Governance News

22 January 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

Remuneration

Airbnb has reportedly tied executive bonuses to the achievement of social goals including safety and sustainability ahead of its anticipated IPO

The WSJ reports that Airbnb Inc has outlined a plan for running the company to 'benefit all our stakeholders over the long term'.

Reportedly, the plan includes:

- **tying executive bonuses to the achievement of social goals** including safety and sustainability including revenue, earnings before interest, taxes and amortization, and cash flow (though financial metrics will still be use of 'guideposts' for company performance)

- **establishing a board level 'stakeholder committee'** to be headed by outgoing Chief Operating Officer Belinda Johnson representing the interests of the five groups of stakeholder identified as making up its community (guests, hosts, communities, shareholders and employees).

- **monitoring (by executives) of progress on social goals/commitments** with a further commitment to transparency. Airbnb will host a stakeholder day to report on progress.

Response? The WSJ quotes Erik Snyder, CEO of the Drawdown Fund (described as a private-equity firm that invests in companies addressing climate change) as welcoming Airbnb's proposed plan, and more particularly the use of non-financial metrics in awarding bonuses. 'They get a lot of credit for saying this stuff is important and that they're going to tie compensation to it and weave it into their corporate governance' Mr Snyder reportedly said.

Reportedly Mr Snyder added that more is needed with respect to outlining the social costs of Airbnb's business — eg details around the contribution Airbnb rentals may make to climate change, and the role Airbnb play in addressing accessibility of affordable lodging in certain neighbourhoods — before the company goes public (this is reportedly expected to occur later in the year).

Part of a broader shift in thinking? Citing the Business Roundtable's statement last year (see: Governance News 21/08/2019 at p8) and BlackRock's stance on sustainability issues, The WSJ links Airbnb's announcement to a broader shift away from a profit led/shareholder led model, towards a model in which positive impact on society, the environment, customers and employees is also expected. The WSJ comments that it remains to be seen how successful the approach will be in practice given that Wall Street is 'known to be somewhat allergic to "longer time horizons"'.

[Source: [registration required] The WSJ 18/01/2020]

Institutional Shareholders and Stewardship

Integration of ESG is becoming 'commonplace': State Street has released the findings of research examining the factors driving institutional investors to adopt ESG, and the key barriers to ESG adoption

State Street has released the findings of research into the factors driving institutional investors globally to consider environmental social and governance (ESG) in their investment approach and the barriers to ESG adoption.

Some Key Findings

Overall there are three key drivers or motivators for adopting ESG

1. **responding to/getting ahead of regulation:** 46% of institutional investors globally nominated this as the key motivator for adopting ESG. State Street comments that for most respondents (57% of respondents), domestic or local regulation is the most influential factor 'though institutions with more mature ESG policies in place are more heavily influenced by global initiatives such as the UN's PRI or the SASB framework'.

2. **meeting fiduciary requirements:** an equal number of respondents (46%) globally nominated meeting fiduciary requirements (ie meeting the responsibility to their beneficiaries to mitigate ESG investment risks and shape a sustainable economy) as the key driver. State Street suggests that this is an indication that viewing ESG (including climate risk) as part of fiduciary duty is 'becoming common place'.

3. **mitigating ESG risks in the portfolio:** 44% nominated mitigating ESG risk in their portfolio as the key driver. State Street comments that measurement in this context remains a challenge and that going forward, more focus may need to be directed on quantifying investment impact.

Coming in at four and five were keeping up with market standard settings (eg UN PRI) (34% of respondents nominated this as the key motivator for them in adopting ESG); and avoiding reputational risk (31% respondents identified this as their key motivation).

All investor groups nominated fiduciary duty and regulatory pressure as key drivers: Despite variation in the top motivators for different investors (pension funds, endowments and foundations and sovereign wealth funds), State Street found that fiduciary duty and regulatory pressure were common to all groups.

State Street found a link between the key motivation for adopting ESG and the investment approach adopted. For example, those motivated by mitigating ESG risks were found to be more likely to implement systematic integration or positive screening. In contrast, investors driven by regulatory change and beneficiary pressure were found to be more likely to apply exclusionary screening.

Different drivers in different geographical regions

State street also found that the key factors pushing institutional investors to adopt ESG varied by region.

- In the Asia Pacific Region the top three drivers were: mitigating ESG risks (47%); meeting fiduciary obligations (38%); and pressure from beneficiaries (37%). Meeting/getting ahead of regulation ranked as the next most important factor (35%).

- In North America the top three key drivers were: 1) meeting fiduciary obligations (59%); 2) keeping up with market standard setters (48%); and meeting/getting ahead of regulation (57%).

- In Europe the top three key drivers were: 1) meeting/getting ahead of regulation; 2) mitigating ESG risks (45%); and 3) avoiding reputational risk (39%). The next most important factor was meeting fiduciary obligations (37%).

What about generating higher returns?

State Street found that a belief that adopting ESG would generate higher returns was not a key motivating factor, with only 6% of respondents nominating it as their key push factor. State Street suggests that this may be due to the challenges of attributing performance to ESG factors and also to the fact that benefits are likely to be realised in the long term.

Barriers to ESG? Three factors driving investors away from ESG

State Street identifies: 1) poor data quality, particularly consistency and coverage of data (44% of respondents); 2) internal resource constraints (43% of respondents); and 3) the need for expertise in ESG integration (40% of respondent said a lack of expertise in integrating ESG was a key barrier) as the key barriers to ESG adoption.

Measuring social and environmental impact remains a challenge? State Street found that most investors reported measuring governance as 'far easier' than measuring environmental or social impact. State Street indicating that 'reporting refinements are sorely needed'.

Conclusions: Ultimately, State Street considers that ESG has reached a 'tipping point'. State Street writes, 'despite the mix of drivers pushing and pulling investors to or from ESG investing, it has clearly reached a tipping point where institutional investors cannot afford to ignore it — either for the risk that it may pose or, perhaps even more compellingly, the opportunities it presents'.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 13/01/2020]

MSCI calls on investors to integrate ESG considerations into investment processes: MSCI has released the MSCI Principles of Sustainable Investing with the aim of assisting investors to incorporate ESG considerations into their investment strategies, approach to portfolio management and investment research

MSCI has called on investors globally to integrate environmental, social and governance (ESG) considerations into their investment processes and has issued a framework — the MSCI Principles of Sustainable Investing — to assist investors to 'improve practices for ESG integration across the investment value chain'.

MSCI Principles of Sustainable Investing

The framework is structured around three core 'pillars to full ESG integration':

1. **Investment Strategy:** Asset owners should integrate ESG considerations into their processes for establishing, monitoring and revising their overall investment strategy and asset allocation;

2. **Portfolio Management:** Portfolio managers should incorporate ESG considerations throughout the entire portfolio management process, including security selection, portfolio construction, risk management, performance attribution and client reporting; and

3. **Investment Research:** Research analysts assessing companies and issuing investment. recommendations to portfolio managers should integrate ESG considerations (including ESG company ratings) into their fundamental company analysis.

Announcing the release of the framework, Chair and CEO of MSCI Henry Fernandez said 'The world is rapidly evolving due to dramatic environmental, social and governance shifts, including the effects and implications of climate change and the move to a low carbon economy, which will significantly impact the pricing of financial assets and the risk and return of investments, and lead to a large-scale re-allocation of capital over the next few decades…The need for a set of guidelines that will help all investment institutions around the world manage emerging opportunities and inherent risks associated with ESG considerations in pursuit of long-term, sustainable investment performance has never been greater'.

[Sources: MSCI media release 21/01/2020; MSCI Principles of Sustainable Investing]

Other Shareholder News

Global governance trends report: Russell Reynolds report finds that globally the focus on the environmental and social aspects of ESG and on corporate purpose is increasing, including in Australia

Report overview | Russell Reynolds report: 2020 Global & Regional Corporate Governance Trends

Russell Reynolds has released its fourth annual report into global corporate governance trends. For the first time, the report includes Australia.

The report is based on interviews with 40 global institutional and activist investors, pension fund managers, proxy advisors and other corporate governance professionals.

