Governance News

26 February 2020

Mark Standen
Partner
Email Mark

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

Siobhan Doherty
Partner
Email Siobhan

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

Kate Hilder
Consultant
Email Kate

T +61 2 9921 8785 |

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

Contents

Diversity

A new requirement to take positive action towards achieving workplace gender equality: The Victorian Gender Equality Bill has passed both Houses

Key Takeouts

- The legislation introduces a new requirement for certain organisations (the public sector, councils and universities) to take positive steps towards achieve workplace gender equality.
- Organisations covered by the Bill will be required to develop a Gender Equality Action Plan every four years. The plans will include strategies for improving gender equality in the workplace.
- According to the Victorian government, over 300 organisations will be covered by the Bill
- Organisations will report publicly every two years on their progress.
- The Public Sector Gender Equality Commissioner will able to take steps to help ensure compliance including publicly naming entities who fail to comply.

The Gender Equality Bill 2019 (Vic) has been passed by both Houses. The Bill requires certain defined entities (broadly, the public sector, councils and universities) to take positive action towards achieving workplace gender equality and to promote gender equality in their policies, programs and services. The Bill also establishes the Public Sector Gender Equality Commissioner (Commissioner).

Announcing the passage of the Bill Victorian Premier Daniel Andrews said that 'history has been made with the Andrews Labor Government's Gender Equality Bill 2019 passing through Victorian Parliament – a landmark step in breaking-down discrimination and gender barriers in the workplace'.

Some Key Points

- **The legislation establishes the role of the Public Sector Gender Equality Commissioner** and outlines the Commissioner's functions and powers.
- **Imposes a duty on defined entities to promote gender equality:** The legislation requires defined entities to consider and promote gender equality and take necessary and proportionate action towards achieving gender equality when developing policies and programs and in delivering services that are to be provided to the public, or have a direct and significant impact on the public. The explanatory memorandum says that undertaking a gender impact assessment would be one kind of action that defined entities can take towards meeting this duty. In imposing this duty, the legislation makes clear that the intention is not to: a) create in any person any legal right or give rise to any civil cause of action; or b) affect in any way the interpretation of any law in force in Victoria; or c) affect the validity, or promote grounds for review, of any judicial or administrative act or omission.
- **Requires a defined entity to carry out a gender impact assessment** when developing or reviewing any policy or program or service provided by the entity that has a direct and significant impact on the public. The legislation sets out the requirements for the gender impact assessment.
- **Requires a defined entity to undertake a workplace gender audit before preparing a Gender Equality Action Plan** and the requirements for both the audit and the plan. The legislation also sets out the requirements for the publication and submission of the Gender Equality Action Plans to the Commissioner.
- **Requires a defined entity to make reasonable and material progress** in relation to the workplace gender equality indicators (as defined in the legislation).

- **Provides that the regulations may prescribe targets and quotas relating to the workplace gender equality indicators.** The regulations may also prescribe the defined entities or class of defined entities to which those targets or quotas apply.

- **Compliance and enforcement:** The legislation enables the Commissioner to issue a compliance notice to a defined entity in certain circumstances, and sets out the actions the Commissioner may take where the defined entity does not comply within the specified timeframe. This includes (among other things) naming the entity on the Commissioner's website.

Timing

- The Bill comes into operation on a day or days to be proclaimed or on 31 March 31 2021 if not proclaimed before that date.

- Part 9 of the Bill (which amends section 46(4) of the Local Government Act 2019 to require Council CEOs to have regard to the requirements of the Bill when developing and maintaining a workforce plan) comes into operation on 1 July 2021 to align with the commencement date of the Local Government Bill 2019.

[Sources: Premier Daniel Andrews media release 21/02/2020; Victorian Government: Gender Equality Bill; Gender Equality Bill 2019 (Vic); Explanatory Memorandum]

In Brief | The WGEA has announced the latest list of Employer of Choice Gender Equality (EOCGE) citation holders and separately, a report showing the effectiveness of the citation in improving workplace diversity. For example, the report found that EOCGE organisations had: a faster reduction in their gender pay gap than other organisations; a greater proportion of women in all levels of management when compared to non-EOCGE reporting organisations; a stronger pipeline of women moving into senior management roles over the same five-year period; a higher representation of women on their boards; and a higher proportion of female employees working full-time

[Sources: WGEA media release 25/02/2020; List of 2020 citation holders; WGEA media release 25/02/2020; Report: Employer of Choice for Gender Equality Leading Practices in Strategy, Policy and Implementation]

Shareholder Activism

Growing support for ShareAction's climate resolution at Barclays? The FT reports that the UK's largest pension fund has signalled support

Context: As previously reported in Governance News (15/01/2020 at p18) in January, ShareAction announced that 11 institutional investors, and 100 individual shareholders led by ShareAction filed a resolution at Barclays calling on the bank to phase out its financing of fossil fuel companies whose activities are inconsistent with the goals of the Paris Agreement. In addition, the resolution calls on Barclays to consider the social dimension of the transition to a low-carbon economy ie achieving a 'just transition'. According to ShareAction, the resolution is the first climate change resolution riled at a European Bank.

Nest has reportedly signalled support for the resolution: The FT reports that UK's largest pension fund, Nest has signalled its support for a shareholder resolution, coordinated by ShareAction, calling on Barclays to stop financing energy companies whose activities are not aligned with the goals of the Paris Agreement. Reportedly, the Church of England Pensions Board and EdenTree Investment Management, have also signalled their support of the resolution.

Reportedly, Nest has called on Barclays ahead of the May AGM, to 'show leadership on this critical issue [climate change] and present a clear and robust plan on how they'll phase out all financial services to companies that are not working to support the Paris Agreement'.

The FT comments that though Nest is not a large shareholder in Barclays, its support of the resolution is significant because many of its members are clients of the bank.

Barclays is reportedly engaging with shareholders on the issue: Reportedly, since the resolution was filed, Barclays has approached large shareholders to discuss the proposal. The FT quotes Barclays as saying that the bank continues to engage with ShareAction and with other shareholders on the issue and will make a further statement 'at the appropriate time'.

ShareAction has reportedly called on investors to make their voting intentions known to the board: The FT quotes ShareAction's campaign manager as calling on investors to make their voting intentions known to the board. 'There's clearly a tide of support swelling among the investor community for Barclays to tighten its energy policy and align its fossil fuel financing with the Paris climate goals. We urge investors sympathetic to the resolution to make their voting intention known to the board of Barclays and to their peers."

[Sources: ShareAction media release 08/01/2020; [registration required] The FT 22/02/2020]

Engagement results in withdrawal of shareholder proposal at Wells Fargo: Wells Fargo has ended mandatory arbitration for sexual harassment claims following dialogue with activist shareholder Clean Yield Asset Management

Wells Fargo & Company has announced that the company will no longer require employees who complain of sexual harassment to go through a mandatory arbitration process.

The statement notes that the decision was made following 'internal dialogue and feedback from various stakeholders' including with Clean Yield Asset Management, which submitted a shareholder proposal late last year that focused on mandatory arbitration of workplace sexual harassment claims. Clean Yield has since withdrawn the proposal.

The announcement quotes David Galloreese, head of Human Resources at Wells Fargo as saying that the board and CEO 'value and appreciate input from our stakeholders as we consider opportunities to enhance our practices and transparency…We are working hard to improve our company for our stakeholders.'

Response from Clean Yield Asset asx Management (Clean Yield)

In a statement welcoming Wells' announcement, and noting that the decision was made following dialogue with Clean Yield, Clean Yield called on other companies at which it has filed similar proposals, to follow suit. 'Wells Fargo has raised the bar for financial institutions aiming to root out sexual harassment in the workplace. This is a win for Wells Fargo's more than 250,000 employees. We urge other companies, particularly other big banks to follow suit' Clean Yield's Director of Shareholder Advocacy Molly Betournay said.

[Sources: Wells Fargo media release 12/02/2020; Clean Yield media release 12/02/2020]

Escalation of pressure at Alphabet? The FT reports that failed engagement with activists on human rights has prompted the filing of a resolution at Alphabet calling for increased human rights monitoring

The FT reports that a group of more than 10 large Alphabet shareholders including Axa Investment Managers, the Church of England and Aviva Investors, have co-filed a resolution at Alphabet calling on the company to strengthen its oversight of the human rights risks, including digital human rights risks (eg risks to individual freedoms such as freedom of expression and privacy) posed by its business. Reportedly, the resolution was co-ordinated by the Investor Alliance for Human Rights.

Increased human rights monitoring: According to The FT, the resolution calls on the company to set up an independent committee at board level tasked with monitoring human rights risks in its products and value chain.

Context: Reportedly, the resolution was filed following failed engagement with Alphabet at the end of 2019 on the issue. According to The FT, a group of 83 investors wrote to Alphabet last year raising concerns about the controls in place to monitor human rights risks and requesting a meeting to discuss the issue with the company. Reportedly, Alphabet dismissed the concerns raised and declined to meet with the group. According to the FT, this prompted the filing of the resolution.

