Governance News

Weekly wrap up of key financial services, governance, regulatory, risk and ESG developments.

28 April 2021

Contents

Shareholder Activism

Investors step up the pressure on Barclays ahead of 5 May AGM

Context: Shareholder ESG resolution

Market Forces has coordinated a shareholder resolution, calling on Barclays to align its financing decisions and exposure to coal, oil and gas with the goals of the Paris Agreement. If passed, the resolution would require the bank to: a) set further and tighter short, medium, and long-term targets; b) commit to a timebound plan to phase out its provision of financial services to fossil fuels; and c) report annually on its progress on implementing the plan from 2022. (You can find the full text of the resolution here and the supporting statement here.)

This is the second consecutive year that Barclays will face a resolution of this kind. Market Forces states that the resolution was filed after changes made to policies following the 2020 AGM were found to be insufficient.

In particular, Market Forces is concerned that:

- Barclays intends to remain a 'significant funder' of the coal sector until at least 2030. Market Forces considers this to be inconsistent with Barclays' climate commitments because it will mean that the bank is effectively funding the expansion of the industry while 'scientists warn that global energy from coal needs to drop by 80% from 2010 levels by 2030'.
- Unless tighter targets and restrictions on fossil fuel investment are implemented, Barclays will 'continue to expose itself and its shareholders to unnecessary and unacceptable financial, reputational, policy and legal risks, identified by the G20 Financial Stability Board's Task Force on Climate-related Financial Disclosures.'

Investors step up the pressure

ShareAction, together with 17 investors representing $4.3 trillion in assets under management, have written to Barclays ahead of its 5 May AGM, calling on the bank to more closely align its financing decisions with its stated climate commitments. In particular, the group is concerned about the bank's high exposure to fossil fuel assets, including coal and oil sands.

The letter (you can access the full text here) calls on Barclays to:

- Stop providing:
  - financing, underwriting or advisory services to companies that are developing new coal mines or power plants
  - financial services 'in connection with new oil sands projects and related infrastructure…and companies that are highly dependent on oil sands, regardless of their carbon intensity'
- Commit to both:
  - putting in place a 'clear, time-bound plan to phase out' existing exposure to coal and oil sands assets; and
  - helping clients to 'develop, publish and implement coal and/or oil sands phase out plans by a specific date and no later than December 2023'
- Provide 'additional information on the bank's expectations for clients highly exposed to fossil fuels with regards to their transition plans'.

Senior Campaign Manager at ShareAction Jeanne Martin commented,

> 'This letter sends a strong signal to the board of Barclays that investors remain dissatisfied with the bank's financing of the coal and oil sands industries. Barclays is facing a shareholder resolution on climate change for the second consecutive year and the level of ambition shown by its new energy policy will no doubt influence investors' voting decisions. If Barclays wants the financial community to take its green ambitions seriously, it needs to start by immediately ending new financing for coal and oil sands companies and set clear climate-related expectations for its wider base of fossil fuel clients.'
>
> [Sources: ShareAction media release 26/04/2021; Full text of the Letter]

Shareholders push for more information about how net-zero commitments will be achieved: Shareholder resolutions filed at Mitsubishi UFJ Financial group and separately at Sumitomo Corporation

MUFG resolution

A shareholder resolution has been filed at Mitsubishi UFJ Financial group (MUFG) calling on the bank to adopt and disclose a plan to align its financing and investments with the goals of the Paris Agreement. According to Market Forces this is significant because it marks only the second time that an ESG resolution has been filed with a Japanese financial institution.

The filers' key concern is that MUFG's current policies will not enable the bank to achieve net zero emissions by 2050 because they do not rule out financing to fossil fuels and deforestation. You can find more detail here.

> [Sources: Market Forces media release 29/04/2021; Explanatory material for investors: Shareholder Proposal for 16th Annual General Meeting of Shareholders of Mitsubishi UFJ Financial Group]

Sumitomo Corporation resolution

A shareholder resolution (filed by a representative of Market Forces) has also been filed at Sumitomo Corporation, again calling on the company to adopt and disclose a plan outlining its business strategy to align its business with the goals of the Paris Agreement. The full text of the resolution is here.

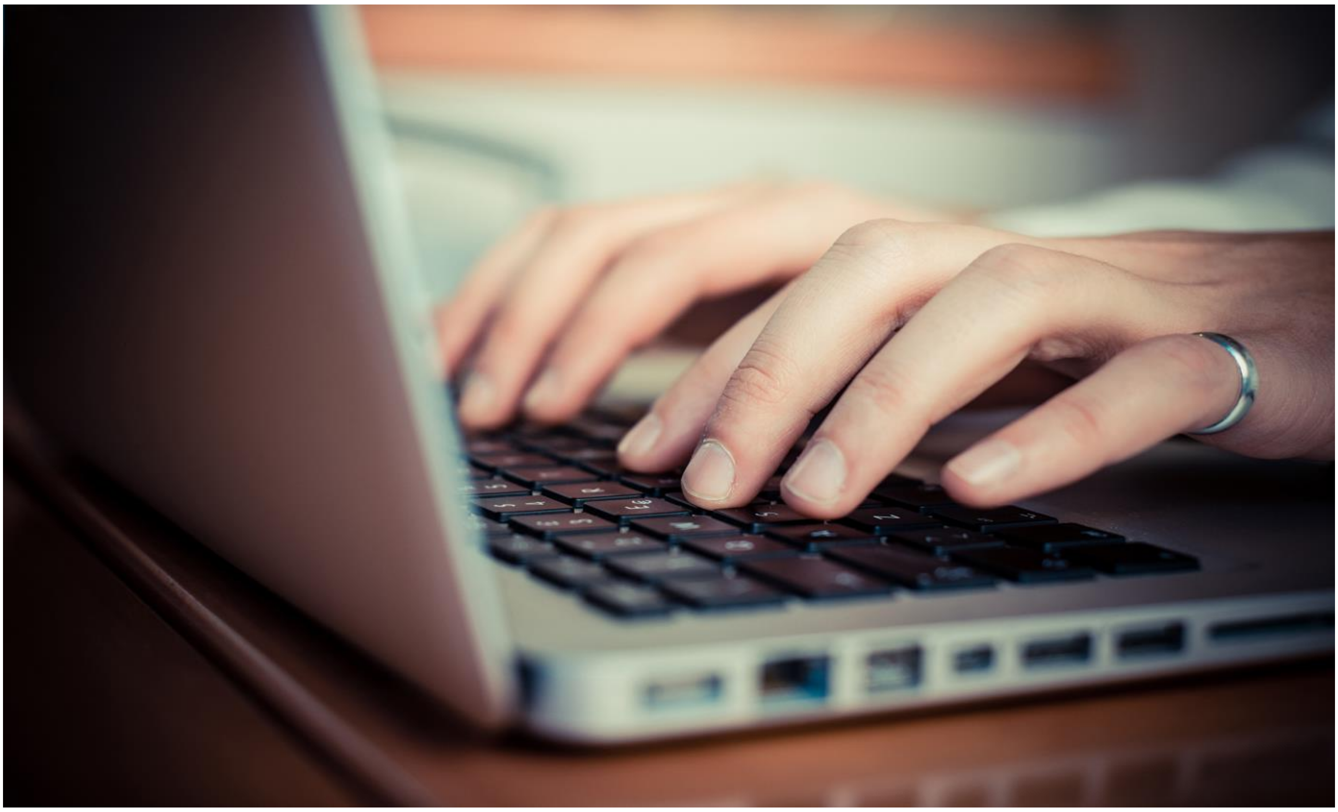
Again the key concern behind it is that Sumitomo's current policies/targets will not enable it to achieve its net zero ambition. In particular there is concern that the company has not: set any interim targets to achieve net zero emissions by 2050; conducted scenario analysis; and has no coal/oil/gas decarbonisation or phase out plans. You can find more detail in the investor briefing here.

