaan Van Jaarsveldt, Senior Advisor, Risk, Brookfield Infrastructure, Sydney and Mark Salomon Controls project manager at Growthpoint Properties (Chairing session) – discussed the effectiveness of the three lines model in practice and provided their insights into overcoming the challenges embedding the model effectively.

Some interesting points

Three lines of defence model – is this model sacrosanct?

Overall, the panellists agreed that the three lines of defence model is useful in ensuring that there are clear lines of accountability but that in order to be effective, it needs to be well-understood and supported throughout the organisation, including at board level. In addition, it needs to be implemented in way that ensures that there is focus on opportunities as well as risks.

Adriaan Van Jaarsveldt, Senior Advisor, Risk, Brookfield Infrastructure emphasised the importance of the board in making the three lines model work, and more particularly the role of the board in acting as a central coordinator or 'general of the troops' marshalling and directing them and ensuring open communication. The board is also crucial, he said, because they hold responsibility for the risk framework within the organisation and for setting the organisation's risk appetite. Given this, he considers it essential that risk is spoken about at board level and that the board is actively engaged on the issue. He suggested that if the three lines model is not working it 'may well be the board's fault'.

Commenting on the challenges of embedding a sound risk management framework with clear lines of accountability throughout the organisation, Luciennce Layton, Chief Risk Officer for Crestone Holdings Limited suggested it may be helpful to think of risk management and change management are 'two sides of the same coin' – a question of 'How do I manage this change? How can I make this happen?'

Ms Layton said that embedding sound risk practices/sound decision making throughout the organisation is a question of culture – that where the culture within the organisation is right, then there will be greater acceptance that risk management is both an opportunity and a responsibility.

In a similar vein, David Tattam, Chief or Research, Knowledge and Consulting at The Protecht Group spoke about the importance of ensuring that the three lines model is not seen/understood as a barrier to business. He said that the model should not be seen as being purely about 'defence' (guarding against negative risk) but also about capitalising on opportunities.

Could a more 'collaborative' approach be effective?

The panellists were asked for their views on whether rigid separation of the three lines is required in order for the model to be effective in practice or whether a more integrated or collaborative approach could be effective. The panel spoke about the fact that the model isn't hierarchical or even sequential – the effectiveness of each line of defence is not measured by its ability to block risks from flowing to the next line. Overall, there was agreement that provided that accountabilities are clearly understood, accepted and embedded within the organisation, that a collaborate approach can be effective.

Ms Layton suggested that there is too much focus on the model rather than the outcomes – ultimately she said that the model is only a means to an end. She stressed the importance of embedding understanding and acceptance of risk management as an organisational responsibility and suggested that, bearing this in mind, the three lines model is a useful way to conceptualise/articulate the responsibilities/accountabilities within the risk management framework, but that it should be treated as 'only a tool – not an outcome'.

As such, the three lines will play different roles according to the circumstances/needs of the organisation at different points.

For example, in a 'business as usual' context, Line 2 roles (risk management/compliance) will be focused on providing direction – ensuring that the business does not slip into complacency with respect to its compliance obligations. In contrast, in a startup context, where the biggest problem is getting the product off the ground – the focus will be on 'attack' or challenge. In the crisis context, where the challenge facing the business is unpredictability of future events, Line 2's role will be more to coach, encourage, train and 'hold hands' with management.

Each line has a different role in each scenario - so long as acceptance of the different lines of accountability is embedded in the culture, the model works effectively.

Mr Van Jaarsveldt suggested that as the independence of internal audit is safeguarded, and provided there is understanding and acceptance of the accountabilities embedded in each of the three lines across the business, that some blurring of lines 1 and 2 can work well in practice.

> 'At Brookfield risk managers are operational managers – they contribute to operational decisions, sit in on all meetings etc. This way they know the operational aspects of the business'.