Global trends: Five key trends for 2020

1. **Focus on the environmental and social aspects of ESG is increasing.** 'Environmental and social issues appear to be taking the greatest precedence for investors, moving from being a national or regional focus to being a truly global phenomenon' the report states. The report predicts that there will soon be consensus around the use of reporting frameworks such as the Task Force on Climate-related Financial Disclosures (TCFD) and Sustainability Accounting Standards Board (SASB) given increased expectations of the way in which climate and sustainability risks are managed and reported.
2. **'Corporate purpose' is growing in importance.** There is increasing acceptance that stakeholders (rather than shareholders) should be at the centre of corporate purpose/a shift away from shareholder primacy as the accepted model. The report cites the release of the Business Roundtable statement and the World Economic Forum Manifesto as evidence of this. However, the report comments that there is also a level of scepticism around what this means in practice/how it will translate into action.

[Note: The Business Roundtable Statement is a reference to the statement issued by the US Business Roundtable redefining the purpose of a corporation to include delivery of benefits to all stakeholders. See: Governance News 21/08/2019]

[Note: The manifesto referred to is the Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution released late last year. For a summary and expert insights into the implications from MinterEllison Partner Geraldine Johns-Putra see: Governance News 11/12/2019]

3. **There is an expectation of better board oversight of corporate culture and human capital management.** Boards are under increasing investor pressure to provide more specific data around the actions/plans they have in place to ensure organisational culture is robust and able to withstand transformation/change. Accordingly, the report says that data and analysis is expected to play a larger role. This also has implications for management who will be expected to satisfy the board that the company has the culture/talent needed to successful execute strategy.
4. **The focus on board diversity is broadening beyond gender diversity** to include ethic and racial diversity (though the report suggests that the trend is likely to struggle to gain traction in some jurisdictions where the collection of data on ethnicity/race is either illegal or highly regulated).
5. **Companies are facing wider forms of activism.** The report observes that globally there is variation in activist strategies, though investor activism continues to 'evolve and grow'. The report suggests that in 2020, activist success rates will increase and that larger non-governmental organisations (in addition to 'activist investors') will play a greater role.

   The report adds that in some countries, boards' strategies for dealing with activists threats is improving – for example, measures being implemented by some boards in response to employee activism eg tightening board evaluation processes, increasing engagement with management in scenario planning.

Australia

- **Key challenges for Australian boards in 2020:** The report identifies a number of challenges for Australian directors arising from: a) the repercussions from the Financial Services Royal Commission; b) heightened regulatory enforcement; and c) greater engagement from the superannuation funds. It's suggested in particular, that one result of the challenges facing boards has been a diminution of 'even well-reasoned risk taking'. It's suggested that 'balancing growth, innovation and appropriate risk taking is becoming an increasing challenge for Australian directors and should be addressed in 2020'.

- **Addressing the loss of trust — boards to increase their focus stakeholders and ESG:** To help restore trust, the report suggests that boards will be expected to oversee management with greater focus around: 1) 'their strategy to put the stakeholder first, bolstering the company's social license to operate'; 2) management of environmental and social risks through KPIs and targets; 3) increased disclosure on corporate purpose; and 4) development of thoughtful investor engagement strategies.

- **Pressure to enhance ESG data disclosure will intensify:** It's predicted investors will increase pressure on boards for disclosure of ESG data to ensure their investments are considering the company's strategy 'in tandem with the global transition into a low-carbon economy, despite Australia being the world's largest coal exporter'. More particularly, the report suggests that in 2020, 'investors and NGOs will push Australian companies to disclose material ESG issues — particularly environmental issues — on a consistent basis. Also expect to see increased disclosure concerning the board's role in considering stakeholders beyond shareholders'.

- **Regulatory enforcement will trigger further changes:** The report predicts that increased regulatory enforcement in financial services will trigger 'further dialogue and challenges to the market's corporate governance norms' for example in the context of remuneration (given APRA's proposed changes to the prudential standard CPS 511). ASIC's 'intensified regulatory scrutiny across the financial services sector' is also, the report suggests, 'creating "fear" in the business community and among some board members around balancing appropriate risk taking and encouraging growth'.

- **Heightened expectations of directors:** The report suggests that trends in regulatory enforcement have will have repercussions for directors, not only in the financial services sector but more broadly, with some boards 'heightening their oversight of risk, audit, legal and compliance matters as well as placing greater emphasis on stakeholders rather than just shareholders'. The report suggests that in 2020, significant investors will be raising their expectations around overboarding, effective long-term and social license oversight and voluntary adoption of annual director elections.

- **Increased investor stewardship and engagement:** The report suggests that 'an unexpected consequence' of the Financial Services Royal Commission has been the increased investment flows into superannuation funds. In consequence, it's suggested that Australia is moving from a retail market to an institutional investor market, and that this in turn, has shifted the focus from a short-term to a long-term profit time horizon. It's predicted that in 2020, 'best-in-class companies' will begin to actively initiate direct engagements with individual investors.

[Sources: Russell Reynolds report: 2020 Global & Regional Corporate Governance Trends; Harvard Law School Forum on Corporate Governance and Financial Regulation 18/01/2020]

Disclosure and Reporting

United Kingdom | The FRC's Financial Reporting Lab has released a report calling for improvements to reporting on workforce related issues

Financial Reporting Council's (FRC's) Financial Reporting Lab has released a report calling for improvements to reporting on workforce related issues including: working conditions, changing contractual arrangements and automation.

Overall, the report found that 'despite regulatory focus over recent years and increasing company and investor interest, there is a lack of consistent disclosure on workforce matters. A gap remains between the reporting investors are looking for and what is being disclosed'. In particular, the report identifies that investors are seeking a 'basic understanding of the composition of the workforce, but also an indication of whether the workforce is a strategic asset and how this relates to longer-term value creation.'

Four key areas for improvement

Broadly, the report identifies that investors seek greater insight into four areas.

1. **Governance and management:** how boards consider and assess 'the topic of the workforce', including what information the board sees and clarity on who they consider 'the workforce' to be (including total headcount, demographics and employment composition such as direct employees, contractors and/or others in the supply chain)

2. **Business model and strategy:** how the workforce contributes to the success of the business model (whether it is considered a strategic asset, how it is invested in, and what changes might need to be made to strategy in order to maximise workforce related opportunities). Investors are also looking for information about how the board engages with the workforce and the impact this has on the board's consideration of strategy decisions

3. **Risk management:** the risks and opportunities related to the workforce and how the company is responding to these including the prioritisation of risks and their likelihood and impact (eg health and safety metrics), as well as opportunities to increase value

    - how the desired culture is being driven from the top including how 'buy in' has been achieved from the workforce and how culture and values help achieve the strategy, including: employee engagement retention and turnover; values being applied in the working environment; and other measures of culture that the company monitors

    - how the company is incentivising its workforce to deliver value including details of remuneration/other benefits, training and development, progression

4. **Data/metrics:** more data around how the company measures the contribution of the workforce and how it has taken into account the workforce's views (including financial relevant information and 'reliable, transparent metrics')

Guidance for boards?

Appendix A of the report (p 21) includes a number of questions for boards and suggestions around what should be included in reporting around these issues.

Appendix B of the report (p 26) includes examples of 'current practice which resonated with investors'.

'Obvious overlap and linkage' between reporting on workforce issues and sustainability reporting? The report comments that though it is focused on workforce issues, the areas of investor concern outlined above, and the recommendations in the report around improvements in reporting practices 'could equally apply to other sustainability-related topics, such as climate change'.

New reporting requirements: Announcing the release of the report, the FRC notes new and increased reporting requirements around workforce engagement, remuneration matters and corporate culture including:

- updates to the UK Corporate Governance Code 2018 which includes specific provisions on the board's engagement with the workforce (see: Governance News 23/07/2020; 15/01/2020 at p10)
- new reporting requirements on CEO and employee pay ratios
- the requirement to report on how directors have had regard to a range of factors, such as the interests of a company's employees, in carrying out their duty to act in a way that promotes the success of the company (their section 172 duty).

[Sources: FRC media release 20/01/2020; Report Summary: Workforce-related corporate reporting; Full report: Workforce-related corporate reporting: where to next?]