[Source: [registration required] The FT 24/02/2020]

Institutional Shareholders and Stewardship

ACSI will reportedly step up pressure on companies to take climate action over the next 12-18 months

ACSI will reportedly step up pressure on companies to plan for/act on climate risk: The Australian reports that the Australian Council of Superannuation Investors (ACSI) has flagged that it will pursue and expanded climate agenda in 2020 including: a) expecting companies to 'do climate modelling' and to apply rigour to the process; and b) for smaller companies to engage with ACSI on climate issues.

ACSI CEO Louise Davidson is quoted as saying that 'over the next 12-18 months, there will be more companies expected to do climate modelling, and more rigour expected from that modelling…Our members have been working in this area for a long time, but the recent bushfire season has really changed the public perception and expectations about the changing climate…Change has to happen; otherwise what we saw over summer is going to happen every summer, and that would be terrible for all of us'.

In addition, Ms Davidson reportedly said that engagement with listed companies on climate-related issues will include engagement with smaller companies. 'There will be companies that we'll have discussions with for the first time…What investors don't like is nasty shocks, so one of the things they would really like to see happening is an orderly, planned transition instead of being subjected to green bans and a scramble for change.'

Supportive of BlackRock's approach: Reportedly Ms Davidson expressed support for recent commitments/comments made by BlackRock in relation to climate issues. In particular, Ms Davidson reportedly expressed support for BlackRock's decision to exit thermal coal, and its commitment to 'active ownership' including through increased engagement. Ms Davidson is quoted as saying 'For me, the real power of the BlackRock announcement is its pledge for more scrutiny of companies' climate preparedness, and to back it up with voting power, on the index part of their portfolios…That's what our members want to see, so what BlackRock has done is consistent with what a lot of their clients would be wanting them to do'.

ACSI's voting record on shareholder climate resolutions: The Australian comments that ASCI supported only one shareholder requisitioned climate resolution in 2019. Ms Davidson reportedly gave a number of reasons for this including that some resolutions are 'not well-formulated'. For example, Ms Davidson is quoted as saying that 'There are resolutions that ask companies to do things that they've already committed to do, and we don't support resolutions that do that…And there are other cases where the discussions leading up to the shareholder resolution being put result in companies making commitments that the resolution calls for.'

Reportedly, Ms Davidson also questioned whether ACSI's voting record alone is a reliable indication of active ownership given it does not reflect the level of engagement taking place. Engagement, Ms Davidson reportedly suggested, could lead to more attractive outcomes than voting against a particular resolution.

[Source: [registration required] The Australian 22/02/2020]

HESTA is reportedly facing increased pressure to divest itself of fossil fuel stocks

The SMH reports Healthy Futures (an affiliate of Friends of the Earth) has stepped up efforts to persuade HESTA to divest itself of fossil fuel stocks. The group is calling on members to write to the fund asking that it pull out of 19 fossil fuel producers with business models the group considers to be inconsistent with the Paris climate agreement.

HESTA argues that divestment is necessary on the basis that continued investment in such companies is: 1) contrary to the financial interests of members; and 2) because of the global health threat climate change poses (ie the pollution caused by combustion of fossil fuels causes 'hundreds of thousands of deaths worldwide each year).

Reportedly, support for the campaign has risen following the fires over the summer.

According to The SMH, Healthy Futures has requested a meeting with HESTA, but has received no response from the fund. Healthy Futures is reportedly planning to protest at the fund's Melbourne office to demand a meeting.

The SMH reports that HESTA has made no comment, but has previously maintained (as have other funds) that retaining a stake in the fossil fuel industry enables it to lobby for more sustainable practices.

[Sources: The SMH 24/02/2020; Healthy Futures]

In Brief | Time to 'focus' on a carbon tax? BlackRock CEO Larry Fink has reportedly said that Australia should 'go much faster into renewables' but that the transition away from coal will necessarily take time. Mr Fink also reportedly said that Australia and other countries should 'focus on a carbon tax' to reduce demand for carbon (though he reportedly emphasises that it needs to be carefully designed to ensure it doesn't unfairly disadvantage those who cannot afford it)

[Sources: [registration required] The Australian 25/02/2020; [registration required] The AFR 26/02/2020]

In Brief | Active management as an antidote to 'greenwashing'? The Australian reports that three fund managers — Capital Group, MFS Investment Management and Baillie Gifford — are set to announce the formation of a landmark Australian alliance, the Active Advantage 2020 collaboration, to address promote the credentials of active managers. Reportedly the alliance replicates similar initiatives launched elsewhere over the past year

[Source: [registration required] The Australian 24/02/2020]

Meetings and Proxy Advisers

United Kingdom | Levels of 'significant dissent' on the rise at UK companies? The Investment Association has identified that a quarter of FTSE all-share companies were added to the public register in 2019

Context: For the past three years, the UK Investment Association (IA) has kept a public register, tracking when FTSE all-share companies receive a vote of over 20% at an Annual General Meeting (AGM) or General Meeting (GM).

Levels of 'significant' dissent on the rise

The IA has announced that in 2019:

- a quarter of the FTSE all-share companies, and 298 individual resolutions, were added to the register (up from 151 companies and 294 resolutions in 2018)
- 39 companies appeared on the Register for the same resolution in both 2018 and 2019
- The IA found that executive pay continues to be a key concern for investors: 62 companies were listed on the register in 2019 for pay-related resolutions including 31 FTSE 250 companies (an increase of over 29% on 2018).
- Opposition to individual director re-election also remained a key investor concern, with the number of resolutions against individual directors remaining constant at 103 in 2019 (105 in 2018).
- The IA found that companies are doing more to acknowledge shareholder dissent, with over 80% of firms now making a public statement acknowledging the concerns and outlining how they plan to engage with shareholders – an increase from 55% in the Public Register's first year.

Announcing the findings, Andrew Ninian, Director for Stewardship and Corporate Governance at the IA, said: 'Investment managers are keeping up the pressure on companies to align executive pay with their long-term strategy. With a quarter of FTSE All Share companies ending up on the Register in 2019, investment managers will be paying close attention this year when companies bring their pay policies to the table to see whether they've heeded the high levels of dissent.'

[Sources: Investment Association media release 20/02/2020; [registration required] The FT 20/02/2020]

Markets and Exchanges

The ASX, in partnership with S&P Dow Jones Indices, has announced the launch of the All Tech Index

The ASX, in partnership with S&P Dow Jones Indices has announced the launch of the S&P/ASX All Technology Index (All Tech Index) which captures companies in the technology sector.

The statement says that the All Tech Index will operate under an S&PDJI methodology and at launch, will have 46 constituents with a combined market capitalisation of over $100 billion.

Eligibility for the index includes minimum float-adjusted market cap, daily traded value and liquidity thresholds. The index does not have a set number of constituents; its makeup can change at each quarterly rebalance.

ASX CEO and Managing Director, Dominic Stevens said that the All Tech Index will enhance the profile and understanding of listed technology companies in Australia and increase opportunities for investors. 'Many of the companies included in the All Tech Index started as small caps and have grown into billion dollar companies…International firms, such as those from the United States, New Zealand and Europe, also see the opportunity to list and grow on the ASX market. A number are included in this new index' Mr Stevens is quoted as saying.

[Source: ASX media release 21/02/2020; Investor Daily 21/02/2020; [registration required] The AFR 24/02/2020]

ASIC consults on proposals to reduce 'red tape' for IPOs: ASIC is seeking feedback on proposals to grant conditional relief for voluntary escrow arrangements and pre-prospectus communications

The Australian Securities and Investments Commission (ASIC) Consultation Paper 328 Initial public offers: Relief for voluntary escrow and pre-prospectus communications seeks feedback on proposals to grant relief in the context of an initial public offer (IPO) to:

- allow public companies, professional underwriters and lead managers who have obtained relevant interests as a result of voluntary escrow arrangements to disregard them for the purposes of the takeover provisions (but not substantial holding provisions); and
- permit companies to communicate certain factual information to security holders and employees before the company lodges an IPO prospectus.

ASIC says that the proposed changes are intended to reduce and simplify the regulatory costs for companies undertaking an IPO while maintaining investor protection and market integrity.

Announcing the changes, ASIC Commissioner John Price said: 'It is important that voluntary escrow arrangements and pre-prospectus communications continue to be appropriately regulated so that our market remains orderly and transparent. The proposals strike a balance between reducing red-tape for an IPO and managing the risks that might otherwise occur in the absence of regulation'.

[Note: Page 27 of CP 328 includes a table summarising ASIC's proposals and questions on which ASIC seeks feedback. The table can be accessed on the ASIC website here.]

Timing: The due date for submissions is 6 April 2020.

[Sources: ASIC media release 24/02/2020; CP 328: Consultation Paper 328 Initial public offers: Relief for voluntary escrow and pre-prospectus communications; [registration required] The Australian 24/02/2020]

Regulators

The ACCC has announced its 2020 Compliance and Enforcement Priorities: Competition and consumer issues in the funeral services sector and digital platform issues are among the ACCC's ten top priorities over the next twelve months

On 25 February, Australian Competition and Consumer Commission (ACCC) Chair Rod Sims announced the ACCC's compliance and enforcement priorities for 2020 in a speech to the annual Committee for Economic Development Australia (CEDA).

2020 Priorities

The ACCC's priorities are determined following external consultation and an assessment of existing or emerging issues and their impact on consumer welfare and the competitive process. They include current priorities and 'enduring priorities'.