Market Forces Campaigner Megu Fukuzawa comments,

> 'By aiming for carbon neutrality, Sumitomo acknowledges its destination. Unfortunately, it appears to have no plan for how to get there, and its current targets are out of line with the latest scientific findings…When it comes to managing climate risks, the time for feel-good statements is over. Investors are judging companies on what they do, not what they say. And today, Sumitomo is not matching words with action.'
>
> [Source: Market Forces media release 29/04/2021]

Other Shareholder News

Modernising business communications: The government has announced plans to make certain laws technology-neutral



Treasurer Josh Frydenberg and Assistant Minister to the Prime Minister and Cabinet Ben Morton have jointly announced that as part of the government's deregulation agenda, the government intends to introduce legislation that will make laws within the Treasury portfolio technology neutral.

According to the statement, legislation to implement phase one of the planned changes will finalised by the end of 2021. Planned changes include:

- expanding the range of documents that can be validly signed electronically
- increasing the range of documents that can be sent electronically to shareholders and amending requirements to contact lost shareholders
- improving flexibility for customers when changing address and consenting to electronic communication with credit providers
- removing prescriptive requirements for notices to be published in newspapers, where suitable alternatives have been identified
- addressing provisions in Treasury legislation were only non-electronic payment options are in place.

Subsequent changes may include amending existing requirements concerning:

- communication with regulators (for example, the conduct of hearings)
- reducing or removing Treasury portfolio legislation exemptions to the Electronic Transactions Act 1999
- product disclosure and record keeping requirements

[Source: Joint media release Treasurer Josh Frydenberg and Assistant Minister to the Prime Minister and Cabinet Ben Morton 21/04/2021]

Institutional Investors and Stewardship

ASX 200 companies on notice: From 2022 ACSI may recommend that members vote against individual directors at companies that fall short on climate risk

The Australian Council of Superannuation Investors (ACSI) has announced a new climate change policy.

From 2022, ACSI may recommend that members vote against the election/reelection of the individual directors most accountable for oversight of climate change-related risks – eg Chairs, Risk Committee or Sustainability Chairs - where the expectations set out in the policy are not met, and where engagement with the company has not been successful.

Initially ACSI will focus on ASX 200 companies in sectors most exposed to climate risk including Energy, Utilities, Transport, and Materials.

ACSI's expectations

ACSI expects companies to:

- Align their disclosure with the recommendations of the TCFD recommendations
- Align their corporate strategy with the goals of the Paris Agreement
- Align their policy and advocacy activity (including activity taken directly and activity undertaken by industry associations) to ensure consistency with the goals of the Paris Agreement
- Set short, medium and long-term emissions reduction targets in alignment with the Paris Agreement
- Undertake scenario analysis and stress test the resilience of their portfolios and company strategy against climate change scenarios.
- Analyse and manage physical risk by undertaking analysis of the physical risks arising for assets within its portfolio.

- Plan for just and equitable transitions by taking employees, communities and other stakeholders into account in transition strategy and planning.

The policy also supports an investor 'Say on Climate', calling on climate exposed companies to adopt an advisory investor vote on climate reporting at company annual general meetings in 2022. ACSI considers this to be an important mechanism for enabling investors to voice concerns, to increase transparency and to support engagement.

Announcing the policy, ACSI CEO Louise Davidson said that it is aimed at accelerating the pace of change.

> 'Our active and constructive engagement with ASX200 companies has led to major improvements in company practices – but there is much more to be done to address climate risk. Not all companies have listened to investor expectations and in many cases, the pace of change is moving too slowly. In order to increase the focus on climate-related risks in the companies they invest ACSI may recommend members vote against the re-election of directors…As the impact of climate change becomes a reality, the approach that investors take to manage these risks has to be more active. ACSI and our members will constructively engage with companies, however, where a company fails to meet investor expectations we will take action. Our members will not shy away from this responsibility.'
>
> [Source: ACSI media release 25/04/2021]

Growing support for the Net Zero Asset Managers Initiative

Context

The Net Zero Asset Managers Initiative which launched in December 2020, is an international coalition of asset managers committed to achieving the goal of net zero greenhouse gas emissions by 2050 (or sooner) and to 'supporting investing' aligned with this goal.

In line with this, signatories to the initiative commit to:

- setting an interim (2030) emissions reduction target
- reporting annually on their progress against the TCFD recommendations

Signatories are asked to submit an interim target within 12 months of joining the initiative for the proportion of assets to be managed in line with reaching net-zero emissions by 2050 (or sooner).

The initiative is managed globally by six founding partners: Asia Investor Group on Climate Change (AIGCC), CDP, Ceres, Investor Group on Climate Change (IGCC), Institutional Investors Group on Climate Change (IIGCC) and Principles for Responsible Investment (PRI). The initiative is also endorsed by The Investor Agenda.