Regulators

APRA has published its inaugural year in review document

The Australian Prudential Regulation Authority (APRA) has released its inaugural 'year in review' document — Safeguarding Australia's financial wellbeing: APRA 2019 Year in Review — which provides an overview of the key activities and decisions undertaken by the regulator in 2019. APRA says that the publication is one component of a package of measures aimed at increasing public awareness and understanding of APRA's role/operations, activities and progress in line with the regulator's commitment to enhanced transparency.

APRA Chair Wayne Byres said, 'this new annual publication is designed to highlight the actions and decisions APRA has taken over the past year to fulfil its mandate to protect the financial wellbeing of the Australian community'.

As such, the report does not identify new actions/information, so much as provide a summary of previously announced initiatives/actions. In addition, the report outlines APRA's perspective on the financial environment/key issues facing APRA regulated sectors and includes financial metrics for those industries (such as industry composition, profitability and financial strength).

APRA's role: The first chapter of the report explains APRA's operating environment, APRA's mandate and underlines its commitment to ensuring the ongoing financial resilience, soundness and stability. The explanation of APRA's mandate emphasises that APRA is 'not tasked with ensuring nothing can go wrong' but rather with 'balancing the financial safety that is desired for the community with the trade offs needed to promote competition, innovation and economic growth'.

The chapter also recaps some of milestone events over the past year and some of APRA's achievements including (among others): the delivery of the Financial Services Royal Commission's final report and APRA's progress toward implementing the Commission's recommendations; the completion of APRA's capability review; the release of APRA's corporate plan; APRA's focus on IT and cyber risk and work in this area; APRA's focus on climate related financial risk and work in this area; APRA's focus on governance, culture and accountability (GCRA) risk; APRA's new enforcement approach; and APRA's commitment to greater transparency.

Some sector specific insights: Chapter 2 of the report provides an overview of sector specific developments in general insurance; life insurance; private health insurance; superannuation and for authorised deposit taking institutions (ADIs).

- **Challenges for life insurers:** The report identifies a number of challenges facing the life insurance sector. APRA writes that 'for a fifth straight year, the performance of individual disability income insurance (DII) worsened, taking losses over that time to more than $3 billion. The profitability of individual lump sum insurance and group DII also deteriorated, due in part to poor product design and aggressive selling methods, as highlighted by the Royal Commission'. In addition, APRA says that some long-standing issues including: a) dealing with legacy products; b) the mis-selling of life insurance products to consumers through direct marketing channels; and c) poor claims management processes, 'remain unresolved'. However APRA comments that notwithstanding these challenges, life insurers remained financially resilient in 2019.

- **Challenges for private health insurers:** APRA identifies sustainability (given declining membership especially among younger fitter members and rising premiums) as a key challenge for the sector. 'Having signalled in early 2018 a focus on these sustainability challenges, APRA in 2019 stepped up pressure on private health insurers (PHIs) to address the various headwinds, including affordability and adverse selection' APRA states. APRA cautions that 'although a strengthened capital framework will boost insurer resilience, it's not enough in isolation to help the industry overcome the challenges of a shrinking and ageing membership base'. However, APRA comments that notwithstanding these challenges the industry continued to maintain a strong capital position with assets increasing 5.7% over the 12 months to June 2019.

- **Superannuation:** APRA confirmed that 'improving outcomes for superannuation members' as set out in its 2019-2023 Corporate Plan will be one of its top four strategic priorities for the next four years. APRA said this work is aimed at driving 'a culture of continuous improvement, the delivery of enhanced member outcomes and support improved financial performance and efficiency across the entire superannuation industry.' Commenting on the industry landscape APRA says that consolidation in the sector proceeded at a 'slower pace than previous years'. There were 187 APRA regulated funds with more than four members as at 30 June 2019, down from 193 one year earlier. Over the ten years to 30 June 2019, the number of funds on this basis fell 55% and the number of trustees fell 59%.

- **Authorised Deposit-taking Institutions (ADIs):** APRA says that the ADI sector remained financial sound and resilient throughout 2019 notwithstanding various 'ongoing challenges associated with reputational damage from cases of misconduct' though the sector remains 'exposed to a number of headwinds and vulnerabilities' for example: a) operational risks (underinvestment in compliance, IT systems and data management); b) increasing levels of household debt; c) ongoing reliance on foreign wholesale funding; d) historically low interest rates; and e) low rates of economic growth. Commenting on the industry landscape APRA, notes that there were 148 ADIs operating in Australia as at 30 June 2019 (up from 145 in 2018). The 148 ADIs comprised 93 banks, 47 credit unions and building societies, seven other ADIs, and one Restricted ADI. APRA comments that this represents the first net increase in sector participants representing the first net increase in the number of sector participants in almost 15 years.

  As at 30 June 2019, total ADI industry assets stood at $4.54 trillion, up from $4.32 trillion the year prior. The four major banks hold around 75% of industry assets (slightly down on prior years).

- **Internal operational changes at APRA**: Chapter 3 outlines some of the internal changes that occurred internally at the regulator over the course of 2019 including (among other examples): APRA's new organisational structure and the introduction of a comprehensive enterprise-wide behavioural capability framework as well as a 'refreshed performance management framework'.

[Source: Safeguarding Australia's financial wellbeing: APRA 2019 Year in Review]

APRA may oversee Facebook's Calibra? APRA has released its submission to the Senate Select Committee on Financial Technology and Regulatory Technology

The Australian Prudential Regulation Authority (APRA) has published its submission to the Senate Select Committee on Financial Technology and Regulatory Technology.

The submission affirms APRA's commitment to supporting innovation within the industry 'without undue policy or supervisory barriers, while ensuring risks are appropriately managed' in line with APRA's mandate. It also: outlines the regulators 'direct' and 'supporting role' in the sector; gives examples of work undertaken/larger projects (eg APRA's superannuation data project); and gives examples of APRA's work with other regulators and industry.

Some Key Points

- **Proposed new framework for digital wallets (including potentially Calibra):** Currently, the regulatory framework for providers of digital wallets involves three regulators — the Reserve Bank of Australia (RBA), the Australian Securities and Investments Commission (ASIC) and APRA. APRA writes that the framework is currently under review through the Council of Financial Regulators (CFR) (with involvement from the RBA, APRA, ASIC and the Treasury) and that the CFR has recently delivered a paper to government setting out its recommendations for a new graduated and simpler framework.

  APRA says that the proposed new framework: a) proposes to regulate entities proportionate to the risks of their activities; and b) has been designed to be capable of accommodating future developments and technological advances.

  Under the proposal APRA's role in the framework would be to oversee wallets that are widely used as a means of payment and store significant value for a reasonable amount of time (eg potentially Facebook's Calibra proposal should it go forward).

  [Note: Figure 2 of the submission outlines the potential role of the regulators in regulating the proposed 'stored value framework'.]

  A new prudential standard? Accordingly, as part of this work, APRA is in the process of developing a new APRA principles-based prudential standard that simplifies the regulatory requirements and is able to accommodate a range of business models that have emerged. APRA says that the timing of the release of the new standard is 'dependent on the broader government response'.

- **Non-regulatory barriers for new entrants?** The submission also identifies non-regulatory barriers facing new entrants. Namely: 1) access to capital, 2) capital acquisition; and 3) recruiting staff. In the insurance sector, APRA observes that most tech start ups tend to collaborate with existing insurers rather than to compete directly. This is attributed to the time needed to develop reliable risk data and the need for operational experience with regulatory compliance.

- **APRA said it is reviewing its outsourcing prudential standard CPS 231** to reflect the changing environment. More particularly, APRA is planning at some point this year to consult on proposed changes that would require entities to conduct appropriate due diligence when entering into service provision arrangements, and to appropriately manage these arrangements on an ongoing basis.