1. **Competition and consumer issues in the funeral services sector:** Mr Sims raised concerns that some funeral businesses are using their significant market power bundle services and block new entrants to the market or engage in unconscionable conduct. 'There have been reports from people within the sector of anti-competitive conduct such as misuse of market power and exclusive dealing. We strongly encourage whistleblowers to come forward' Mr Sims said. There is also concern, Mr Sims said, about: a) the lack of price transparency for funeral services; b) the 'the difficulties consumers face in making an informed decision'; c) complaints from consumers about 'misleading and deceptive practices in the sector' eg hidden fees, add on services; d) allegations of unfair contract terms within funeral service and pre-paid funeral contracts; and e) inflated pricing, complex and opaque pricing and product bundling. Mr Sims said that by selecting this as a priority, the ACCC aims to improve our understanding of the market and undertake targeted action.

2. **Competition and consumer issues relating the digital platforms:** Mr Sims said that as outlined in ACCC's 2019 Digital Platforms Inquiry final report, the ACCC has concerns about 'consumers being misled over the collection and the use of their personal data, as well as a range of important competition issues, some also linked to data'. Mr Sims said that the Federal Government has now funded the establishment of a permanent Digital Platforms Branch at the ACCC to ensure proactive scrutiny of the sector and the regulator is 'advancing many investigations'. Mr Sims added that the ACCC has 'advanced investigations involving digital platforms allegedly misleading consumers about the collection and the use of their personal data, and we have important competition matters before us'.

[Note: The full text of the ACCC's 2019 Digital Platforms Inquiry Final Report is here. For an expert summary of the report see: ACCC calls for competition reforms that will impact digital platform operators and beyond 08/08/2019. For a summary of the government's response to the report see: Government's support of ACCC Digital Platforms Inquiry 13/12/2019]

3. **Competition and consumer issues arising from the pricing and selling of essential services with a focus on energy and telecommunications:** Mr Sims said that the pricing and selling practices of essential services, combined with the lack of transparency in their pricing, continue to be an area of concern for the ACCC, and have therefore been retained as a priority in 2020.

4. **Misleading conduct in relation to the sale and promotion of food products**, **including health and nutritional claims, credence claims and country of origin:** Mr Sims said that 'the growing community attention to health-related issues has led the ACCC to take a more active role in preventing deceptive conduct in the marketing of food products'. Mr Sims said that in 'selecting this as a priority we are focusing on those products that make misleading claims about the health or nutritional content of foods, either on the product itself and/or in its associated marketing, and have capacity to cause substantial consumer detriment'. Mr Sims added that the ACCC will work closely with other regulators to improve compliance in this area

5. **Conduct affecting competition in the commercial construction sector**, **with a focus on large public and private projects and conduct impacting small business:** Mr Sims said that the ACCC's 'dedicated Commercial Construction Unit' is 'looking at conduct affecting competition and poor trading practises in the commercial construction sector, including secondary boycotts and other conduct impacting small businesses and large public and private projects'. Mr Sims flagged that 'the fear of reprisal and

unwillingness of complainants or whistleblowers to come forward is, however, a fundamental problem we must overcome'. In addition, Mr Sims said that the ACCC has investigations underway into secondary boycotts, activity aimed at damaging individual small businesses and unfair contract terms.

6. **Ensuring that small businesses receive the protections of the competition and consumer laws, with a focus on the Franchising Code of Conduct:** Mr Sims said that the ACCC 'remains concerned that many franchisees cannot freely operate their business because of the prevalence of some questionable industry practices', adding that the regulator has a 'number of important cases we want to bring before the courts which we think will highlight some of the significant problems in the sector'. In addition, Mr Sims said that the regulator is concerned that franchise systems do not focus on running a viable system, to the benefit of both franchisees and franchisors. He said that the regulator is working with the government's Franchising Taskforce to address some of these concerns.

7. **Ensuring compliance with the Dairy Code of Conduct:** The Dairy Industry Code of Conduct came into effect on 1 January 2020. Mr Sims said that the ACCC will be working closely with the affected dairy farmers and processors to ensure a smooth implementation, and to educate them about their rights and obligations under the Code. The ACCC will also enforce the Code where significant non-compliance issues arise. A review of the Code's role, impact and operation will take place after 12 months.

8. **Empowering consumers and improving industry compliance with consumer guarantees**, **with a focus on high value goods such as motor vehicles and electrical and whitegoods:** Mr Sims said improving 'industry compliance with consumer guarantees through a combination of industry education and guidance and enforcement action where appropriate' will be a focus for the ACCC this year. 'There will be a particular focus on educating consumers to understand their consumer rights, and empowering them to enforce them' Mr Sims said. Mr Sims added that 'it is hoped that further enforcement and compliance initiatives will result in the long anticipated change in industry behaviour and drive increased compliance with consumer guarantee obligations'.

9. **Pursuing regulatory options to prevent injuries and deaths to children caused by button batteries**: Mr Sims said that 64 children are known to have died globally and 'hundreds' of others have been hospitalised as a result of swallowing button batteries. Mr Sims said that the Button Batteries Taskforce which was established last year is reviewing the adequacy of industry actions to mitigate these risks and to consider what regulatory options might be available. Options being considered include requirements for secure battery compartments on products containing button batteries, child resistant packaging and warnings. Draft recommendations outlining proposed regulatory options will be released for public comment in the first half of 2020.

10. **Finalising the compulsory recall of vehicles with Takata airbags:** Mr Sims said that the regulator has made 'good progress with the largest-ever recall in Australia, with 2.6 million of the 3 million affected vehicles now repaired; but that the work is not yet complete'. As such, completing the work remains a priority for the ACCC. Mr Sims said that the ACCC has been working with the Department of Infrastructure, Transport, Regional Development and Communications to assist the transitioning of full responsibility for motor vehicle safety from 1 July 2021, when the Department gains compulsory recall powers for motor vehicles. The ACCC is also assisting the department on other significant airbag recalls not covered by the compulsory recall notice.

'Enduring priorities': In addition to the above, the ACCC identifies the following five areas: a) cartel conduct causing detriment in Australia; b) anti-competitive agreements and practices and the misuse of market power; c) product safety issues which have potential to cause serious harm to consumers; d) conduct impacting vulnerable and disadvantaged customers; and e) conduct impacting Indigenous Australians as 'enduring priorities' on the basis that the conduct is 'so detrimental to consumer welfare and the competitive process that the ACCC will always regard them as a priority'.

Other issues that will be prioritised by the regulator: In addition to these areas, the ACCC says that it will give 'particular consideration' to matters where the conduct is: a) of significant public interest or concern; b) results in substantial consumer or small business detriment; c) is national conduct by large traders (with potential for greater consumer detriment/with potential to influence other market participants); d) involves a significant new or emerging market issues or where the ACCC's action is likely to have an educative or deterrent effect; or e) where the ACCC's action will assist to clarify aspects of the law (especially newer provisions of the Act).

Compliance and enforcement strategy

The ACCC uses four flexible and integrated strategies:

1. encouraging compliance with the law, particularly by educating and informing consumers and traders about their legal rights and responsibilities;

2. enforcement of the law, including resolution of possible contraventions both administratively and by litigation and other formal enforcement outcomes;

3. undertaking market studies, or reporting on emerging competition or consumer issues with a view to identifying any market failures and how to address them, and to support and inform compliance and enforcement measures and identify possible areas for policy consideration; and

4. cooperation with other agencies to implement these strategies, including through coordinated approaches.

Strategic approach to enforcement

The ACCC states that it 'cannot pursue all matters that come to our attention'. Rather, it views its role as addressing issues to deliver the greatest overall benefit, that is, focusing on issues that will have/have potential to impact vulnerable consumers, harm the competitive process or result in widespread consumer or small business detriment.

The ACCC states that in deciding which compliance or enforcement tool (or combination of such tools) to use, its first priority is achieving the best possible outcome for the community and to manage risk proportionately. 'Our enforcement actions seek to maximise impact and leverage any outcomes across an industry sector. For example, we use the outcome of one court proceeding to encourage other industry participants in the sector to change their practices'.

[Sources: ACCC media release 25/02/2020; ACCC Compliance & Enforcement policy & priorities 2020; ACCC Summary 2020 Compliance and Enforcement Priorities; Speech to the Committee for Economic Development Australia, ACCC 2020 Compliance and Enforcement Priorities, 25/02/2020; [registration required] The AFR 26/02/2020]

New Zealand | RBNZ flags plans to take a 'more proactive interest' in overseeing the effective management of cyber-risk given the scale of potential costs for NZ's financial system

The Reserve Bank of New Zealand (RBNZ) has released an article as part of an expanding program of work on risks to the financial system, on the potential costs of cyber threats to New Zealand's financial system.

Some Key Findings

- **Cyber-attacks could cost New Zealand's financial sector more than $100 million a year on average**, with the modelling indicating that in any given year there is a 5% change the costs could exceed $2.3bn. However, these estimates do not include 'additional costs' such as the possible loss of confidence in the financial system.

- **The country's cyber-security agency CERT NZ found more than 60% of cyberattacks on New Zealand organisations in 2018 targeted firms in the financial and insurance services sector**.

Implications: RBNZ writes that the findings underline the need for industry resilience to counter the threat of cyber-attacks.