Support for the initiative has significantly increased

- The initiative launched with 30 signatories.
- This has now nearly tripled to 87 signatories including BlackRock, Vanguard, and State Street Global Advisors.
- Collectively the group has nearly $37 trillion in assets under management (or nearly 40% of the total assets under management globally).

Commenting on the growing support for the initiative, US Special Presidential Envoy for Climate John Kerry said,

> 'The largest financial players in the world recognise energy transition represents a vast commercial opportunity as well as a planetary imperative. As countries around the world move to decarbonise, the large sums these institutions are dedicating to climate solutions reflect a growing understanding that the transition to a low-carbon global economy will be critical for their business models. To be credible and effective as market signals, these financial commitments should adhere to clear definitions, metrics, and reporting. Ultimately, the transition to this new economy will create a massive number of new jobs and increase our collective ability to tackle climate change.'
>
> [Source: Net Zero Assets Initiative media release 20/04/2021]

Meetings and Proxy Advisers

ASIC extends reporting deadlines and AGM no-action timeline

Reporting deadlines

The Australian Securities and Investments Commission (ASIC) has announced it will extend the deadline for lodgement of financial reports, directors' reports and audit reports for listed and unlisted entities (under Chapters 2M and 7 of the Corporations Act 2001 (Cth)) by one month for balance dates from 23 June to 7 July 2021 (inclusive).

Instruments extending the deadlines are expected to be registered on the Federal Register of Legislation shortly.

ASIC states that the extensions will not apply for reporting for balance dates from 8 January 2021 to 22 June 2021 as 'there does not appear to be a general lack of resources to meet financial reporting and audit obligations for these reporting periods'. ASIC will however, consider granting relief on a case by case basis.

The relief will not apply to registered foreign companies.

'No action' position on Annual General Meetings

ASIC will also extend its 'no-action' position for public companies to hold their AGMs from within 5 months to within 7 months after the end of financial years that end up to 7 July 2021.

ASIC states that this is intended to allow additional time for distribution of financial reports to members prior to the AGM for those companies that have relied on the extension of time for lodgement of financial reports.

[Source: ASIC media release 23/04/2021]

Financial Services

APRA has released draft climate guidance for consultation

APRA is consulting on draft Prudential Practice Guide CPG 229 Climate Change Financial Risks (CPG 229).

Key Takeouts

- The draft guidance is aligned with the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) recommendations and was developed in consultation with both domestic and international peer regulators.
- APRA's expectation is that management of material climate-related risks is integrated into existing risk and governance frameworks to support informed decision making. As such, the draft guidance is intended to be read alongside/supplement APRA's existing guidance in CPS 220, SPS 220, CPS 510 and SPS 510.
- The draft guidance is targeted at all APRA-regulated entities. APRA has drafted the guidance with the intention that it allows entities sufficient flexibility to be able to tailor their approach as appropriate to their size, customer base and business strategy.
- The deadline for submissions is 31 July 2021. APRA has indicated that it expects final guidance to be released 'before the end of 2021'.
- The release of the draft guidance has been welcomed by the Investor Group on Climate Change (IGCC). IGCC Emma Herd commentedthat it is likely to act to accelerate and consolidate climate action across the financial services sector. Ms Herd also commented that 'Other markets are moving to mandatory climate risk disclosure regimes, including New Zealand, the United Kingdom, Hong Kong and potentially the United States. The draft APRA guidance serves as a good basis to begin moving towards a similar mandatory regime in Australia.'

Overview

The Australian Prudential Regulation Authority (APRA) is consulting on draft guidance - Draft CPG 229 Climate Change Financial Risks – that aims to both clarify regulatory expectations around the management of material climate-related risks and opportunities and to assist all APRA-regulated entities to integrate management of these risks into their existing governance and risk frameworks to support informed decision making.

Announcing the release of the draft guidance APRA Chair Wayne Byres commented,

> 'The prudential practice guide doesn't direct or prevent APRA-regulated entities making any particular business or investment decision. Rather, it is aimed at ensuring decisions are well-informed and appropriately consider both the risks and opportunities that the transition to a low carbon economy creates.

The draft guide is aligned with the recommendations from the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) and was developed in consultation with both domestic and international peer regulators. It provides insights into APRA's view of what constitutes 'sound practice' in governance, risk management, scenario analysis and disclosure.

Figure 1 at p6 of the draft guidance is a diagram summarising APRA's overall approach.

A flexible approach

APRA emphasises that the draft guidance does not impose/create new obligations and is not intended to be prescriptive. APRA states, that

> …'subject to meeting the requirements of the prudential standards, an APRA-regulated institution has the flexibility to configure its approach to climate risk management in a manner best suited to achieving its business

objectives. Not all of the practices outlined in this PPG are relevant for every institution and some aspects may vary depending upon the size, business mix and complexity of the institution'.

The draft guidance is intended to be read alongside/supplement APRA's existing guidance in in CPS 220, SPS 220, CPS 510 and SPS 510.

Governance: oversight of material financial risks posed by climate change are a board responsibility

The draft guidance makes clear that APRA views 'ultimate responsibility for the sound and prudent management' of an APRA-regulated entity's business operations as resting with the board. Consistent with this, the draft guidance underlines the importance of board oversight and involvement in the management of climate risk (ie the financial risks arising from climate change, including physical, transition and liability risks).

APRA considers it to be 'prudent practice' for boards to seek to understand and to 'regularly assess' how the financial risks posed by climate change may impact their business, in the context of discharging their oversight duties. APRA further expects boards to be able to evidence their ongoing oversight of material risks.

The draft guidance suggests (at para 16 p10) that a 'prudent' board would be 'likely to undertake' the following.

- Ensure board and sub-committee members have 'an appropriate understanding' of climate risk, and opportunity to discuss it at board and subcommittee meetings. The draft guidance suggests that this may 'include appropriate training for board members'.
- Ensure that there is clear responsibility for the management of climate risk at senior management level and that senior managers are held to account for executing these responsibilities
- Ensure that climate change related risks, opportunities and accountabilities are regularly re-evaluated, and that considerations of climate-change related risk is integrated into strategy and business planning approval processes
- Ensure that the impacts of climate-related risks are considered over the short and long term, which APRA comments 'may be beyond the institution's regular business planning horizon'
- Ensure the entities' risk appetite framework incorporates material climate-related risks including 'the risk exposure limits and thresholds for the financial risks that the institution is willing to bear'

On the issue of delegation, APRA comments that though boards may elect to delegate certain functions, as with other risks, APRA expects that the board to ensure that appropriate monitoring mechanisms are in place. The draft guidance also suggests that board-level engagement on the issue is important in ensuring that management of climate-related risk 'holds sufficient standing' within institutions, and helps ensure boards receive 'institution-wide insights to strategically respond to the risks'.