[Sources: APRA submission to the Senate Select Committee on Financial Technology and Regulatory Technology (released 21/01/2020); [registration required] The AFR 21/01/2020; The SMH 21/01/2020]

In Brief | Funding ASIC's new enforcement approach is more expensive than anticipated? The AFR reports that superannuation trustees, financial advisers and mortgage and stock brokers, have been billed almost 200% more for regulatory supervision by ASIC than the indicative levies released in March 2019 forecast. The AFR quotes ASIC as saying that the increase is 'primarily driven by the increase in enforcement matters adopted following the recommendations of the financial services royal commission' including ASIC's new approach to litigation

[Source: [registration required] The AFR 15/01/2020]

In Brief | The CSIRO's submission to the Senate Committee on Financial Technology and Regulatory Technology suggests that Commonwealth legislation should not only be published in words but in machine readable which would enable it to be ready by computers, potentially boosting the adoption of new technology, improving compliance and reducing costs. ASIC's submission to the same committee flags regtech as a key focus for the regulator and identifies a number of initiatives for FY 2019-2020 including the use of regtech (machine leaning) to monitor compliance with the responsible lending obligations by credit providers

[Sources: CSIRO submission 19/691; ASIC submission; [registration required] The AFR 16/01/2020]

Financial Services

Top story | ASIC has approved changes to the Banking Code of Practice adopting Hayne Royal Commission Recommendations

MinterEllison has released an article summarising recent changes to the Banking Code of Practice in response to the recommendations of the Financial Services Royal Commission which have now been approved by the Australian Securities and Investments Commission (ASIC).

The article is available on the MinterEllison website here.

'Fixing the issue of multiple accounts': A public hearing on legislation proposing to enable workers under workplace determinations/enterprise agreements to nominate their preferred superannuation fund will be held on 29 January

On 28 November 2019, the Senate referred the provisions of the Treasury Laws Amendment (Your Superannuation, Your Choice) Bill 2019. The Bill proposes to give employees under workplace determinations/enterprise agreements the opportunity to choose their preferred superannuation fund.

In his second reading speech Minister Dan Tehan said that the Bill is aimed at 'fixing the problem of multiple accounts by preventing Australians from being forced into having multiple accounts because of their enterprise agreement or similar workplace determination'.

The Bill was referred to the Economics Legislation Committee for inquiry and report by 21 February 2020. A public hearing on the Bill will be held on 29 January.

[Sources: Treasury Laws Amendment (Your Superannuation, Your Choice) Bill 2019, Minister's second reading speech; Inquiry home page]

Making insurance claims handling a financial service: FSC response to the consultation on draft legislation proposing to implement the government's response to FSRC recommendation 4.8

Context: The Financial Services Royal Commission recommended that the handling and settlement of insurance claims, or potential insurance claims, should no longer be excluded from the definition of 'financial service' (see recommendation 4.8). Following earlier consultation (see: Governance News 06/03/2019 at p21) on 29 November 2019, Treasury released exposure draft legislation and explanatory materials proposing to: 1) remove the exclusion of insurance claims handling and settlement services from the definition of a 'financial service' in the Corporations Act 2001; 2) make handling and settlement of an insurance claim, or potential insurance claim, a 'financial service' under the Corporations Act 2001; and 3) tailor application of the existing financial services regime to the new financial service of handling and settling an insurance claim in line with the Commission's recommendation (see: Governance News 04/12/2019 at p14). Consultation closed on 10 January.

Financial Services Council (FSC) submission

The FSC prefaces its submission by stating that it 'continues to wholly support Recommendation 4.8 and welcomes the opportunity to submit a response to the proposed legislation'.

Suggested exemptions and requests for clarification: The submission seeks 'clarification' on a number of points and suggests some changes including the following.

- **Clarification on timing**: The FSC has asked for 'clarification and certainty' on the timing that obligations would be expected to commence on 1 July 2021 for those that provide claims handling and settling services, 'irrespective of early issue of licences or technical delays in the licensing process, provided the applicant lodges the licence application or variation with ASIC by 31 December 2020'. Further, the FSC says that 'it is also important that the licensing of applications be a streamlined, iterative and collaborative process to ensure CHS [claims handling services] services can continue to be processed smoothly in the event of any possible delays in the licensing process ie illness, fires and car crashes don't stop because of licencing rules, processes, backlogs and issues'.

- **Statements 'of a factual basis' should not be considered financial product advice:** The FSC seeks clarification that 'statements of a factual basis' that are designed to inform and assist the claimant, will be regarded as a necessary part of the claims handling process and therefore will not constitute financial product advice. 'Imposing additional disclosure obligations for factual statements would unreasonably hinder the quality and efficiency of the CHS [claims handling services] provided to the claimant' the FSC states.

- **Suggested exemptions**: The FSC suggests that 'persons acting in their professional capacity to provide an "expert" opinion' — including: doctors, physiotherapists and accountants acting in their professional capacity by providing an expert opinion in claims matters — be excluded from the group deemed to provide claims handling services in respect of insurance products. The FSC argues that: a) these experts are external to the insurer and hold no delegated authority to make a claims decision and b) that if they are not exempted they are likely to withdraw their services which result in a 'deterioration in the efficiency and quality of the CHS services which would be provided to the claimant'. In addition, FSC CEO Sally Loane comments that the conduct/compliance of such professionals may already be governed by their own professional body and associated licencing arrangements (for example in the case of doctors).

  In addition, the submission suggests a further broadening of the existing carve out for lawyers. 'The existing carve-out contemplates the external lawyer scenario but does not currently fit with or sufficiently exclude internal lawyers' the FSC argues.

- **'Timely release' of ASIC's information guide**: Referencing the fact that the Australian Securities and Investments Commission (ASIC) plans to release an information guide outlining regulatory expectations under the changes, the submission requests that the release of the guide be 'timely' in order to facilitate effective implementation. 'The successful implementation of Recommendation 4.8 will require industry to act immediately and invest significant resources in order to ensure that legislative requirements are satisfied on both an initial and ongoing basis' the FSC states.

- **Treatment of superannuation trustees**: The FSC suggests that the wording in the legislation clarify that superannuation licensees (and the activities of the administrator appointed by the trustee) be 'wholly excluded from the proposed legislation' on the basis that the government is set to consult separately on legislation dealing with regulation of claims handling by superannuation trustees as part of its response to the Financial Services Royal Commission.

[Sources: FSC media release 16/01/2020; FSC submission: Making Insurance Claims a financial services 10/01/2020]

LIBOR transition: UK regulators have called on firms to accelerate their preparations in order to meet the transition deadline

The Bank of England, Financial Conduct Authority, and the Working Group on Sterling Risk-Free Reference Rates have each released plans detailing priorities and milestones for 2020 on LIBOR transition with the aim of encouraging immediate action from market participants and to ensure they are prepared for LIBOR cessation by the end of 2021.

'The time to act is now: with the tools published today and the support of the official sector domestically and internationally, market participants have what they need to leave LIBOR behind' the media release states.

An issue of global concern? The FT comments that given LIBOR underpins the pricing of approximately $400tn of products globally and that global authorities are equally concerned about the rate of their own market participants transition.

[Source: Bank of England media release 16/01/2020; [registration required] The FT 16/01/2020]

In Brief | The Financial Services Council has announced that life insurers will treat people making a claim related to the bushfires as vulnerable customers requiring additional support under its life insurance code

[Source: FSC media release 15/01/2020]

In Brief | Westpac has appointed Colin Carter as the final member of the three-member Advisory Panel assessing board risk governance and accountability in relation to the issues raised in AUSTRAC's Statement of Claim. Mr Carter will join previously announced Panel members Ziggy Switkowski and Kerry Schott

[Source: Westpac media release 16/01/2020]

In Brief | Following a recent review, APRA is reportedly investigating the adequacy of private health insurers' technology systems. Reportedly, APRA is particularly concerned about the level of access third party providers may have to sensitive consumer data and the level of third party security levels

[Source: [registration required] The Australian 20/01/2020]

In Brief | Open finance? UK regulator, the FCA has called for input on the opportunities/risks associated with extending open banking principles to a broader range of financial product offerings including savings, insurance, mortgages, investments, pensions and consumer credit. Feedback will be used to help inform strategy. The closing date for comments is 17 March

[Source: FCA media release 17/12/2020]

In Brief | The case for central bank digital currency? The Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, the Sveriges Riksbank and the Swiss National Bank, together with the Bank for International Settlements, are assessing the potential cases for central bank digital currency (CBDC) in their home jurisdictions and have created a group to share information

[Source: Bank of England media release 21/01/2020]

In Brief | National Australia Bank has appointed Simon McKeon as non-executive director, effective 3 February 2020. Mr McKeon said that joining the board would allow him to 'assist the improvement process from the inside, while also supporting the bank's ambitions at a time of seriously enhanced competition'. Mr McKeon will remain in his current roles as Chancellor of Monash University and a non-executive director on the boards of Rio Tinto and Spotless Group

[Source: NAB media release 20/01/2020]

Climate Risk

Top Story | A threat to global financial stability: BIS cautions that climate risk could trigger the next GFC

Climate risk is a serious threat to global financial stability and could trigger the next GFC. Moreover, the Bank of International Settlements (BIS) considers that though collective action is required, central banks must play a more 'proactive' role in addressing it.