Next steps: The Reserve Bank says that it is strengthening its efforts to enhance the resilience of the financial system from cyber threats, including by: a) developing risk management guidance; and b) promoting information-sharing in collaboration with industry and other public organisations.

[Sources: RBNZ 25/02/2020; Reserve Bank Bulletin, Vol 84, No 2 February 2020: Cyber incident cost estimates and the importance of building resilience]

United Kingdom | The FRC has released guidance for companies on disclosure or risks/reporting consequences arising from the emergence/spread of COVID-19

On 18 February, The Financial Reporting Council (FRC) released guidance for companies on disclosure of risks and other reporting consequences arising from the emergence and spread of Coronavirus (COVID-19).

The guidance states that 'companies should consider whether to refer to the possible impact of COVID-19 on their business in their reporting of principal risks and uncertainties. Where mitigating actions can be taken, these should also be reported alongside the description of the risk itself. As well as possible inclusion within a company's disclosures of principal risks and uncertainties, the carrying value of assets and liabilities might also be affected with a need to perform additional impairment tests and to assess whether leases have become onerous…Given the potential for rapid spreading of the virus, required disclosures will likely change over time as more information about the epidemic emerges. As a result, companies will need to monitor developments and ensure that they are providing up-to-date and meaningful disclosure when preparing their year-end reports'.

The FRC says that the guidance will be 'particularly relevant' for companies either operating in/with close trading connections with China but that depending on the extent to which the virus spreads outside of China, other companies could also become affected.

In a statement, announcing the release of the guidance the FRC said it is also discussing with audit firms whether the virus affects their ability to review component audits in China and the consequences to delivering timely audit opinions.

The FRC said that given the rapid spread of the virus, it expects companies to 'monitor developments and ensure they are providing up-to-date and meaningful disclosures to their shareholders when preparing their year-end reports.'

Global issue

- The WSJ reports that US regulators have also issued warnings to companies and investors and Apple Inc has already said it expects to miss revenue forecasts for the current quarter due to the virus outbreak.
- The AFR reports that the International Monetary Fund (IMF) has identified both the spread of the virus and the recent bushfires as threats to Australia's economy. 'Disruption in China will flow to Asia-Pacific through four channels: people flows, supply chains, goods trade, and commodity prices' the IMF is quoted as stating.
- BlackRock CEO Larry Fink has reportedly cautioned that the virus could slow the global economy, with markets underestimating its likely impact.
- According to media reports, companies across a range of sectors are flagging that the virus outbreak may/in some cases will, impact results. The Australian report that the S&P/ASX 200 index closed down 111.67 points, or 1.6%, at 6866.6 points after falling as much as 2.6% to a seven-week low of 6800 in early trading on 26 February. This followed the largest one day fall since 5 February 2018 in the US S&P 500 index.

[Sources: FRC media release 18/02/2020; FRC guidance; [registration required] The WSJ 18/02/2020; [registration required] The AFR 20/02/2020; The ABC 20/02/2020; [registration required] The Australian 19/02/2020; 25/02/2020; 26/02/2020; Mining Technology 13/02/2020; 18/02/2020]

Financial Services

Tightening accountability is 'smart business practice': APRA Deputy Chair Helen Rowell encourages industry to take a proactive approach to preparing for the FAR

Key Takeouts

- Australian Prudential Regulation Authority (APRA) Deputy Chair Helen Rowell emphasised that the regulator considers tightening accountability to be good business.
- Ms Rowell called on industry to take a proactive approach to tightening accountability, including taking steps to prepare now for the proposed Financial Accountability Regime (FAR). Ms Rowell also identified

some examples of areas where entities struggled with BEAR implementation and suggested workarounds.

- Commenting on the proposed changes to APRA's prudential standard on remuneration (draft CPS 511) she said that APRA is 'thinking hard' about the feedback received and expects to 'publicly announce the next steps in this process in the coming months'.

In a speech entitled, 'A is for Accountability' Australian Prudential Regulation Authority (APRA) Chair Helen Rowell spoke about the steps APRA will be taking in 2020 to ensure both APRA-regulated entities, and APRA itself, are held to a higher standard of accountability.

Ms Rowell said that it is imperative for financial institutions to accept, and 'to take the lead on enhanced accountability' in the post-Hayne environment. 'It is ultimately in institutions' long-term financial interests for their boards and management to take the lead on enhanced accountability, because a greater emphasis on accountability in the post-Hayne era is inevitable' Ms Rowell said.

Some Key Points

Work still to do

Reflecting on the progress made since the Financial Services Royal Commission's final report was handed down Ms Rowell said that the issues identified have not yet been fully rectified. Though, she also observed that given the scale of the issues in question, and the scope and complexity of the recommended reforms, 'that's to be expected'.

Ms Rowell identified the lack of clear accountability and consequences as 'significant contributing factors to the misconduct and poor behaviour highlighted by Commissioner Hayne' and have this as the reason for APRA's focus on lifting industry standards in this area.

APRA's approach to accountability

Ms Rowell said that APRA's approach to accountability is underpinned by APRA's view that: 1) boards are ultimately responsible and therefore accountable for their companies, executives employees and for the outcomes they deliver to consumers; and 2) that APRA is responsible for holding entities, including boards and senior managers, to account for meeting their prudential obligations, and accountable for ensuring it has the tools/powers needed to do so. This is reflected in the information paper released in November last year, outlining the regulator's approach to GCRA Ms Rowell said.

[Note: The information paper referred to appears to be APRA information paper: Transforming governance, culture, remuneration and accountability: APRA's approach which sets out APRA's intensified approach to the supervision of GCRA risk within regulated entities. The paper is available on the APRA website here. For a summary see: Governance News 20/11/2019.]

No expectation that nothing will go wrong, but APRA does expect prompt action when they do

Ms Rowell said that 'APRA acknowledges that issues will always arise and things will go wrong. What is important in determining how APRA responds when this occurs is the timeliness, comprehensiveness and effectiveness of your response, and the openness and transparency of your engagement with APRA. Indeed, APRA's objectives in this regard should be largely aligned with the boards of the entities we regulate – namely well governed and prudentially sound entities with a culture that promotes good outcomes for consumers. And that includes being prepared to take prompt and appropriate action when that is not the case'.

APRA is 'thinking hard' about proposed changes to CPS 511 Remuneration

Ms Rowel cited APRA's proposed changes to CPS 511 Remuneration as an example of APRA's approach to accountability. Ms Rowell observed that APRA has received a lot of feedback on the proposed changes reflecting the 'divergent and often strongly-held, views across various stakeholders on how best to promote appropriate remuneration outcomes for executives' much of which was 'critical of what APRA was proposing'.

She said that 'disappointingly from APRA's perspective, we received much less in the way of realistic alternative suggestions as to how we could design the standard differently to satisfy disgruntled stakeholders while still achieving our regulatory objectives'. Ms Rowell said that thought eh 'status quo is not an option', APRA also recognises the 'genuine concerns raised by stakeholders about some aspects of draft CPS 511' and has therefore been 'thinking hard about the options, especially around the 50 per cent limit on financial performance measures…Our challenge in revising the draft standard is to design a package of requirements that remains true to the intention of the [Financial Services Royal Commission's] recommendation'. Ms Rowell said that APRA plans to 'publicly announce the next steps in this process in the coming months'.

Proposed Financial Accountability Regime (FAR)

- **APRA is considering how the proposed new remuneration prudential standard will interact with the extended Banking Executive Accountability Regime (BEAR)** and has been engaging with government on the design of the FAR. Ms Rowell said that though 'the Government has foreshadowed its intention to introduce legislation creating the FAR before the end of the year…there is much that entities can and should be doing now to ensure they are well prepared'.

- **APRA is supportive of 'the principle of increasing the clarity of accountability for insurers and superannuation licensees'** given the benefits it has seen from the BEAR, though the decision to expand the BEAR to other areas of the financial services industry, along with the design of the new regime, are ultimately matters for government Ms Rowell said.

- **An opportunity for industry:** Ms Rowell said that 'the FAR proposals provide an opportunity for entities to be pre-emptive, and establish clear lines of accountability to potentially head off future problems. Doing so will ensure that if and when significant failings happen, the entity itself can quickly and effectively enforce appropriate accountability'.

- **Suggested steps to prepare for the FAR:** Ms Rowell identified three areas where organisations implementing the BEAR 'struggled' in implementation and suggested work-arounds to avoid them.

  - **The first step should be clarifying internal lines of accountability:** Ms Rowell said that 'irrespective of the FAR, this is a useful process that can highlight any deficiencies and weaknesses, including any unduly complex arrangements within an institution's governance and accountability arrangements, and enable them to be addressed. Based on APRA's experience of BEAR implementation, this is a more helpful first step than focusing on the content and format of the accountability statements and maps'.

  - **Concentrate on the 'appropriateness of who is included as an accountable person' not on the number of accountable persons** Ms Rowell advised. Ms Rowell suggested that 'institutions should…seek to meet requirements in a way that reflects the understanding of senior executives and directors of how accountability should work in practice within their organisation. Nevertheless, a very small number of accountable persons may be an indication that accountability is overly concentrated, while a very large number of accountable persons may be an indication that accountability is inappropriately diluted'.