The role of senior management

The draft guidance also identifies (para 17 p11) a number of actions/functions that APRA considers senior management would 'typically' be responsible for. These include:

- drawing on the entity's risk management framework to 'assess and manage climate risk exposures on an ongoing basis, including developing and implementing appropriate policies'
- 'regularly reviewing the effectiveness of the framework, policies, tools and metrics and making appropriate revisions'
- 'providing recommendations to the board on the organisational objectives, plans, strategic options and policies as they relate to climate risks that are assessed to be material, including the establishment and use of relevant tools, models and metrics to monitor exposures to climate risks, so as to enable the board to make informed decisions in a timely manner'
- 'ensuring adequate resources, skills and expertise are allocated to the management of climate risk, eg through training of senior staff'.

Risk Management

Climate risk management policies and procedures should be documented

- The draft guidance suggests that entities should document how they are managing climate risk through written risk management policies, management information and board risk reports.

- The draft guidance suggests that 'as a matter of good practice, the policies and procedures developed under the risk management framework would include a clear articulation of the respective roles and responsibilities of business lines and risk functions (ie Line 1 and Line 2 activities) in relation to managing climate risk'.

Identifying risks and recording exposure

- In APRA's view, a 'prudent institution would seek to understand climate risks and how they may affect its business model including being able to identify material climate risks and assess the potential impact on the institution'. The draft guidance suggests that scenario analysis, could be useful in this context.
- The draft guidance suggests that climate risks could be considered within the established risk categories in CPS 220 and SPS 220. APRA's expectation is that entities are able to demonstrate how the materiality of climate risk has been determined within each of these categories.
- The draft guidance states that a 'prudent institution would likely seek to identify economic sectors with higher or lower exposures to physical and/or transition climate risks'.
- The draft guidance further suggests that assessment of economic sectors could be used to develop sector-specific policies/procedures for the institution when undertaking business engagements (eg insuring, investing etc). APRA suggests that 'good practice' would see an 'integrated approach to climate risks taken across different business lines (such as underwriting, investment, product development and lending functions)'.
- The draft guidance states that in APRA's view, the Internal Capital Adequacy Assessment Process (ICAAP) 'is an appropriate framework to consider and record the material impact on capital adequacy of climate risks for those institutions required to complete an ICAAP'. The draft guidance suggests that where institutions are not required to complete an ICAAP, they may 'benefit from adopting a similarly formal approach to recording material exposures and how the assessment of those exposures is considered'.

Risk monitoring

- APRA observes that 'better practice in monitoring climate risks includes both a qualitative and quantitative approach, including developing metrics to measure and monitor climate risks appropriate to an institution's size, business mix and complexity of business operations'.
- In APRA's view, quantitative metrics are likely to be useful in assisting entities to 'understand the potential current and future impacts of climate risks on its customers, counterparties, and organisations to which the institution has an exposure'.
- The draft guidance suggests that 'more advanced quantitative risk metrics' could take a variety of forms. For example: direct and indirect emissions (scope 1, scope 2 and relevant scope 3 emissions) or exposure to physical risks (among other examples).
- APRA suggests that where an entity does not have the necessary information to assess the impacts of climate risk, it is 'appropriate for the institution to engage with customers and counterparties to form an understanding of the extent to which the impacts may be material to the institution's own risks'. The draft guidance suggests that a 'prudent institution' is likely to use data from both publicly available and proprietary sources and may potentially seek assistance from external experts (where necessary).
- APRA considers that a 'prudent institution' would ensure that climate risk data and metrics are updated regularly to support decision-making by the institution's board and senior management.
- APRA also suggests that 'better practice in risk monitoring extends to monitoring the impacts that climate risks may have on outsourcing arrangements, service providers, supply chains and business continuity planning'. .

Risk management

Where material climate-related risks are identified, APRA expects that a 'prudent institution' would establish/implement plans to mitigate/limit its exposure as well as to regularly review and assess the effectiveness of these actions.

The draft guidance states,

> 'In most cases, APRA envisages that an APRA-regulated institution would choose to work with customers, counterparties and organisations which face higher climate risks, to improve the risk profile of those entities. Indeed, providing finance to assist customers to adapt to climate change is an important function of the financial system. However, where the institution considers this engagement will not result in the climate risks being adequately addressed, an institution may need to consider mitigation options such as:
>
> a) reflecting the cost of the additional risk through risk-based pricing measures;

b) applying limits on its exposure to such an entity or sector; or

c) where the risks cannot be adequately addressed through other measures, considering the institution's ability to continue the relationship'.

Internal risk reporting

- In the interests of promoting well-informed decision making, APRA's expectation is that prudent institutions would establish procedures to provide relevant information on its material climate risk exposures (including monitoring and mitigation actions) to the board and senior management on a routine basis.
- The draft guidance does not specify how often this reporting should occur. APRA states that 'The extent and frequency of reporting should be tailored to the nature and magnitude of the risks to which the APRA-regulated institution is exposed'.

Scenario analysis and stress testing

APRA's expectations around the use, scope and implementation of scenario analysis are set out in detail at p15-17 of the guidance.