Report Overview | Bank of International Settlements (BIS) report, The Green Swan: Central banking and financial stability in the age of climate change

Key Takeouts

- **What is the report about?** The focus of the report is primarily on the role of central banks in 'preserving financial stability' in the 'age of climate change'.
- **Why are central banks concerned about climate change?** The report identifies climate change as unequivocally representing a risk to financial and price stability and therefore, consistent with their current mandates, a key concern for central banks that should be integrated into financial stability monitoring and financial supervision.
- **The seriousness of the threat: Climate risk could trigger the next global financial crisis**
  - **What is a 'green swan' event?** The 'green swan' label is based on, and is similar to, the concept of the 'black swan' event developed by Nassim Nicholas Taleb. However, green swans differ in a number of respects including (among others) that were such an event to occur, the causes of the crisis may be irreversible and more the consequences more devastating (because more far-reaching) than a black swan event.
  - **A green swan event could trigger the next GFC?** One example of the ways in which a green swan event could potentially trigger the next global financial crisis is if fossil fuel reserves were to become 'stranded assets' (due to a too-rapid transition to a low-carbon economy). Were this to occur, the BIS suggests that it could trigger a 'fire sale' the knock on effects of which could 'potentially' trigger a financial crisis.
- **A new approach to measuring climate risk is required:** The report cautions that traditional backward-looking risk assessments and existing climate-economic models cannot accurately predict the form that climate-related risks will take and as such, a shift in thinking and the development/adoption of forward-looking modelling and scenario-based methodologies (as advocated by the TCFD) is required. The report notes that there is emerging consensus among central banks/supervisors that this shift is necessary, as well as growing acceptance of the need to implement mandatory disclosure.
- **Central banks shouldn't be relied on to provide a complete solution, collective action is required:** The report cautions that 'relying too much on central banks would be misguided for many reasons', primarily because 'the instruments that central banks and supervisors have at their disposal cannot substitute for the many areas of interventions that are needed to transition to a global low-carbon economy'.
- **What role should central banks play?** Chapter 4 of the report argues that the integration of climate-related risks into prudential regulation and (to the extent possible) into the relevant aspects of monetary policy will not of itself, 'suffice to shield the financial system against green swan events'. However, the report does not suggest that central banks seek to 'replace' governments or private actors by taking direct climate action (despite mounting pressure on central banks to do so) or that they stop at improving the way in which they measure climate risk. Rather, BIS argues that central banks should take a pro-

active approach to calling for climate action, in coordinating actions by other players and in 'framing the debate'.

The Bank of International Settlements (BIS) has released a report — The green swan — Central banking and financial stability in the age of climate change — which considers the role of central banks, regulators and supervisors in 'preserving financial stability' in the 'age of climate change'.

Ultimately BIS cautions that 'relying too much on central banks [to address climate change] would be misguided'. Instead, the report makes clear that collective action (including action from governments, private actors and others) is required.

In this context, the report argues that central banks should: integrate climate risk into prudential regulation and (to the extent possible) into the relevant aspects of monetary policy; be more proactive in calling for climate action; and take an active role in coordinating the actions other 'other players'. 'An important contribution of central banks is to adequately frame the debate and thereby help promote the mobilisation of all efforts to combat climate change' BIS writes.

Structure of the report

The report is broken into five chapters.

- Chapter 1 outlines the 'climate emergency'
- Chapter 2 explains how climate change is a threat to global financial and price stability and the changes in thinking required to measure the threat
- Chapter 3 assesses the methodological strengths and weaknesses of the various approaches to measuring climate risk
- Chapter 4 explains that addressing climate risk requires collective action and the role central banks might play in this context (beyond improving the way in which they measure climate stability).
- Chapter 5 concludes by outlining how financial and price stability and climate stability can be considered as two (increasingly) mutually dependent public goods

A high level summary of some of the key points raised in the report is below.

Why are central banks concerned about climate change?

The report identifies climate change as unequivocally representing a risk to financial and price stability and therefore, consistent with their current mandates, a key concern for central banks. 'Climate change is a source of financial (and price) instability: it is likely to generate physical risks related to climate damages, and transition risks related to potentially disordered mitigation strategies. Climate change therefore falls under the remit of central banks, regulators and supervisors, who are responsible for monitoring and maintaining financial stability' the report states.

Further to this, the report identities the two 'main channels' through which climate change could impact financial stability as physical risks (the rising economic costs and financial losses due to the increasing frequency and severity of climate related weather events) and transition risks (the uncertain impacts that could result from a too-rapid low carbon transition). In turn, BIS explains that each of these could manifest as credit risks, market risks, liquidity risks, operational risks and insurance risks.

The seriousness of the threat: Climate risk could trigger the next GFC

The report argues that a 'green swan' event could potentially have systemic consequences for the global financial system and even trigger the next financial crisis.

What is a 'Green swan' event? BIS explains (in Box A p3) that the 'green swan' label is based on the concept of the 'black swan' developed by Nassim Nicholas Taleb. Black swan events have three characteristics: 1) they are unexpected and rare (ie outside the 'realm of regular expectations); 2) their impacts are wide-ranging or extreme; and finally, 3) they can only be explained after the fact.

Though 'green swans' share many of these characteristics, BIS explains, they differ in three key respects: 1) there is certainty about the need for ambitious actions to address climate change risks notwithstanding the uncertainty around the timing and nature of impacts of climate change; 2) 'climate catastrophes are even more serious than most systemic financial crises' ie BIS considers that the risks of climate change could 'pose an existential threat to humanity'; and 3) climate risks is more complex that the risks associated with black swan events in that 'the complex chain reactions and cascade effects associated with both physical and transition risks could generate fundamentally unpredictable environmental, geopolitical, social and economic dynamics'.

Further to this, the causes of green swan events may also be irreversible.

How could a green swan event trigger another GFC?

The report suggests that 'green swan' events 'could be behind the next systemic financial crisis'.

BIS suggests that one way in which this could occur, is through a too-rapid transition to a low-carbon economy. For example, BIS suggests that 'a rapid and ambitious transition' would mean that a large fraction of proven reserves of fossil fuel cannot be extracted. They would then be 'stranded assets'. The report suggests that 'an archetypal fire sale might result if these stranded assets suddenly lose value, potentially triggering a financial crisis'.

In this instance, BIS adds 'there would be little ground for central banks to rescue the holders of assets in carbon-intensive companies. While banks in financial distress in an ordinary crisis can be resolved, this will be far more difficult in the case of economies that are no longer viable because of climate change. Intervening as climate rescuers of last resort could therefore affect central bank's credibility and crudely expose the limited substitutability between financial and natural capital.

A new forward-looking, scenario based approach to risk modelling is required

BIS explains that given climate change is both fundamentally unpredictable and 'nonlinear,' traditional backward looking risk assessment models are unable and unsuited to predicting the future systemic risk it poses. In particular, backward looking risk models based on historical data and assumptions that shocks are normally distributed, are unable to predict 'green swan' events.

As such, the report argues that a change in thinking (what is referred to in the report as an 'epistemological break') and shift towards forward-looking risk approaches, based on scenario based analyses (as advocated by the Task Force on Climate-related Financial Disclosures (TCFD)) is required.

Emerging consensus?

BIS writes that there is emerging consensus among central banks, supervisors and practitioners involved in climate related risks that this shift is necessary, and that it is beginning to be integrated into prudential regulation in 'several jurisdictions'. In addition, BIS considers that there is also growing acceptance that 'mandatory disclosure should be implemented to strengthen and systematise the integration of climate related risks'.