  - **Over-use of consultants:** Ms Rowell said that APRA 'observed that the entities more likely to face challenges implementing the BEAR requirements were those that engaged consultants to do it for them, including drafting their accountability statements and maps, rather than utilising consultants to facilitate structured internal discussion and assist (rather than drive) their development. Institutions may well wish to use external advisors to facilitate, provide structure or challenge their internal dialogue, however it remains the responsibility of each institution to own and drive its understanding of how accountability works within its organisational structure'. Ms Rowell added that accountable persons should be involved 'early and deeply in the process as they are the ones who must meet their FAR obligations and ultimately bear the risk of breaches should they not do so'.

- **Proposed new enforcement tools under the FAR:** Commenting on the proposed more 'flexible set of enforcement tools' under the FAR, including the power to issue financial penalties, Ms Rowell said that the 'the ability to issue fines under the FAR would…provide an intermediate option between taking no action and the nuclear option of pursuing disqualification'.

Steps to increase APRA's own accountability

- Increased transparency: Ms Rowell said that over the past 12 months APRA has taken steps to increase its own accountability to parliament and the community, primarily through greater transparency. For example, she noted the release of APRA's own accountability map and statements at the end of last year.

- Support for the creation of the Financial Regulator Assessment Authority: In addition, Ms Rowell said that APRA is engaging with government to support Commissioner Hayne's recommendation that a new oversight body — Financial Regulator Assessment Authority — be established to oversee APRA and ASIC. 'With consultation on the draft legislation now underway, APRA is working with the Government to ensure the new Financial Regulator Assessment Authority is well placed to provide the Government with an effective assessment of regulator performance against their respective mandates' Ms Rowell said.

- APRA's 'constructively tough' approach to enforcement: Ms Rowell said that 'APRA's constructively tough approach not only involves adopting a lower threshold for taking formal enforcement action, but a greater willingness to make actions known publicly. This approach also aligns with our new GCRA approach, with its declared intent to sharpen supervisory focus on holding entities accountable for promptly addressing deficiencies, and sharing insights with industry and the public to reinforce prudential expectations and act as a general deterrent'.

Tightening up accountability frameworks is good business

Ms Rowell concluded by saying that she is encouraged by the progress that has been made. Ms Rowell emphasised that 'tightening up accountability frameworks and practices within financial institutions – or any type of institution – is smart business practice…It is ultimately in institutions' long-term financial interests for their boards and management to take the lead on enhanced accountability, because a greater emphasis on accountability in the post-Hayne era is inevitable'.

[Source: Deputy Chair Helen Rowell - speech to the Australian Institute of Company Directors Breakfast, A is for accountability 20/02/2020; Investor Daily 20/02/2020]

ASIC is consulting on draft guidance on the new best interests duty for mortgage brokers

Overview of ASIC consultation: CP 327: Implementing the Royal Commission recommendations: Mortgage brokers and the best interests duty, and draft guidance

Key Takeouts

- **Context:** Legislation implementing the government's response to Hayne Commission recommendations 1.2 (best interests duty for mortgage brokers) and 1.3 (broker remuneration) — Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Bill 2020 (Act No 2, 2020) received Royal Assent on 17 February.

- **Scope:** Broadly, the draft guidance explains ASIC's: a) interpretation of the best interests obligations; b) expectations for meeting the obligations; and c) general approach to administering the obligations.

- **Timing:** Mortgage brokers will need to comply with the best interests obligations — ie to act in the best interests of consumers and to prioritise consumers' interests when providing credit assistance — from 1 July 2020. The deadline for submissions to the consultation is 20 March 2020. The regulatory guide will be released in May 2020.

- **Industry encouraged to take a proactive approach:** ASIC says that it is issuing draft guidance as early as possible in order to give industry a 'chance to 'make changes and improve practices before the new obligations commence'. ASIC says that over time, its approach to administering the best interests obligations may evolve and it intends to update the guidance as required.

Context

Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Bill 2020 (Act No 2, 2020) received Royal Assent on 17 February.

Among other things, the legislation introduces a best interests duty for mortgage brokers in response to Hayne recommendation 1.2. That is, from 1 July 2020 brokers will be required to: a) act in the best interests of their consumers (best interests duty); and b) prioritise their consumers' interests when providing credit assistance (conflict priority rule).

Draft guidance on complying with the new obligations

The Australian Securities and Investments Commission (ASIC) has released a consultation paper, CP 327: Implementing the Royal Commission recommendations: Mortgage brokers and the best interests duty — and draft guidance on the new obligations for consultation. The guidance is intended to assist brokers to comply with the new obligations.

Broadly, the draft guidance explains ASIC's: a) interpretation of the best interests obligations; b) expectations for meeting the obligations; and c) general approach to administering the obligations.

Principles-based approach

ASIC explains that consistent with the new obligations, the draft guidance is principles-based and does not contain a 'safe harbour' within which a broker is deemed to have complied with the obligations.

The purpose of the guidance is to explain the new obligations, ASIC writes, rather than to 'prescribe conduct or impose additional obligations', and as such the guidance is principles-based. This approach is supplemented by examples, which are intended to illustrate what the obligations may require in particular situations.

Overview: Proposed Guidance and Feedback Questions

[Note: The consultation paper includes a table listing ASIC's proposals and specific questions on which the regulator is seeking feedback at p28. The consultation paper is available on ASIC's website here]

- **Structure of the guidance:** ASIC proposes to provide high-level guidance on its expectations for what mortgage brokers may need to do to meet the best interests duty when: a) gathering information about the consumer; b) making an individual assessment of what is in the consumer's best interests; and c) presenting information and recommendations. ASIC seeks feedback on both its proposed approach to structuring the guidance around the mortgage broking process and whether any steps relevant to the best interests duty are missing from the guidance.

- **Gathering relevant consumer information:** The draft guidance suggests that mortgage brokers should gather relevant information to ensure they can provide recommendations that will be in the consumer's best interests and that this may involve 'an iterative process of receiving instructions and making inquiries'. ASIC seeks feedback on: a) what information brokers typically gather before considering products currently; b) what steps are currently taken to verify this information; and c) the circumstances in which mortgage brokers should make further inquiries into a consumer's circumstances to act in their bests interests.

- **Making a product assessment: assessing which product is in a consumer's best interests**

    - **Conducting a 'holistic' assessment of which product is in a consumer's best interests:** ASIC proposes that mortgage brokers should 'consider products holistically to assess whether they are in the consumer's best interests'. The draft guidance identifies factors which may be relevant to this assessment, though ASIC says that the factors and their relative importance will depend on the individual circumstances of the consumer. ASIC seeks feedback on whether stakeholders agree with this approach.

- **Cost of a product should be 'prioritised':** ASIC proposes to provide guidance that the cost of a product should be prioritised by brokers when assessing which product is in a consumer's best interest.

- **Other non-cost considerations**: ASIC proposes to provide guidance that where other non-cost considerations 'affect what is in the consumer's best interests, brokers should assess whether those considerations or loan features have a realistic possibility of offering the consumer good value or a net benefit relative to other options'.

- **ASIC seeks feedback on**: a) which factors are most relevant to assessing whether home loan products are in individual consumer's best interests; b) whether there are other factors/circumstances relevant to determining whether a product is in the consumer's best interests that should be included in the guidance; and c) whether stakeholders agree with ASIC's proposed approach to the way in which cost and non-cost factors should be considered by brokers when making a product assessment.

- **The range of products available:** ASIC proposes that: a) that mortgage brokers must be satisfied that the range of products they can access and recommend is sufficient to allow them to act in consumers' best interests; and b) that brokers should be expected to maintain 'an awareness of products and features that may be available on the market'. ASIC seeks feedback on whether mortgage brokers should be required to consider products provided by parties outside their panel of credit providers. ASIC also seeks feedback from brokers on whether their current software presents them with product options they are not accredited to recommend.

- **Recommendations on packages:** ASIC proposes to provide guidance that recommendations by brokers on packages should be based on a 'holistic assessment of the package and involve a process of comparison with other available products, such as other packages or standalone home loan products'. ASIC seeks feedback from brokers on: a) when they would typically recommend a package to a consumer; b) whether they typically compare a range of packages; and c) whether they compare packages to standalone home loan products (and if so, how this is done).

- **Presenting product options and recommendations**: ASIC proposes to provide guidance to: a) 'encourage mortgage brokers to…tailor how they present product options and recommendations to account for the consumer's expectations and circumstances'; and b) to 'emphasise the educative role of mortgage brokers and the importance of presenting a range of options'. ASIC seeks feedback on:

  - how and in what form mortgage brokers typically present information to consumers;

  - the circumstances in which mortgage brokers would only provide one product option or recommendation;

  - whether brokers agree that consumers should generally be presented with more than one option;

  - whether stakeholders agree that mortgage brokers should 'educate consumers and help them to understand potential implications of different choices' eg the nature of credit products and their features;

  - stakeholder views on how brokers can act in a consumer's best interests in circumstances where the broker is assisting the consumer to apply for a different credit product than the one recommended; and

  - whether there are other factors relevant to the presentation of information that should be included in the guidance.