- The draft guidance states that 'APRA considers it prudent for institutions to develop capabilities in climate risk scenario analysis and stress testing, or to have access to external scenario analysis and stress testing capabilities, to inform their risk identification in both the short and long term'.
- The draft guidance states that in developing their capability, entities should have regard to leading practice. Broadly, APRA considers that this entails:
  - a short term assessment of the institution's current exposures to climate risk in line with current business planning cycles
  - a long term assessment of the institution's future exposures based on a range of difference climate-related scenarios (potentially extending to 2050 'or beyond)
- The draft guidance suggests that scenarios should:
  - assess both the physical and transition risks within each scenario (possibly with input from external experts)
  - be used to assess the possible impact of climate risks on a range of business obligations and considerations eg solvency, liquidity and the ability to meet obligations (eg obligations to depositors or superannuation fund members where appropriate)
  - incorporate 'forward-looking information such as: considering future trends in catastrophe modelling, technology innovation or policy development'
- The draft guidance identifies the following as 'key considerations' when building such scenarios.
  - Future temperature rise: APRA suggests that scenarios could include global average temperatures continuing to rise eg temperature increases in excess of 4˚C by 2100 and global average temperatures rising by 2˚C or less consistent with the goals of the Paris Agreement
  - The economic pathway to transition: scenarios should reflect the potential impacts of an 'orderly transition' to a lower-emissions economy and a 'disorderly transition'
- The draft guidance notes that 'useful guidance' has also been published by the TCFD, the Climate Measurement Standards Initiative and the Network for Greening the Financial System.
- Entities required to complete an ICAAP:
  - APRA considers that a narrative-driven process is 'a useful approach to considering climate risk scenario analysis and stress testing to assess potential risk exposures and available capital resources'.
  - The draft guidance suggests that it is good practice to maintain appropriate documentation of the process and results climate risk scenario analysis and stress testing.
  - ARPA's expectation is that where material, 'the results would be communicated to the institution's board and senior management, and used to inform business planning and strategy setting, as well as setting and reviewing the institution's overall climate risk management approach'.

Lessons from Climate Vulnerability Assessments to be shared with industry

- In a letter to industry, released with the draft guidance, APRA comments that scenario analysis is an area where it has observed a 'wide range of capabilities and practices'. APRA states that it will share the 'lessons' to emerge from the climate vulnerability assessment exercise it is currently undertaking with broader industry once it is completed to further support entities to improve their approach.

Disclosure of material climate risks

- The draft guidance states that APRA 'considers the framework established by the TCFD to be a sound basis for producing information that is useful for an institution's stakeholders.
- The draft guidance also flags that APRA considers it likely that demand for reliable and timely climate risk disclosure to continue to increase. APRA observes that for entities with international activities, 'there is a need to be prepared to comply with mandatory climate risk disclosures in other jurisdictions'.
- In light of this, APRA considers that 'a prudent institution would continually look to evolve its own disclosure practices, and to regularly review disclosures for comprehensiveness, relevance and clarity, to ensure it is well-prepared to respond to evolving expectations in relation to climate related disclosures'. The draft guidance also makes clear that 'a lack of absolute certainty in relation to climate risks' future impacts should not be considered a reason to avoid disclosure of exposure to these risks'.

The IGCC has welcomed the release of the draft guidance

In a short statement, welcoming the release of the guidance the CEO of the Investor Group on Climate Change (IGCC) Emma Herd commented,

> 'This is critical work from APRA that will go a long way to consolidating the accelerating action across the financial sector to address the systemic financial risks created by climate change. The draft APRA guidance sends a clear message to directors and trustees that climate risk is financial risk. It means assessment, disclosure and management of an organisation's climate risk exposure is clearly identified as being consistent with proper risk management practices and regulator expectations'.

Noting moves in other jurisdictions to mandate climate disclosure, Ms Herd also suggested that the draft guidance 'serves as a good basis to begin moving towards a similar mandatory regime in Australia.'

[Sources: APRA media release 22/04/2021; Letter to industry; Draft CPG 229 Climate Change Financial Risks April 2021;IGCC media release]

Disclosure and reporting (including greenwashing) and cyber resilience flagged among ASIC's top regulatory priorities for 2021

In her speech to the Australian Institutional Investor Roundtable hosted by Standards Board for Alternative Investments (SBAI), Australian Securities and Investments Commission (ASIC) Deputy Chair Karen Chester provided a regulatory update on 'what matters to ASIC for investors for 2021-22'.

Some Key Takeaways

Ms Chester said that while ASIC continues to focus on implementing regulatory action to support Australia's COVID-19 economic recovery, consumer and investor protection remain 'top of mind' for the regulator

In particular, Ms Chester said that there are three 'tests' that 'frame' ASIC's regulatory priorities for 2021. They are as follows:

- 'As investors move up the risk curve in the hunt for yield, how are you evaluating the impact of your product disclosure and governance practices on those consumers?' Ms Chester used the example of ESG investment to frame discussion around this.
- 'With Australia's superannuation system under more scrutiny than ever before, how can you live up to your stakeholders' expectations and deliver value?'
- 'How well are you prepared for the real and growing threats posed by operational risks – particularly cyber?'

Disclosure and Reporting

Climate risk management and disclosure

- Ms Chester said that ASIC has observed high levels of engagement by private sector on climate risk issues. In response, she noted that:
  - 78% of ASX100 companies now acknowledge climate change as a financial risk to their business and almost 60% are 'following' the TCFD recommendations

- 40 listed asset managers have also publicly committed to supporting the TCFD recommendations

- Ms Chester said that ASIC has conducted a number of surveillance exercises on the climate change-related disclosure practices of large listed companies and will continue to do so as practices develop.
- Product labelling (including greenwashing): Ms Chester said that ASIC is working with the IOSCO Sustainability Taskforce on its greenwashing project.

Product labelling and product advertising

- More broadly, Ms Chester said that ASIC continues to monitor the outcomes and to 'consider appropriate regulatory action' arising from its 2020 true-to-label review.
- Product advertising:
  - Ms Chester said that ASIC remains focused (following its recent successful enforcement actions) on ensuring that marketing is 'true to label', regardless of whether the customers being targeted are retail or wholesale, and especially during the post-COVID-19 recovery period.
  - Ms Chester commented that,

    > 'The Mayfair case, along with our current matter against La Trobe, illustrate ASIC's standpoint that marketing and product suitability are not the exclusive concern of the retail market. We will continue our work to extend the legal principles protecting consumers from misleading and deceptive marketing. Not only do issuers need to ensure their product ads and websites represent their product risk, return and liquidity truthfully, they also must ensure their advertising methods – including domain names, meta-title tags, and Google Ads – do so as well. This is an emerging area of law, and while ASIC does not directly regulate Google advertising, we do ask you to take heed'.

Design and Distribution obligations

Ms Chester flagged that compliance with design and distribution obligations (DDOs) (set to commence from 5 October 2021) will also be a focus for ASIC.