Mr Van Jaarsveldt also suggested that there may be room for lines 1 and 2 (via the board) to have some input into where internal audit focuses its efforts, eg to point out to internal audit where a review might be helpful – even if uncomfortable, and for line 1 to review lines 2 and 3.

> [Source: Notes from the Governance Institute Conference 2020: Panel discussion, Risk concurrent 1B: Rethinking the three lines of defence approach 07/12/2020]

The evolution of risk management – Insights from an expert panel into the key challenges facing risk professionals

In a panel discussion at the Governance Institute 2020 Conference, entitled Risk management in the new world, an expert panel - Jason Brown, National Security Director at Thales; Minali Gamage, Manager Risk and Assurance at Fortescue; Joshua Hayward Deputy Head, Internal Audit at Energy Australia, chaired by Catherine Maxwell, General Manager Policy & Advocacy at the Governance Institute of Australia - reflected on the role of risk in a rapidly evolving environment and the challenges facing risk professionals now and looking into the future.

The discussion was informed by the findings of the Governance Institute's recent report – The Future of the Risk Management Professional which provides insights into the current state of the profession and the challenges facing risk professionals given the rapidly evolving environment. You can find the full text of the report here and our summary at page 29 of Governance News 02/12/2020 here.

Some interesting points

Ensuring risk is understood throughout the whole of the organisation

Asked for his thoughts on how understanding and responsibility for risk can best be transmitted throughout the organisation, National Security Director for Thales in Australia and New Zealand Jason Brown said that the board plays a key role – the board needs to accept and own accountability for risk and to resource the risk management function effectively.

In addition, he said that the risk management function within organisations also needs to direct line of communication to the board, and the support of the CEO.

From a risk management perspective, risk managers need to be forward-looking and ensure that they remain focused on the effect of uncertainties on the achievement of business objectives. The focus should not be purely on how to prevent something from happening to how best to enable the business to optimise opportunities.

Are risk managers perceived as firefighters?

Asked to comment on how the risk function is typically viewed, Manager of Risk and Assurance at Fortescue Minali Gamage said that in her experience, risk managers can be viewed very differently in different organisations.

In some organisations, risk is a formal compliance driven activity and in others it is more plugged into and driven by, what the business is doing with a strong focus on enabling better-decision making to achieve business objectives. Ultimately, her view is that it's unimportant what framework is used.

What's important is that risk management needs to be fit for purpose in the context of the organisation in which it operates – the risk management function needs to assist the organisation to make better decisions in furtherance of business objectives.

Future of risk management – the key skills risk managers are expected to have and will be expected to have going forward

The panel agreed that narrowing down a list of skills is diffiult, given the breadth of the role and the rapidity of changing conditions. Overall, technology and communication skills, as well as adaptability, a positive mindset and a willingness to think creatively and imaginatively about how to approach the role are/will be important.

Asked to comment on the skills risk managers are currently expected to have and the skills they will need looking forward, Deputy Head, Internal Audit Energy Australia Joshua Hayward said that it's challenging to pin down what exactly will be required given the ever-increasing complexity of the business environment and the rapidity with which it's changing.

The expectation is that risk managers 'cover everything' in order to be able to provide a high level view and present the board/executive with the information they need to make the best possible decisions now and looking forward. Understanding of current regulatory developments and increasingly, understanding/skills in technology are both important in this context, but are not in themselves the only new skills that risk managers will need.

Mr Hayward observed that one challenge, given that the risk environment is constantly changing, is maintaining a focus on the one constant in the role – a focus on purpose.

Asked to comment on her experiences in keeping purpose top of mind amid the changing landscape, Ms Gamage said that organisational values and personal values play a key role in helping to clarify where you can add value/where you can best deploy your skills. In addition, Ms Gamage said that there needs to be a willingness to 'immerse yourself in data' and the ability to adapt and think creatively about the best tools to deploy. For example, it may be appropriate to borrow from other disciplines eg psychology, in order to better understand decision making.