Further, the report notes that 'discussions have emerged with regard to how the three pillars of the Basel Framework' could integrate climate related risks'.

Limitations?

The report makes clear that forward-looking scenario based analysis is 'only a partial solution to apprehend the risks posed by climate change for financial stability' due both to the 'deep uncertainties involved' and the fact that no 'single model or scenario can provide a full picture'.

Also, BIS acknowledges that in the absence of system-wide action, 'climate-related risks will remain largely unhedgeable'.

Central banks cannot afford to stop at measuring climate risk

The report emphasises that immediate changes are required. 'Exceeding climate tipping points could lead to catastrophic and irreversible impacts that would make quantifying financial damages impossible. Avoiding this requires immediate and ambitious action towards a structural transformation of our economies, involving technological innovations that can be scaled but also major changes in regulations and social norms' the report states'.

BIS explains that central banks are faced with a difficult choice.

If they 'sit still and wait for other government agencies to jump into action' they risk, exposing themselves to the risk of not being able to deliver on their mandates of financial and price stability. For example, BIS suggests that in the worst case scenario, 'green swan events may force central banks to intervene as "climate rescuers of last resort" and buy large sets of devalued assets [ie stranded assets (unused fossil fuel reserves)], to save the financial system'.

On the other hand, BIS considers that it would be inappropriate for central banks to act to address the lack of action by governments and private actors. 'Central banks cannot (and should not) simply replace governments and private actors to make up for their insufficient action, despite growing social pressures to do so. Their goodwill could even create some moral hazard. In short, central banks, regulators and supervisors can only do so much (and many of them are already taking action within their mandates), and their action can only be seen as enhancing other climate change mitigation policies' BIS writes.

As such, BIS cautions that 'relying too much on central banks would be misguided'.

Central Banks need to be proactive in calling for and coordinating climate action

The report argues that action on the following issues is required to address the threat climate risk poses to financial stability: pricing carbon; long-termism and sustainable finance; coordination between green fiscal policy, prudential regulation and monetary policy; international monetary and financial coordination and reforms; and integration of natural capital into national and corporate systems of accounting. This necessarily requires collective action.

BIS argues that central banks have a role to play (primarily) by coordinating measures to directly 'fight climate risk' by 'other players' (eg governments, the private sector, civil society and the international community) through what the report describes as the 'five Cs': 'contribute to coordination to combat climate change'.

'This coordination task is urgent since climate-related risks continue to build up and negative outcomes could become irreversible. There is an array of actions to be consistently implemented. The most obvious ones are the need for carbon pricing and for systematic disclosure of climate-related risks by the private sector' BIS states.

In addition, it's suggested that central banks have a role to play in 'framing' the debate, thereby promoting 'mobilisation' around climate risk.

Other 'essential' actions?

Other actions identified in the report, which are acknowledged to be 'difficult to take' yet 'essential' to preserving long term financial stability include: a) exploring new policy mixes (fiscal-monetary-prudential) that can better address the climate imperatives ahead and that should ultimately lead to societal debates regarding their desirability; b) considering climate stability as a global public good to be supported through measures and reforms in the international monetary and financial system; and c) integrating sustainability into accounting frameworks at the corporate and national level.

Social acceptance for combating climate change relies on fair distribution of costs/benefits of mitigation strategies

BIS observes that the risks and adaptation costs of climate risk mitigation strategies, 'fall disproportionately on poor countries and low income households in rich countries.' In consequence, sociopolitical backlashes against climate action are expected to continue unless there is a 'clear indication' of how the costs/benefits of climate mitigation strategies will be 'distributed fairly and with compensatory transfers'.

As such, BIS argues that 'the needed broad social acceptance for combating climate change depends on studying, understanding and addressing its distributional consequences'.

Response: A level of scepticism?

The AFR reports that Treasurer Josh Frydenberg has rejected the suggestion that in the worst case scenario, central banks may have to act as rescuers of last resort. 'I can't see that happening' The AFR quotes Mr Frydenberg as saying.

Likewise, the AFR reports that former Reserve Bank of Australia board member Warwick McKibbin considers that the chances of such an extreme situation occurring is unlikely. The AFR quotes Mr McKibbin as saying that central banks, would 'only in the extreme case that involves a systemic problem for the financial system which is highly unlikely to happen'.

[Sources: BIS media release 20/01/2020; Bank of International Settlements report: The Green Swan, Central banking and financial stability in the age of climate change January 2020; [registration required] The Australian 21/01/2020; The SMH 20/01/2020; International Business Times 20/01/2020; [registration required] The AFR 22/01/2020; Investor Daily 21/01/2020]

United States | Legislating to ban ports from exporting coal: Richmond California has reportedly joined other West Coast cities in taking steps to choke off fossil fuel exports

The AFR reports that the city of Richmond California has legislated to phase out the shipping of coal and petroleum coke through its port over the next three years. The Richmond facility reportedly shipped almost 1 million tonnes of coal to Japan and South Korea last year).

The AFR comments that move follows similar legislation in other West Coast cities including Oakland.

According to The AFR, Richmond Port operator Levin Richmond has threatened to sue on the basis that the ban will make business unviable and efforts are being made to negotiate a settlement. However, at this stage, the AFR reports that no agreement has yet been reached.

[Source: [registration required] The AFR 16/01/2020]

United States | The New York AG will reportedly not appeal against Exxon ruling

Climate Liability News is reporting that New York Attorney General Letitia James has confirmed there will be no appeal against the Exxon climate fraud ruling that cleared Exxon of wrongdoing (see: Governance News 18/12/2019 at p22).

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

Ms James is quoted as saying that despite the result, bringing the action resulted in valuable concessions. 'The oil giant has never taken seriously the severe economic impact that climate change regulations will have on the company, and that truth was laid bare at trial' Ms James is quoted as saying.

In addition, Climate News suggests that the action served as a roadmap for a similar suit being brought by the state Massachusetts.

[Source: Climate Liability News 13/01/2020]

Germany | Back on track to phase out coal fired power generation by 2038?

The AFR reports that following drawn out negotiations, the German government has negotiated a deal with German energy producers and affected regions to facilitate the phasing out of coal-fired power generation by 2038.

According to the AFR, under the agreement:

- the German government has agreed to financially compensate affected regions and affected energy producers. Reportedly, Germany's biggest coal-fired power producer Utility RWE AG, will receive €2.6 billion ($4.2 billion) in payments and Lignite operators in eastern Germany will receive €1.75 billion.

- The government will also pay for retraining programs for power and lignite mine workers impacted by plant closures.

The AFR comments that the chief voter concern in Germany is climate change, and Germany is at present set to miss its 2020 Paris Agreement targets.

[Source: [registration required] The AFR 17/01/2020]

Dutch insurer Aegon has reportedly added 104 coal companies to its exclusion policy

Greenpeace has issued a statement welcoming news that Dutch insurer Aegon has added 104 coal companies (including eight Australian companies) to its exclusion list as part of its broader coal divestment policy.

Greenpeace notes that the exclusion policy also applies to Aegon's US investment branch, Transamerica, covering a total of $225 billion in investments, including its Dutch account valued at $132 billion.

Greenpeace Australia Pacific CEO David Ritter said the move is further proof that coal is a poor investment. 'Insurers know better than anyone that climate-induced extreme weather events are becoming increasingly common and the costs are growing. The smart money is on getting out of coal and burning fossil fuels. These are the main causes of climate change and that's why Aegon is making a wise move by limiting investments in this dirty power source' he is quoted as saying.

[Source: Greenpeace media release 14/01/2020]

Reportedly investment in renewable energy decreased in Australia in 2019

Shadow Minister for Climate Change and Energy, Mark Butler has released a statement citing figures purportedly showing that investment in renewable energy decreased in Australia by 60% in 2019. Mr Butler attributes this decline to uncertainty in the market as a result of the government's climate and energy stance.

Out of step with the global trend? Mr Butler appears to base his statement on an article in The SMH. The SMH comments that the drop in investment is out of step with global trends. Reportedly, investment in renewable energy capacity worldwide increased last year to $US282.2bn with investment in onshore and offshore wind seeing the largest increase (increasing 6% to $US138.2bn).