- **'Basic' guidance on tax implications**: ASIC proposes that mortgage brokers should be able to give guidance about the suitability and value of product features for each consumer, including a basic understanding of tax implications. In proposing this, ASIC clarifies that it does 'not expect mortgage brokers to advise on matters outside their expertise'. ASIC seeks feedback from brokers on how they currently handle requests from tax advice from consumers; and what other matters (outside of their expertise) consumers seek guidance on.

- **Records**: ASIC proposes to provide guidance on the types of records mortgage brokers may keep to help them demonstrate that they have acted in the consumer's best interests. ASIC seeks feedback on whether: a) stakeholders agree with ASIC's expectations about record keeping; b) there are any examples of the types of records that could be referred to in the guidance; and c) the length of time records should be retained. ASIC also seeks feedback from credit licensees on whether they currently require the mortgage brokers they authorise to keep standardised records, and if so, what form this takes.

- **When the best interest duty applies:** ASIC proposes to provide guidance that the best interest duty 'generally applies at the time of the assessment and whenever a mortgage brokers provides credit assistance'. ASIC seeks feedback on whether stakeholders agree that: a) the duty should apply at the time of the assessment; b) when making subsequent assessments, brokers cannot necessarily rely on the initial assessment; and c) that changes which occurred after the recommendation, which were reasonably foreseeable when the recommendation was made, should eb relevant in considering whether the interests duty has been complied with.

- **Conflict priority rule**: ASIC proposes to provide guidance that complying with the conflict priority rule requires mortgage brokers to: a) identify what interests they or their related parties have, and prioritise the consumer's interests; and b) not provide credit assistance where it would not be possible to prioritise the consumer's interests. ASIC seeks feedback from stakeholders on whether they agree with this approach; whether there are any factors relevant to the prioritisation of consumers' interests that should eb included in the guidance; and whether there are other types of activities or conduct that would contravene the conflict priority rule where ASIC should provide guidance.

- **Interaction with responsible lending obligations**: The best interests obligations operate alongside other laws that affect how credit assistance is provided to consumers, including the responsible lending obligations. ASIC is of the view that the best interests duty applies **in addition to** existing responsible lending obligations. On this basis, the draft guidance explains the interaction of the two obligations, including that information gathered for the purpose of complying with the responsible lending obligations may help brokers to comply with the best interests duty and distinguishes between the two sets of obligations. ASIC seeks feedback on: a) whether further guidance on the distinction between the new best interests duty and existing responsible lending obligations is needed; and b) whether there are any other requirements in the new National Credit Act that interact with the new obligations and require further guidance.

- **Reasonable steps requirement for credit licensees:** Credit licensees must take reasonable steps to ensure that their credit representatives who are mortgage brokers comply with the best interests duty. ASIC proposes to provide guidance that licensees 'should be proactive' in meeting the reasonable steps requirement. For example, ASIC suggests that proactive steps may include the provision of systems by the licensee (including when the licensee is an aggregator) and consistent monitoring so that any potential breaches can be identified before they become detrimental to the consumer. Further, the proposed guidance suggests that: a) what constitutes reasonable steps may vary depending on the nature and scale of the mortgage broker's operations and their relationship with the credit licensee; and b) in determining whether steps taken are reasonable, ASIC would consider factors such as the likelihood of the mortgage broker not complying and the harm that would result from that non-compliance. ASIC seeks feedback on whether stakeholders agree with ASIC's 'general expectations about the practical steps credit licensees should take to comply' and whether there are any other relevant factors. ASIC seeks feedback from credit licensees on how they currently monitor their authorised mortgage brokers and how they intend to monitor compliance with the best interests obligations.

Submissions to the consultation

ASIC says it is seeking feedback on its proposed approach to administering the new but is 'not seeking feedback on the government's legislation or policy'.

Timing

- The deadline for submissions to the consultation is 20 March 2020. The regulatory guide will be released in May 2020.

- ASIC says that the draft guidance is 'intended to help industry make changes and improve practices before the new obligations commence' adding that over time, ASIC's approach to administering the obligations may evolve.

[Sources: ASIC media release 20/02/2020; ASIC consultation paper 327 (CP 327) Implementing the Royal Commission recommendations: Mortgage brokers and the best interests duty; Attachment to CP 327: Draft regulatory guide; [registration required] The AFR 20/02/2020; Financial Standard 20/02/2020]

A 'number of areas requiring ongoing improvement': APRA has released the key findings of a stress testing assessment it carried out on 28 ADIs

Key Takeouts

- Over 2018-19, APRA conducted an assessment of the internal stress testing capabilities of 28 ADIs, focussing on governance, scenario development and use of stress testing.
- APRA identified 'areas for ongoing improvement in stress testing for all entities'.
- APRA said it plans to test resilience to broader scenarios, including the impacts from operational and climate change financial risks.
- APRA expects ADIs to review their internal stress testing framework in light of the findings and consider ways to improve their capabilities.
- APRA plans to consult with industry in the second half of 2020 on a prudential practice guide on stress testing to promote industry better practice and consistency.
- Transitioning to annual stress testing in 2020: To complement the ongoing improvement in stress testing capabilities and application, APRA is moving towards greater frequency and depth of stress testing for ADIs. This includes transitioning in 2020 to annual stress testing of large ADIs.

Over 2018-19, the Australian Prudential Regulation Authority (APRA) conducted a qualitative assessment of the internal stress testing capabilities of 28 Authorised Deposit Taking Institutions (ADIs), based on the ADIs' most recent enterprise-wide stress tests (EWSTs) and the most recent internal capital adequacy assessment process (ICAAP) reports. APRA's focus was on governance, scenario development and use of stress testing.

In a letter to industry outlining the key findings of the review, APRA identified a number of improvement areas. These include the following.

Governance

- Though most larger ADIs were found to have enterprise-wide stress tests (EWST) in place, and though there was generally found to be broader engagement in stress testing activities than in other ADIs, APRA found that the frameworks in place, were not always subject to regular independent reviews.
- Other ADIs did not have specific frameworks for stress testing in place, and instead relied on various risk-specific management frameworks and internal capital adequacy assessment process (ICAAP) documentation.
- APRA said better practice examples included: a) having a formalised EWST framework in place; b) applying the framework in practice and subjecting it to regulator independent review (including reviewing resourcing, data and IT infrastructure requirements; c) ensuring stress testing processes adhere to a schedule; c) broad organisation-wide engagement; and d) board and senior management with their 'respective responsibilities for the review and challenge of the scenario design and stress test outputs'.

Scenario development

- Most larger ADIs were found to have structured and integrated scenario development processes in place that engaged stakeholders across the organisation. Stress parameters and impacts were found to be 'generally well considered', and scenarios typically covered all or most material risks identified by the entity.

- For other ADIs, APRA found that the process was less structured and integrated. APRA also found that the scenarios and stress parameters used were typically designed with less sophisticated considerations.
- APRA considers that both all ADIs would 'benefit from better coverage of non-financial and emerging risks'.
- APRA said better practice examples included: a) having a 'structured, repeatable scenario development process with effective consultation, review, and challenge mechanisms'; b) designing scenarios with clear objectives, tailored to the individual risk profile of the organisation, using a range of approaches 'calibrated to be severe yet plausible'; and c) ensuring each annual ICAAP is informed by a range of scenarios (mild, severe and extremely severe scenarios).

Use of stress testing as a forward-looking risk-management tool

- Larger ADIs generally made better use of stress test results and used stress testing in a wider range of decision making than other ADIs. In contrast, the role of stress testing appeared less prominent in smaller ADIs.
- APRA said better practice examples included: a) having an ICAAP process that recognises the importance of stress test results as key input for decision-making, including having a robust capital trigger and mitigating actions frameworks, and a comprehensive set of capital adequacy criteria; b) ensuring details and discussion of the stress testing undertaken eg information on the scenario narrative, scenario selection rationale, key assumptions and limitations, mitigating actions, and stress test results (before and after applicable mitigating actions) are presented in an easily understandable way in ICAAP reports; and c) embedding stress testing into regular decision-making processes such as the processes for making strategic, business planning and recovery planning decisions.

Next steps

- **APRA expects ADIs to review their internal stress testing framework in light of the findings.** APRA expects the results of this self-assessment and actions to improve capabilities to be incorporated in subsequent ICAAP reports.
- **New prudential practice guide on stress testing:** APRA plans to consult with the industry in the second half of 2020 on a stress testing prudential practice guide.
- **APRA plans to test resilience to broader scenarios,** including the impacts from operational and climate change financial risks.
- **Transitioning to annual stress testing in 2020:** To complement the ongoing improvement in stress testing capabilities and application, APRA is moving towards greater frequency and depth of stress testing for ADIs. This includes transitioning in 2020 to annual stress testing of large ADIs.

Broader context

The SMH comments that APRA is not alone in pushing for financial institutions to quantify their exposure to climate change risks. Reportedly, the UK, the Netherland and Singapore are also stepping up surveillance around how prepared financial institutions are to deal with climate change.

[Sources: APRA Media release 21/02/2020; Letter to industry 21/02/2020; [registration required] The Australian 21/02/2020; The SMH 21/02/2020; [registration required] The AFR 21/02/2020]

The superannuation guarantee amnesty Bill — Treasury Laws Amendment (Recovering Unpaid Superannuation) Bill 2019 — passed both houses on 24 February

Treasury Laws Amendment (Recovering Unpaid Superannuation) Bill 2019 which provides for a one-off amnesty to encourage employers to self-correct historical superannuation guarantee non-compliance, passed both houses on 24 February.