Superannuation funds: delivering value

Review of governance practices

- Ms Chester said that ASIC is currently reviewing the governance practices of 10 responsible entities of managed investment schemes to 'evaluate the quality and effectiveness of their governance structures, processes and policies'. This includes reviewing board governance practices, compliance committee practices, and how responsible entities engage with/rely on third party service providers.
- Ms Chester said that the review is expected to provide ASIC with a 'a clearer understanding of current industry practice' as well as help the regulator to identify where registered entities 'may not be meeting their obligations'.
- Ms Chester said that ASIC plans to release a report 'later this year' setting out ASIC's observations and flagging any areas of concern.
- Importantly, Ms Chester said that this report will 'identify the cohort of REs surveyed, and we are expecting to identify REs where their conduct has been exemplary – or concerning'.
- Ms Chester said that 'there have been expressions of concern among some REs' about whether the review will result in ASIC issuing new standards, or law reform. On this point, Ms Chester said, 'All I'll say is that law reform is solely a matter for Government. And at any rate, it's far too early to know what the findings of the review might be'.

ASIC's role as a conduct regulator for superannuation

- Ms Chester spoke briefly about ASIC's role as the conduct regulator for superannuation. Ms Chester said that ASIC remains 'focused on protecting consumers' interests – we want to see super funds operate in a way that is fair to members and promotes confidence in the superannuation system'. In particular, Ms Chester said that ASIC would like to see trustees 'go beyond compliance by placing members' interests first' and consider 'issues around value, transparency, fees and costs'.
- Ms Chester said that an interim report from Deloitte Access Economics did not find 'significant evidence to suggest that competition is not effective in the managed funds industry' but did identify areas for improvement. The final report is due to be delivered to ASIC 'in the coming months'.

Management of operational risks, including cyber risk

- Ms Chester said that in light of the accelerating threat of cyber risk, ASIC is asking business to 'consider your operational security – are your systems, policies and processes up to scratch? Where are your weakest links and what are you doing about them?'
- Ms Chester observed that for superannuation trustees, the starting point for this is APRA Prudential Standard 234 on Information Security. In particular, Ms Chester underlined the importance of ensuring appropriate measures are in place to 'be resilient against information security incidents (including cyber-attacks) by maintaining an information security capability commensurate with vulnerabilities and threats'. Ms Chester used the 16 November ASX outage as an example of a situation that showed where resilience (in some cases) could be improved.
- Ms Chester noted that ASIC has expanded its focus on cyber risk to include taking 'deterrence-based enforcement action' where appropriate.

  [Source: ASIC Deputy Chair Karen Chester, Speech to the Australian Institutional Investor Roundtable hosted by Standards Board for Alternative Investments (SBAI) 22/04/2021]

Hayne implementation: ASIC has released draft breach reporting guidance for consutlation

Context

Schedule 11 of the Financial Sector Reform (Hayne Royal Commission Response) Act 2020 implements the government's response to Hayne Commission recommendations 1.6 (misconduct by mortgage brokers); 2.7 (reference checking and information sharing); 2.8 (reporting compliance concerns); 2.9 (misconduct by financial advisers); and 7.2 (implementation of the ASIC Enforcement Review recommendations). The reforms are due to commence on 1 October 2021.

Broadly, Schedule 11 proposes to introduce a new breach reporting regime for Australian Financial Service (AFS) Licensees and Australian Credit Licensees (credit licensees). Key changes include:

- clarifying the types of situation that must be reported to ASIC and introducing a requirement for licensees to lodge breach reports in a prescribed form and within a set timeframe
- requiring AFS and credit licensees to report serious compliance concerns about financial advisers and mortgage brokers respectively
- imposing a new obligation on AFS and credit licensees who are mortgage brokers to investigate misconduct and remediate affected clients

Consultation on draft guidance

The Australian Securities and Investments Commission (ASIC) has released Consultation Paper 340 Breach Reporting and related obligations (CP 340), together with a draft regulatory guide and draft information sheet for consultation, ahead of the commencement of changes due to take effect from 1 October 2021.

The consultation paper outlines ASIC's proposed guidance for Australian financial services (AFS) licensees and Australian credit licensees (credit licensees) on new breach reporting obligations as well as ASIC's proposed guidance on the new obligations that apply to AFS licensees who are financial advisers and credit licensees who are mortgage brokers.

Announcing the consultation, ASIC Deputy Chair Karen Chester said that ASIC expects to see an uptick in the volume of reported breaches following the commencement of the reforms, and that this is expected to enable the regulator to 'act decisively to disrupt misconduct and escalating harms and identify patterns of non-compliance across industry'.

Draft guidance for AFS licensees and Australian credit licensees on new breach reporting obligations

Broadly, the draft guide (draft RG 78) explains ASIC's interpretation of 'key concepts' in the breach reporting obligation, the regulator's general approach to administering the obligation and how licensees can demonstrate compliance.

ASIC intends that the guidance (once finalised) will it be read in conjunction with: Regulatory Guide 104 AFS licensing: Meeting the general obligations (RG 104), Regulatory Guide 105 AFS licensing: Organisational competence (RG 105) and Regulatory Guide 205 Credit licensing: General conduct obligations (RG 205).

Principles-based guidance supplemented with illustrative examples

- The draft guide proposes to provide principles-based guidance for AFS licensees and credit licensees on how they can comply with the breach reporting obligations, supplemented with illustrative examples (case studies and scenarios) showing how the principles will apply in different situations. ASIC seeks feedback from stakeholders on whether there are 'specific issues, incidents, challenges or areas of concern' they would like to see included as examples (and why).

When the draft guidance will apply

- The draft guidance (once finalised) will apply to 'reportable situations' that arise on or after 1 October 2021.
- The draft guidance explains that for AFS licensees, the previous breach reporting obligation (as in force immediately before 1 October 2021) will continue to apply if: 'a) the obligation is breached or is likely to be breached before 1 October 2021; and b) before 1 October 2021, the licensee knows that the obligation has been breached or is likely to be breached'.
- ASIC proposes that for this reason, the March 2020 version of the guide (RG 78), will continue to be available on the ASIC website to provide guidance for AFS licensees on the breach reporting framework in s912D of the Corporations Act 2001 (Cth).