By contrast, in Australia despite strong demand, there was a reportedly decrease in investment. The SMH adds that the data CEO of the Clean Energy Council Kane Thornton indicated that this is consistent with the council's own data.

The key to driving investment is keeping costs low: The SMH quotes Energy and Emissions Reduction minister Angus Taylor, as saying that Australia is 'installing new renewable capacity at four or five times the per capita rate of the US, European Union, China or Japan - and we have more than quadrupled our installation rate since 2016…The key challenge to ensuring continued strong growth in new renewable capacity is to drive down the cost of storage and backup'.

[Sources: Statement from Shadow Minister for Climate Change and Energy Mark Butler [accessed via LexisNexis Capital Monitor]; SMH 16/01/2020]

Pledge to remove historic emissions: The AFR reports that Microsoft has set itself the goal of removing as much carbon as it has emitted over the past 45 years

The AFR reports that Microsoft has set itself a goal to remove enough carbon by 2050 to account for all its emissions since its founding in 1975 (including direct emissions from sources such as company vehicles and indirect emissions from electricity use).

Reportedly the plan will entail cutting carbon emissions by more than half by 2030 across its supply chain (which reportedly requires use of technology that does not yet exist). The AFR comments that the measures have been announced following pressure from employees and from activist investors around the company's (alleged) lack of action on climate risk.

According to The AFR, Microsoft's move has been welcomed by US Senators Chris Coons, a Democrat from Delaware, and Mike Braun, an Indiana Republican.

[Source: [registration required] The AFR 17/01/2020]

In Brief | Fossil fuel levy? The Australia Institute has called for the creation of a National Climate Disaster Fund, financed by a levy of $1 per tonne of carbon dioxide pollution resulting from all coal, gas and oil produced in Australia. According to the Australia Institute it is estimated that the level would raise approximately $1.5 billion a year. The Australia Institute argues that 'A modest national levy on fossil fuel production would have a strong positive effect on South Australia's economy and it would help communities like Kangaroo Island and the Mt Lofty Ranges in their time of need'

[Source: Australia Institute media release 15/01/2020]

In Brief | The World Economic Forum's Global Risks Report 2020 released: Climate threats dominate the top five long term risks by likelihood and occupy three of the top five spots by impact

[Sources: WEF media release 15/01/2020; WEF Global Risks Report 2020; The Guardian 15/01/2020]

In Brief | Governor of the Bank of England, Mark Carney has been appointed as the Prime Minister's Finance Adviser for COP26. Mr Carney's key focus will be 'mobilising ambitious action from across the financial system needed to help achieve the 1.5°C goal of the Paris Agreement' though building the frameworks for financial reporting, risk management and returns to bring the impacts of climate change to the mainstream of private financial decision making and to support the transition to a net zero economy

[Source: Bank of England media release 16/01/2020]

In Brief | A Greenpeace report entitled 'It's the finance sector, stupid' has accused banks, insurers and pension funds of being 'as culpable for the climate emergency as the fossil fuel industry' because of their continued funding of fossil fuels, including those attending the World Economic Forum Annual Meeting at Davos

[Sources: worldeconomicfailure media release 21/01/2020; Report: It's the finance sector, stupid]

Technology, Privacy and Cybersecurity

US regulators to report annually on cybersecurity resilience? US Bill passes the House and will now proceed to the senate

The US House of Representatives has passed legislation — HR 4458 Cybersecurity and Financial System Resilience Act of 2019 — proposing to require banking regulators (the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the National Credit Union Administration) to provide annual cybersecurity reports to Congress. The reports would include the regulators': technical procedures; operational policies to ensure accountability for cybersecurity; details around cooperation with domestic and foreign financial institutions; and their resiliency to emerging threats to the financial system.

In a statement welcoming the passage of the Bill through the House, Republican Leader of the House Financial Services Committee and Bill sponsor, Patrick McHenry said the Bill was introduced in response to the growing cybsersecurity threat facing the US financial system and the fact as yet, 'cyber resilience…doesn't yet fit neatly into existing risk frameworks'.

Mr McHenry added that 'The Cybersecurity and Financial System Resilience Act would be a positive step by Congress to hold our regulators to the highest standards of accountability so that they remain a step ahead of tomorrow's threats'.

The Bill will now proceed to the Senate.

[Sources: HR 4458 Cybersecurity and Financial System Resilience Act of 2019 (as introduced); US Congressman Patrick McHenry media release 16/01/2020; Mr McHenry's full statement]

Other Developments

Top Story | Driving positive organisational culture and behaviour

MinterEllison has released a podcast on the issue of organisational culture — the role of leaders in this context and how culture can be measured — with insights from cultural risk expert Elizabeth Arzadon (who was recently appointed by ASIC to their governance taskforce) and MinterEllison Partner, Rahoul Chowdry.

The podcast can be accessed on the MinterEllison website here.

Edelman Trust Barometer 2020: Globally, 56% of respondents said that capitalism in its current form does more harm than good

The Edelman Trust Barometer is an annual global survey that measures levels in public trust in major institutions. The latest survey has identified that overall, despite relatively strong economic conditions, trust has declined: 'no institution is trusted'.

Some Key Points

- **Global trust deficit:** Despite a year of strong global economic performance, none of the four institutions measured — government, business, non-governmental organisations (NGOs) and media — are trusted.

  Trust levels in NGOs and business is at the same level: 58 (any score in the 60-100 falls into the neutral range). Trust levels in government and media is in the 'distrust' range at 49 (any score in the 1-49 range falls in the distrust range).

  Further, the survey found that no institution is seen as both competent and ethical. That is, business is perceived to be competent but less ethical, media and government are seen to be both less competent and unethical and NGOs are seen as ethical but less competent.

- **Widening gap between the perceptions of the informed public vs the general public?** The report comments that among the 'informed public' — described as 'wealthier more educated, and frequent consumers of news' — trust is higher overall. For example, trust in business and NGOs among the informed public is 15 points higher than it is for the mass population; for media, the difference is 14 points; for government, 12 points.

- **There is a growing sense of inequity/unfairness:**

  - Less than one in three people in developed markets believe they and their families will be better off in five years' time.

  - 78% of respondents agreed that 'elites are getting richer while regular people struggle to pay their bills'.

- **The UK sank to its lowest ever position in the Global Trust Index**: In 2020, the UK ranked second from the bottom of the Global Trust Index behind Russia. The report suggests that this loss of trust is not entirely due to Brexit. 'It would be a mistake to think that Brexit alone was to blame for this lack of trust in our institutions. While Brexit did prove to be the spark that lit the gunpowder, the conditions were set by years of institutional failures - the financial crash; the MPs expenses scandal; phone hacking and the advent of fake news on social platforms, and the Oxfam scandal in Haiti – that had already rocked trust in business, government, media and NGOs' the report states.

- **Respondents questioned whether capitalism is the best way forward:** According to the report, more than half (56%) of respondents are of the view that capitalism causes more harm than good and that democracy is losing its effectiveness. Less than 20% of the general population express confidence in the system, and 73% are looking for change.

- **Income inequality has replaced strong economic performance as a key indicator of trust levels in developed markets:** Previously, strong economic conditions have been linked with higher levels of trust/optimism (and this is still the case in developing markets). However, this is not the case in developed markets where 'trust has become uncoupled from GDP growth because people feel they are not getting their fair share of growing prosperity. National income inequality is now the more important factor in institutional trust' the report states.

- **A shift away from shareholder primacy?** According to the report attitudes around the purpose of business have shifted. 'It's no longer business as usual, with an exclusive focus on shareholder returns. Business now sees the need to play a positive role in global governance. The decision by the Business Roundtable to endorse a multi-stakeholder model for American multi-nationals; the initiation of Business for Inclusive Growth focused on fair wages by French multi-nationals; and the signing by 177 multi-nationals to the Business Ambition for 1.5°C are definitive steps toward an essential role for business as a means of improving society'.