Announcing the passage of the Bill, Assistant Minister for Superannuation, Financial Services and Financial Technology Jane Hume said that the 'amnesty will make it easier for workers to secure the super they are owed by not hitting employers with the penalties usually associated with late payment'.

Ms Hume went on to say that 'employers will not be off the hook' as to use the amnesty, they will be required to pay all that is owing (including interest) to their employees'.

Ms Hume added that 'if employers do not take advantage of the amnesty, they will now face significantly higher penalties when they are caught – in general, a minimum 100% penalty on top of the SG shortfall they owe, and up to 200% for the most serious cases. In addition, throughout the amnesty period the ATO will still continue its usual audit and enforcement activity against employers for historical obligations they do not own up to voluntarily'.

The Amnesty will expire six months after the day the Bill receives Royal Assent.

The ACTU has reportedly criticised the legislation: The AFR reports that the Australian Council of Trade Unions (ACTU) has criticised the Bill as a 'blanket pardoning of a serious contravention of federal law with no caveats or limits', at odds with the 'national crisis of wage theft'.

The Australian Small Business and Family Enterprise Ombudsman Kate Carnell has issued a statement welcoming the passage of the legislation. 'This is a one-off amnesty that gives small business an opportunity to get up to date with outstanding payments to current and past employees, without being slugged with the harsh penalties that usually apply…Small businesses should act now to take advantage of the amnesty or face significantly higher penalties if found to be non-compliant' Ms Carnell said.

[Sources: Treasury Laws Amendment (Recovering Unpaid Superannuation) Bill 2019; Assistant Minister for Superannuation, Financial Services and Financial Technology Jane Hume 24/02/2020; Australian Small Business and Family Enterprise Ombudsman media release 25/02/2020; [registration required] The AFR 24/02/2020]

United Kingdom | The FCA has released a report highlighting key areas of concern across financial markets

The UK Financial Conduct Authority (FCA) has released its annual analysis of the impact of macroeconomic developments and common drivers of change emerging across financial markets — sector views 2020.

The report identifies the factors that the FCA considers to be driving harm, as well as considering how the harm may develop over time across seven areas: 1) retail banking and payments; 2) retail lending; 3) general insurance and protection; 4) pensions savings and retirement income; 5) retail investments; 6) investment management; and 7) wholesale financial markets.

The kinds of harms the FCA is concerned about, include (among others):

- The number of UK adults in debt: the data shows that 7.4 million UK adults are over-indebted and find their financial commitment a burden.
- Insurance pricing practices that 'penalise loyal customers': According to the FCA, the 'loyalty penalty' in home and motor insurance cost 6 million longstanding consumers an extra £1.2 billion in 2018. The FCA says that it is 'finalising remedies following its market study'.
- The exposure of retail investors to high-risk investment products: The FCA is concerned that some of the highest risk products are often marketed directly to retail consumers with poor communication about the risks involved, and with 'implications that the investments are regulated, when this is not the case'.
- Inadequate protection/poor compliance by payments firms potentially harm consumers: The FCA is concerned that some products offered by 'new payments firms' lack consumer protections eg e-money services advertised as 'current accounts' aren't covered by the Financial Services Compensation Scheme.

FCA Executive Director of Strategy and Competition and interim CEO designate Christopher Woolard, said that the sector views show that 'many of the harms we are seeing are created by a significant number of smaller firms we regulate or firms beyond our remit.'

He added that the findings 'will contribute' to the FCA's Business Plan and to future decision-making by the regulator.

[Sources: FCA media release 18/02/2020; FCA sector views 2020; [registration required] The FT 19/02/2020]

United Kingdom | Renewed calls for the government to legislate to protect access to cash: The FT reports that the Access to Cash Review Panel has again called on the UK government to legislate to protect access to cash, reportedly Treasury has said that measures are already in place

Context: In March 2019, the independent Access to Cash Review delivered its final report. The report included an 'action plan' to protect access to cash. This included recommendations for: a) urgent government and regulatory action to ensure 'cash remains viable'; b) a 'Guarantee to Cash Access' for all, including those in remote and rural areas; c) a requirement for essential services providers to accept cash payments; and d) a more efficient, effective and resilient wholesale cash infrastructure to ensure that cash remains viable as its use declines. On 18 September 2019, the review Panel wrote to the Chancellor of the Exchequer calling for the government to implement a cash guarantee 'to prevent the UK sleepwalking into a cashless society.

Renewed calls by the Panel for the government to legislate: The FT reports that, the Panel has now written to Britain's new Chancellor Rishi Sunak urging him to include legislation in the upcoming budget to protect access to cash for consumers.

The FT quotes from the letter, 'To rely on commercial companies to maintain universal cash access when they face pressures from shareholders to cut costs would be naïve…We believe the only way to manage the cash system is for the government to legislate'.

Reportedly the Panel says that the legislation should obligate banks to provide suitable cash access for customers, including allowing consumers to obtain free cashback without having to make a purchase at pubs and retailers. The FT quotes Independent Chair of the Access to Cash Review Natalie Ceeney, as saying that legislation of this kind, with sanctions for non-compliance, has been introduced in Sweden and that a similar model should be considered.

The FT quotes the Treasury as responding that measures are already in place to ensure consumers continue to be able to access cash. 'Technology has transformed banking for millions of people, but we know that many still rely on cash. That's why we've invested £2bn to ensure everyday banking services are available at 11,500 Post Office branches across the UK. We're also working closely with industry and regulators to ensure everyone who needs cash can access it' Treasury is quoted as stating.

[Sources: [registration required] The FT 19/02/2020; Access to cash review: Final Report; media release 18/09/2019]

In Brief | Barclays CEO to depart by the end of next year, and possibly as soon as the AGM in May 2021? The FT reports that Barclays is set to appoint headhunters to identify a new CEO to replace Jes Staley. Reportedly, plans for Mr Staley's departure were in place prior to the announcement of the FCA and PRA investigations his relationship with Jeffrey Epstein

[Sources: [registration required] The FT 24/02/2020]

Risk Management

Climate Risk

Top Story | Time to get serious about climate risk: APRA outlines its plans in a letter to industry

Planned actions

On 24 February, the Australian Prudential Regulation Authority (APRA) released a letter to all APRA regulated entities outlining plans to:

1. develop a new climate related financial risk prudential practice guide;

2. develop a climate change financial risk vulnerability assessment in 2020 with a view to conducting the assessment in 2021 (beginning with Australia's largest authorised deposit-taking institutions) (ADIs);

3. update superannuation Prudential Practice Guide SPG 530 Investment Governance (SPG 530) which includes paragraphs related to environmental, social and governance (ESG) investments; and

4. undertake 'deeper supervisory assessments of each entity that participated in APRA's 2018 climate change survey'. The assessments are due to be completed by mid-2020.

[Note: Separately, APRA has written to industry outlining the key findings of a stress testing assessment it carried out on 28 ADIs and identifying areas for improvement. APRA said that it: expects ADIs to review their internal stress testing framework in light of the findings and that the results of this self-assessment and actions to improve capabilities to be incorporated in subsequent ICAAP reports; that it plans to consult in the second half of 2020 on a stress testing prudential practice guide; that it plans to test resilience to broader scenarios, including the impacts from operational and climate change financial risks; and that APRA will transition to annual stress testing of large ADIs in 2020. This is covered in a separate post in this issue of Governance News.]

Details

Climate change financial risk prudential practice guide to be released 'before the end of the year'

The new guidance will be:

1. Aligned with the TCFD framework: APRA says that the new cross-industry guidance will cover areas relevant to the prudent management of climate change financial risks, aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), including aspects of governance, strategy, risk management, metrics and disclosure.

2. Informed by APRA's engagement with other regulators domestically and internationally, as well as its ongoing engagement with industry participants.

APRA says that the new guidance is not 'intended to establish new obligations, but rather will be designed to assist entities in complying with their existing prudential requirements, including those found in Prudential Standard CPS 220 Risk Management'.

Timing: APRA will consult on the draft Prudential Practice Guide in mid-2020 and, and subject to feedback, plans to publish final guidance before the end of the year.

'Vulnerability assessment' to be designed in 2020 and executed in 2021 commencing with large ADIs

- **Entities will be asked to estimate the potential impacts of climate on their balance sheet:** APRA says that the 'vulnerability assessment will involve entities estimating the potential physical impacts of a changing climate, including extreme weather events, on their balance sheet, as well as the risks that may arise from the global transition to a low-carbon economy'. The purpose is to APRA provide insights into the impact of climate change on the broader economy.

- Design of the assessment:

  - APRA says that the scenarios that will form the basis of the vulnerability assessment will be consistent with practices being developed and utilised by peer regulatory authorities internationally.

  - APRA says that it will coordinate with the Australian Securities and Investment Commission (ASIC) and the Reserve Bank of Australia (RBA) via the Council of Financial Regulators to ensure consistency in the application of scenario analysis, disclosure recommendations and to analyse the macro-economic impacts of climate change. In addition, APRA will seek input from the Commonwealth Scientific and Industrial Research Organisation and the Bureau of Meteorology.