What must be reported to ASIC:

- The existing breach reporting obligation in force before 1 October 2021 for AFS licensees is focused on reporting 'significant breaches' of certain obligations. Under the revised breach reporting obligation, AFS licensees and credit licensees are required to report different types of 'reportable situation' to ASIC including any significant breach (or likely significant breach) of 'core obligations', as defined in s912D(3) of the Corporations Act for AFS licensees or s50A(3) of the National Credit Act for credit licensees.
- To assist AFS licensees and credit licensees in identifying what information must be reported, ASIC proposes to provide guidance on:
  - what constitutes a 'reportable situation'
  - whether a breach/likely breach of a core obligation is significant
  - when an investigation is a reportable situation
  - what are 'additional reportable situations'
  - what are reportable situations about other licensees
- Among other things, ASIC seeks feedback on whether further guidance should be provided on:
  - what constitutes a 'core obligation'
  - how to determine whether a breach/likely breach of a core obligation is 'significant'
  - reporting an 'investigation' to ASIC
  - what constitutes 'material loss or damage'
  - reportable situations involving serious fraud or gross negligence
  - reportable situations about other licensees

When and how to report a 'reportable situation' to ASIC

- ASIC proposes to include guidance about the obligation for licensees to report to ASIC within 30 calendar days 'after they first know that, or are reckless with respect to whether, there are reasonable grounds to believe a reportable situation has arisen' as well as to provide general guidance on the types of information it will include in the prescribed form that licensees will need to use to report.

Demonstrating compliance

- ASIC also proposes to provide general guidance including' high-level expectations and other helpful practices', on compliance systems for breach reporting.

You can find a full list of ASIC's proposals and the questions on which the regulator seeks feedback at p19 of the consultation paper.

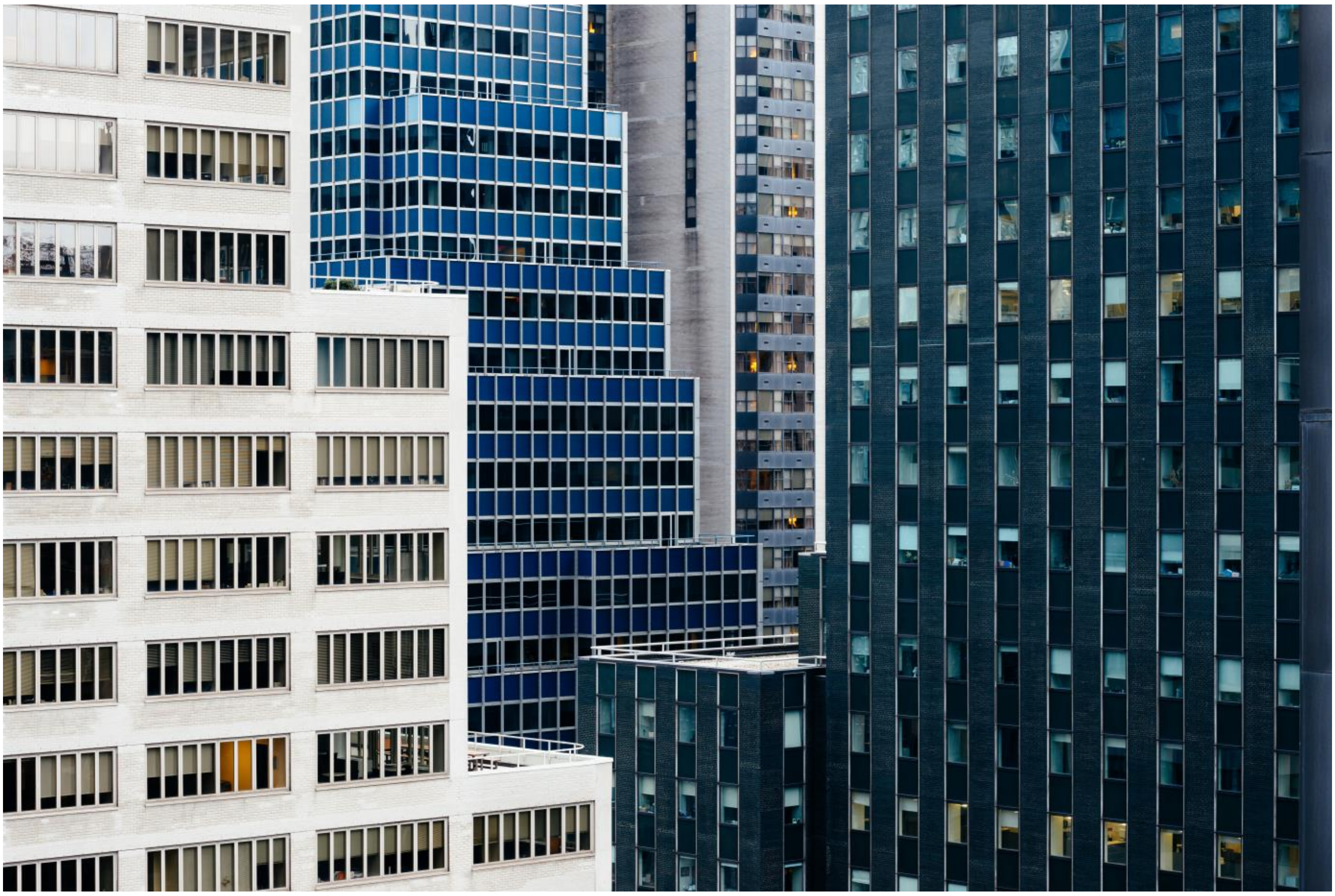
Draft information sheet on new obligations that apply to AFS licensees who are financial advisers and credit licensees who are mortgage brokers

- The draft information sheet is intended to provide AFS licensees who are financial advisers and credit licensees who are mortgage brokers with an overview of their new obligations to 'notify clients affected by certain breaches of the law, investigate the nature and extent of those breaches and remediate affected clients within certain timeframes'.
- The draft information sheet includes high level guidance on the types of information ASIC considers should be included in the notices that must be given to affected clients. ASIC comments that 'while we have not approved a form at this time, we may do so if we become aware of deficiencies in the approach taken by licensees in communicating with affected clients.'
- Among other things, ASIC seeks feedback on:
  - whether the guidance should be included in a separate information sheet to be read alongside the guidance in RG 256 Client review and remediation conducted by advice licensees (as proposed) or incorporated into RG 256. ASIC notes that RG 256 is currently under review following consultation.
  - Whether additional guidance on the circumstances in which licensees must: notify affected clients of a breach of the law; investigate the full extent of that breach; remediate affected clients is required.

Timing

- The due date for submissions on both the draft guidance and info sheet is 3 June 2021.
- ASIC plans to release both the finalised guidance and information sheet in Q3 2021.