- **Lack of trust in societal leaders:** 66% of respondents said that they do not have confidence in current leaders to successful address their country's challenges. Government leaders (42: distrust range), religious leaders (46: distrust range), the very wealthy (36: distrust range) and CEOs (51: neutral range) are not trusted to 'do what is right'. The most trusted people are: scientists (80: trust range), community members (69: trust range) and citizens of my country (65: trust range). The report suggests that this reflects an overall shift from 'top down to horizontal influence'.

- **How to regain trust?**

  - **Suggested actions for business:** The report argues that there are a 'clear set of actions' for businesses to implement to regain lost trust. These include: recognising the 'imperative to serve all stakeholders' (as opposed to just shareholders) and collaborating/partnering with government, NGOs and other institutions to 'solve the pressing issues of our time'.

  - **Suggested actions for government**: The report argues that the way for government to regain trust is for government to 'revitalize its role as an essential partner to business, act and communicate with more transparency and focus on how it can improve people's lives in tangible ways at the local level'. One example suggested in the report is protecting workers in the gig economy and supporting business in retraining/upskilling workers.

  - **Suggestions for NGOs**: The report suggests that NGOs should: a) partner with government and with business; b) ensure transparency around funding; c) expose corruption and d) 'avoid becoming policitised'.

  - **Suggestions for media**: The report suggests that the media sector should (among other things): a) keep social media clean, b) ensure objectivity; c) ensure quality reporting; and d) differentiate between opinion and fact.

- **Time for business to take the lead on change?** In this context, the report calls on business to take the lead on solving the 'trust paradox because it has the greatest freedom to act'. 'An overwhelming number of respondents believe that it is the duty of business to pay decent wages (83%) and provide retraining for workers whose jobs are threatened by automation (79%). Yet less than a third of people trust that business will do these. The time for talk is over. 2020 must be the year of action' the report states.

[Sources: 2020 Edelman Trust Barometer; [registration required] The WSJ 19/01/2020]

Uncertainty is the headline issue for CEOs globally? PwC global CEO survey has identified uncertain economic growth in the top ten threats in every geographical region

PwC's 23rd Annual Global CEO Survey, explored CEO attitudes around key risks/opportunities for the year ahead. The headline finding is that CEOs globally are more pessimistic about the global economic outlook than at any time previously. This is attributed to high levels of uncertainty around a number of issues including: a) economic growth prospects; b) technology regulation; c) upskilling; and d) climate change.

Some Key Findings

Global trends — some key points

- **Uncertain economic growth is a 'top ten' issues of 'extreme concern' globally:** Uncertain economic growth was identified in the top ten threats in every geographical region. Levels of concern were highest in Latin America where 53% of CEOs are 'extremely concerned' about the issue and lowest in Western Europe, where 26% of CEOs are 'extremely concerned'. The report comments that this marks a shift from attitudes last year when uncertain economic growth didn't rank in the top ten threats in a number of regions including North America and Western Europe (among others) last year.
- **Opportunity for Australia?** According to the report, as CEOs in China pivot away from the US, Australia is increasingly perceived as a top growth territory. In 2018, Australia was ranked 8th in the list of top growth territories, in 2020 Australia is ranked 6th (behind the US (1), China (2), Germany (3), India (4) and the UK (5)).
- **Steep uptick in concern around climate change**: The share of global CEOs who are 'extremely concerned' about climate change and environmental damage rose to 24 in 2020, a 25% increase on 2019. CEOs are more likely than they were ten years ago to recognise the benefits of investing in climate change initiatives. For example, globally:
  - In 2010, 16% of CEOs 'strongly agreed' that investing in climate change initiatives would will reputational advantage among key stakeholders (eg employees). In 2020 this rose to 30%.
  - In 2010 13% of CEOs 'strongly agreed' that investing in climate change initiatives would deliver significant new product and service opportunities. In 2020, this rose to 25%. The figure is highest in China at 47% and lowest in the US at 15%.
  - In 2010 5% of CEOs agreed that they would benefit from government funds/financial incentives for green investments. This rose to 14% in 2020.
- **Progress towards a 'greener' economy is slowest in regions where it is most needed:** In general, CEOs in Western Europe and the Asia-Pacific reported being furthest ahead in assessing the risks of climate change initiatives. The report comments that this is unsurprising given that many governments in these regions have committed to net-zero emissions by 2050. However, the report identifies that progress is much slower in other regions including the Middle East where over half of CEOs (55%) have not assessed the potential transition risks to a 'greener' economy. This is of particular concern the report argues because they are 'disproportionately exposed to those risks given their economies' reliance on oil revenues to finance their budgets.

Australia — some key insights

- **Australian CEOs' top five issues of concern/threats:** According to the report, Australian CEOs are most concerned about the following issues: 1) over-regulation (36%); 2) trade conflicts (35%); 3) uncertain economic growth (34%); 4) cyber threats; and 5) policy uncertainty. Globally, overregulation ranks as the chief threat (36%), followed by trade conflicts (35%) and uncertain economic growth (34%).
- **More pessimistic about the global economic outlook:** More than half (59%) of Australian CEOs believe the rate of global economic growth will decline over the next 12 months (as compared with 53% globally). Further, only 31% of Australian CEOs are 'very confident' that their growth prospects will improve over the next 12 months (down from 40% last year). Globally, the share of CEOs 'very confident' in their 12-month growth prospects fell to 27%, the lowest level since 2009.
- **Impact of regulation on the internet?** Australian CEOs were divided on the likely impact of legislation on the internet over the next two years. 56% of CEOs are of the view that the internet will become 'more fractured' due to new legislation regulating content, commerce and privacy, while 33% believe that the

adoption of global legislation regulating content, commerce and privacy will mean the internet becomes 'less fractured'.

- **Attitudes to climate risk have shifted over the last decade.** Ten years ago 17% of Australian CEOs agreed that climate change initiatives would lead to significant new product and services opportunities for their organisation. In 2020, this has increased to 20%. In contrast, 25% of CEOs globally agree that this is the case now (as compared with only 13% ten years ago.)

- **Making less progress than our global peers on upskilling:** 43% of Australian CEOs said that their organisation has made moderate (30%) or significant progress (13%) towards establishing an upskilling program that develops a mix of soft, technical and digital skills. Another 38% said that they are 'starting to make progress'. Globally, 54% of CEOs said that their organisations were making moderate (36%) or significant progress (18%) towards upskilling.

[Sources: [registration required] The AFR 21/01/2020; The Guardian 21/01/2020; PwC CEO survey: PwC Australia's 23rd CEO Survey — Opportunity with uncertainty; Australian insights]

Insolvency and Restructuring

ASIC is consulting on proposed changes to guidance on the circumstances in which it will grant relief to facilitate a s444GA share transfer

The Australian Securities and Investments Commission (ASIC) has released a consultation paper — Consultation Paper 326 Chapter 6 relief for share transfers using s444GA of the Corporations Act — seeking feedback on proposals to 'formalise the existing market practice' on granting relief from Chapter 6 for share transfers under s444GA of the Corporations Act.

Proposed updates to Regulatory Guide 6: Exceptions to the general prohibition (RG 6): ASIC proposes to update guidance in regulatory guide 6 about when it will grant relief from Chapter 6 for share transfers using s444GA of the Corporations Act.

Proposed guidance around requirements for granting relief include:

- explanatory materials being made available to shareholders before the s444GA hearing, including an independent expert report (IER) being prepared consistent with RG 111;

- the IER being prepared on a liquidation basis; and

- the IER being prepared by an independent expert (not the administrator or other party associated with their firm).

[Note: A list of proposals and questions on which ASIC seeks feedback is included at p20 of CP 326.]

ASIC Commissioner John Price said, 'The aim of these proposals is to provide certainty for all stakeholders and ensure that shareholders receive information equivalent to a standard control transaction. We encourage submissions on how we can achieve these goals'.

Timing: The closing date for submissions is 28 February 2020.

[Sources: ASIC media release 16/01/2020; ASIC Consultation Paper 326: Chapter 6 relief for share transfers using s444GA of the Corporations Act]

Other News

In Brief | The US, Russia and China reportedly remain the world's top three most powerful countries according to US News and World Report rankings.   Though there has been some change further down the list, due to political instability and global uncertainty, Australia's position at 15 is unchanged from last year as is the UK (ranked at 5)

[Source: Business Insider 20/01/2020]