- **The assessment will begin with Australia's largest authorised deposit-taking institutions (ADIs)** with other industries to follow.

- **Timing:** The ADI vulnerability assessment will be designed in 2020 and executed in 2021, with other industries to follow. APRA notes that the timing aligns with the expected release of international peer regulator guidance on scenario analysis for the banking sector.

Update ESG prudential guidance for superannuation funds

APRA also plans to update Prudential Practice Guide SPG 530 Investment Governance (SPG 530), to assist registrable superannuation entity (RSE) licensees to comply with the requirements in relation to the formulation/implementation of an investment strategy, including in relation to ESG considerations.

Timing: APRA will consult on specific changes to Prudential Standard SPS 530 Investment Governance and SPG 530 'around the middle of the year', in conjunction with other changes to the superannuation prudential framework as part of APRA's response to the post-implementation review.

APRA encourages a proactive approach: APRA says that though the guidance will provide insights into better practice, 'entities should be proactive in taking steps to assess and mitigate climate change financial risks now, and not delay action until further guidance or scenario analysis from APRA is released'.

'Deeper supervisory assessments' due to be completed by mid-2020

In 2018, APRA surveyed 38 large banks, insurers and superannuation trustees in 2018 to assess their views and practices related to climate-related financial risks.

[Note: The Information Paper containing the full survey results is available on APRA's website here. For a summary see: Governance News 27/03/2019.]

The letter states that APRA considers that the 'data deficit' identified in the 2018 climate change survey can only 'ultimately be tackled through scenario analysis, stress testing and disclosure of market-useful information'.

On this basis, APRA says that it will continue to 'encourage the adoption of voluntary frameworks to assist entities with assessing, managing and disclosing their financial risks associated with climate change, such as the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) recommendations'.

In addition, APRA says that the financial risks of climate change will continue to be a focus of APRA's efforts to increase industry resilience. As such, APRA says that 'more supervisory attention is being given to understanding these risks' including 'deeper supervisory assessments of each entity that participated in APRA's 2018 climate change survey, which are due to be completed in mid-2020'.

Related Content

- The Governance Institute recently released a guide to climate risk reporting under Recommendation 7.4 of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, including practical steps for reporting against the TCFD framework. In his foreword to the guide, APRA member Geoff Summerhayes described the guide as a 'valuable tool' that will support entities and others in their management/public disclosure of climate risk. The full text of the governance institute's guide — Climate Change risk disclosure: A practical guide to reporting against ASX Corporate Governance Council's Corporate Governance Principles and Recommendations — can be downloaded from the Governance Institute's website here. For a summary, see: Governance News 12/02/2020.

- MinterEllison has released a report outlining developments in climate change risk across five key areas — climate risk disclosure and reporting, directors' duties, equity markets, debt finance and emissions reductions policies — and flagging developments to watch in 2020. The report is available on the MinterEllison website here.

[Sources: RA media release 24/02/2020; Letter to industry 24/02/2020; [registration required] The AFR 24/02/2020; [registration required] The Australian 24/02/2020]

United Kingdom | The FRC has launched a review into the reporting and auditing of climate change impacts including the extent to which companies are reporting in accordance with the TCFD framework

Key Takeouts

- The Financial Reporting Council (FRC) has announced what it has termed, a 'major review' of how companies and auditors assess and report on the impact of climate change, including the extent to which companies are reporting in accordance with the Task Force on Climate-related Financial Disclosures (TCFD) framework.
- No timeframe for completion is given.
- The FRC has also flagged that its review of reporting under the Stewardship Code (which will be issued at the beginning of next year) will also consider how investors are addressing climate challenge in the stewardship of their investments.

The Financial Reporting Council (FRC) has announced what it has termed, a 'major review' of how companies and auditors assess and report on the impact of climate change, including the extent to which companies are reporting in accordance with the Task Force on Climate-related Financial Disclosures (TCFD) framework.

Announcing the review, FRC CEO Sir Jon Thompson said that 'not only do boards of UK companies have a responsibility to report their impact on the environment and the risks of climate change to their business, but investors expect them to operate sustainably. Auditors have a responsibility to properly challenge management to assess and report the impact of climate change on their business. The FRC has high standards for company disclosure, including regarding climate change. Company reports and accounts are essential to understanding how the corporate world is responding to the challenge of climate change.'

Details

The review will focus on how the quality of reporting can be improved to support 'informed decision-making by investors and other stakeholders'. The review will involve:

- reviewing a sample of company reports and accounts across industries to assess the quality of their compliance with reporting requirements in relation to climate change;
- assessing a sample of audits to review how auditors are ensuring the impact of climate risk has been appropriately reflected in company reports and accounts, including the key areas of judgement and related disclosures;
- assessing the resources available within audit firms to support audit teams in evaluating the impact of climate change on audited entities;
- evaluating the quality of disclosures under the new UK Corporate Governance Code regarding risk, emerging risk and long-term factors affecting their viability; and
- evaluating whether the Financial Reporting Lab's recommendation for companies to report in line with the Task Force on Climate-related Financial Disclosures (TCFD) framework has been adopted, highlighting developing good practice.

Timing? The announcement does not specify a timeframe for completion of the review.

Review of reports under the new Stewardship Code: The FRC says it also plans to consider how investors are addressing the climate challenge in the stewardship of their investments and in their response to systemic and market risks when it monitors the first reports under the new Stewardship Code, which will be issued from the beginning of 2021.

[Source: FRC Media release 20/02/2020]

Other Developments

United States | Wells Fargo will pay a US$3bn monetary penalty to resolve criminal and civil investigations into historical sales practices involving the opening fake customer accounts

Key Takeouts

- **The settlement resolves all civil and criminal investigations:** The settlement includes agreement with the DoJ resolving the criminal investigation as well as DoJ and SEC civil investigations.
- **Under the Deferred Prosecution Agreement resolving the criminal investigation, Wells Fargo will not be prosecuted during the three-year term of the agreement** provided that it abides by certain conditions, including continuing to cooperate with further government investigations.
- **Admissions of wrongdoing:** As part of the settlement Wells Fargo admitted it collected fees and interest to which is was not entitled; harmed the credit ratings of certain customers; and unlawfully misusing customers' sensitive personal information, including customers' means of identification.
- **The $3 billion monetary penalty includes a $500 million civil penalty** which the SEC will distribute to investors.

The US Department of Justice (DoJ) has announced that Wells Fargo & Company and its subsidiary, Wells Fargo Bank, have agreed to pay $3 billion to resolve criminal and civil investigations concerning historical practices within the bank during the period 2002 and 2016, which led employees to create a number of fake customer accounts to meet 'unrealistic sales goals'.

As part of the agreements with the Department of Justice (DoJ) and the United States Securities and Exchange Commission (SEC), Wells Fargo: a) admitted that it collected fees and interest to which is was not entitled; b) harmed the credit ratings of certain customers; and c) unlawfully misused customers' sensitive personal information, including customers' means of identification.

[Note: The statement of facts accompanying the DoJ's announcement outlines the conduct and the admissions made by Wells Fargo in detail. The statement of facts is available here.]

No criminal charges will be brought if the conditions of the agreement are met: The criminal investigation into false bank records and identity theft is being resolved with a deferred prosecution agreement in which Wells Fargo will not be prosecuted during the three-year term of the agreement provided that it abides by certain conditions, including continuing to cooperate with further government investigations.

Separate agreements to resolve civil charges: Wells Fargo entered into a separate settlement agreement to resolve the DoJ's civil investigation, and a separate administrative order to resolves the SEC's civil investigation.

Monetary penalty: The $3 billion payment resolves both the civil and criminal investigations and includes a $500 million civil penalty to establish the 'Fair Fund' for the benefit of investors harmed by the conduct covered in the agreement. The funds will be distributed by the Securities and Exchange Commission (SEC) to investors.

Response from Wells Fargo

In a statement, Wells Fargo CEO Charlie Scharf, said that the 'conduct at the core of today's settlements — and the past culture that gave rise to it — are reprehensible and wholly inconsistent with the values on which Wells Fargo was built. Our customers, shareholders and employees deserved more from the leadership of this Company. Over the past three years, we've made fundamental changes to our business model, compensation programs, leadership and governance. While today's announcement is a significant step in bringing this chapter to a close, there's still more work we must do to rebuild the trust we lost. We are committing all necessary resources to ensure that nothing like this happens again, while also driving Wells Fargo forward.'

The statement goes on to outline the remedial actions taken by the company since 2016 to ensure that the issues 'can never recur'.

[Note: Last month, the OCC announced enforcement actions against eight former Wells Fargo executives in connection with their involvement in the 'systemic sales practices misconduct problem' during the period 2010-2016, including a settlement with former Chair and CEO John Stumpf. As part of the settlement, Mr Stumpf agreed ('without admitting or denying any wrongdoing') to pay a $17.5m (civil money penalty (CMP)) and a ban from any role at a US bank, 'without prior written consent of both the OCC and the institution's appropriate Federal financial institutions regulatory agency'. For details see: Governance News 29/01/2020 at p21].

[Sources: US Department of Justice media release 21/02/2020; Statement of Facts; Wells Fargo media release 21/02/2020; Financial Standard 24/02/2020]