Ms Gamage said that going forward, risk professionals will need to 'maintain curiosity', to be humble, to learn, to listen to what they're hearing/seeing and to think creatively.

Mr Brown agreed with this, commenting that the capacity to think broadly, to use imagination, and to bring in other ideas to enrich their approach are important in helping risk managers support boards in thinking about the long-term implications of their decisions – in helping boards to build in 'future thinking'.

Does the three lines of defence model need to change?

Asked to comment on the effectiveness of the three lines model and whether it needs to change, the panel agreed that ultimately it's a question of ensuring there are clear lines of accountability and that those lines of accountability are understood within the organisation, whether this is done more formally and stringently or in a more integrated way.

Mr Hayward observed that currently the three lines model is not universally well understood at an organisational level, within a number of organisations. This is evident, he said from the emphasis placed on this issue in the recently issued Internal Auditors guidance.

> [Note: This appears to be a reference to the recently released best practice guide released by The Institute of Internal Auditors (IIA). The full text of the guide is here. You can find a summary at p24 of Governance News 02/12/2020 here]

Achieving a balance between risk and value – the role of risk managers

Asked to comment on how risk managers can best balance analysing risk and enabling the business to take advantage of opportunities Mr Brown suggested that a positive outlook – starting with what 'what will go right, not what will go wrong' could be helpful.

Ms Gamage commented that ultimately, understanding the business will give risk managers a stronger understanding of where the value lies for that particular business.

Mr Hayward commented that effective risk management is not always about resourcing or high spend, but rather about the risk management team focusing on purpose, and finding and focusing on the right activities to support that purpose.

Tailoring information to the needs of the board/executive receiving it, making sure it's as relevant as possible is also key. For example, in the context of COVID-19, providing a list of COVID-19 risks, may not be as helpful as providing a summary of how COVID-19 risks impact the existing risk framework.

Usefulness of scenario modelling

Asked to comment on the usefulness of scenario modelling, Ms Gamage said that ultimately she's found the value lies less in the outcomes of the exercise than in the way in which it raises management awareness/focus on possible future risks.

[Source: Notes from the Governance Institute Conference 2020: Panel discussion, Risk concurrent 2B: Risk management in the new world 07/12/2020]

In Brief | The Currency (Restrictions on the Use of Cash) Bill 2019 which proposed to introduces offences for entities that make or accept cash payments of $10 000 or more is not proceeding

[Source: Currency (Restrictions on the Use of Cash) Bill 2019]

Other News

In Brief | Aged Care Royal Commission to spur M&A activity: Writing in The AFR, MinterEllison's experts say structural issues in the aged care sector highlighted by the aged Commission present a clear opportunity for many in the sector

[Source: [registration required] The AFR 07/12/2020]

In Brief | Treasury is consulting on a new ACNC governance standard aimed at incentivising relevant charities to join the national redress scheme for child sex abuse. The deadline for submissions is 8 January

[Sources: Treasury media release 07/12/2020; [Exposure draft] Australian Charities and Not-for-profits Commission Amendment (2021 Measures No. 1) Regulations 2021; draft explanatory memorandum; FAQs]

In Brief | The government is set to introduce a new mandatory news media and digital platforms bargaining code to redress the bargaining power imbalance between digital platform services (Facebook NewsFeed and Google Search) and media outlets

[Source: Joint media release Treasurer Josh Frydenberg and Minister for Communications, Cyber Safety and the Arts Paul Fletcher 08/12/2020]

Tapping the potential of hydrogen: MinterEllison report released

Twelve months on from the launch of Australia's first National Hydrogen Strategy, Australia is well positioned to be a world leader in the hydrogen sector. According to Australia's national science research agency, CSIRO, hydrogen markets are on the verge of a 'tipping point'.

MinterEllison has developed a report exploring: the potential for hydrogen; financial, supply chain and regulatory issues; and the lessons to be learned from the country's recent experience in the CSG to LNG and solar power sectors.

The full text report can be accessed on our website here.

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