  [Sources: ASIC media release 22/04/2021; Consultation Paper 340: CP 340 Breach reporting and related obligations; Draft Regulatory Guide 78 Breach reporting by AFS licensees and credit licensees; Draft Information Sheet 000 Complying with the notify, investigate and remediate obligations]



Hayne review: Quality of Advice review will be conducted in 2022

In her address to the Financial Services Council's Life Insurance Summit 2021, Minister for Financial Services, Superannuation and the Digital Economy Jane Hume confirmed that the government will conduct a Quality of Advice Review in 2022 as recommended by the Hayne Commission.

> [Note: Hayne Recommendation 2.3 recommended that a review of the effectiveness of measures to improve the quality of advice be conducted 'by the government in consultation with ASIC', 'preferably' by 30 June 2022, and 'no later than 31 December 2022'. In particular, Commissioner Hayne recommended that the review should consider 'whether it is necessary to retain the 'safe harbour' provision in section 961B(2) of the Corporations Act. Unless there is a clear justification for retaining that provision, it should be repealed].

Details

- Senator Hume said that the review, which will be conducted by the Treasury, will have a broad mandate and extend to considering both the quality and affordability of financial advice and the life insurance framework (LIF) (removing the need for a separate LIF review).
- Senator Hume said that this will mean that once the Australian Securities and Investments Commission (ASIC) has completed the data collection phase of the LIF review, the data will be provided to Treasury for 'further analysis in the context of the Quality of Advice Review'.
- Expanding the scope of the review in this way, Senator Hume said, will enable it to consider 'the full breadth of issues impacting on both quality and affordability of all forms of financial advice'.
- Senator Hume said that 'the degree of underinsurance and maintaining access to affordable, quality advice' will be key areas of focus.

> [Note: Senator Hume's announcement appears to signal that the Quality of Advice Review will respond to two Hayne recommendations, recommendation 2.3 (outlined in the note above) and Recommendation 2.5 (Review of Life Risk Insurance commissions). Hayne Recommendation 2.5 recommended that 'when ASIC conducts its review of conflicted remuneration relating to life risk insurance products and the operation of the ASIC Corporations (Life Insurance Commissions) Instrument 2017/510, ASIC should consider further reducing the cap on commissions in respect of life risk insurance products. Unless there is a clear justification for retaining those commissions, the cap should ultimately be reduced to zero.']

Legacy insurance products

Senator Hume also spoke about the issue of legacy products as a barrier to innovation and an ongoing cost burden on industry. Senator Hume observed that the products can also be problematic from a customer value perspective. She said that by the government's estimation, there are 286 outdated life products and $22.6bn of funds under management that are allocated to legacy products.

Senator Hume flagged that the legal/regulatory barriers currently preventing insurers from being able to rationalise these legacy products is an area of concern. 'The ability for insurers to rationalise legacy products is an important issue, and one that I will be looking at closely' she said.

Professionalisation of the advice industry – a 'balanced' approach

Senator Hume observed that FASEA has been focused on raising professional standards across the industry through implementing standards, rolling out a program of continuing professional development and the exam. However, this has imposed 'red tape' on the sector in the form of increased costs/time burdens, which have weighed particularly heavily on sole traders and those advisers working in small businesses.

Senator Hume said that though the government remains committed to raising professional standards within the industry, it believes in taking a 'balanced approach' to achieving this aim.

Senator Hume said that this is reflected in the draft legislation, recently released for consultation, which will wind down FASEA and transfer responsibility for standard setting to the government and introduce a new disciplinary system for advisers.

> [Note: This appears to be a reference to the consultation on draft legislation – [draft] Financial Sector Reform (Hayne Royal Commission Response - A New Disciplinary System for Financial Advisers) Bill 2021 – that proposes to implement the government's response to Hayne recommendation 2.10. Among other things, the draft bill proposes that FASEA will be wound up on 1 January 2022, and its functions will be transferred to the Minister responsible for administering the Corporations Act and to ASIC. It's

proposed that the Minister will be responsible for making education and training standards and for the Code of Ethics while ASIC will be responsible for approving foreign qualifications broadly consistent with the domestic qualifications approved by the Minister and for administering the financial adviser examination approved by the Minister The due date for submissions is 14 May 2021.]

[Source: Minister for Superannuation, Financial Services and Regulatory Technology Jane Hume, Address to the 12th Annual Financial Services Council's Life Insurance Summit 2021 21/04/2021

Life insurance: New professional standards framework launched

AIA Australia, AMP Life (Part of the Resolution Life Group), BT Life Insurance, ClearView, MLC Life Insurance, TAL and Zurich have worked with the Australian and New Zealand Institute of Insurance and Finance (ANZIFF) to develop and launch a Professional Standards Framework for Australia's life insurance industry.

The new framework sets a new 'Foundation Requirement' for all Life Insurance claims and underwriting professionals, consisting of four Certificate IV competencies including ethics; sustainability; products and services; and law and regulation. Life insurers have committed to achieving a Certificate IV level for all Claims professionals by December 2023, and all Underwriting professionals by December 2024.

ANZIIF CEO Prue Willsford described the new standards as a positive step for the life insurance sector and the professional development of its people. Ms Willsford commented,

> 'Competency Frameworks have been developed for Claims, Underwriting, Product and Distribution functions and will provide life insurance companies with a measurement tool for their own existing internal training, while professional development for employees will provide a roadmap for long term consistency across the industry.

The launch of the new framework has been welcomed by the government. Minister for Superannuation, Financial Services and the Digital Economy Jane Hume said,

> 'I applaud the Australian and New Zealand Institute of Insurance and Finance and industry for their hard work putting together these standards and welcome industry taking a proactive approach to create codes and standards enhancing consumer outcomes'.

[Source: The Australian and New Zealand Institute of Insurance and Finance media release 21/04/2021]

CHOICE calls on insurer to implement 'fair' fire definitions

Consumer group CHOICE has coordinated a petition, calling on Auto and General Insurance (the insurer behind Budget Direct, Virgin Money and ING) to follow other major insurers, in updating and clarifying the definition of 'fire' in its home and contents insurance policies.

CHOICE Insurance Campaigner Dean Price commented that under the current definition of fire being used by Auto and General Insurance, damage caused by heat, melting, smouldering or smoke may not be covered ie the policy may only cover damage caused by flames. CHOICE maintains that this may be confusing for consumers and lead to unfair outcomes.

The petition calls on the insurer to clarify and broaden the definition to address these concerns.

[Source: CHOICE media release 22/04/2021]

In Brief | Consultation on Your Future, Your Super Regulations and associated measures: Treasury is consulting on three sets of exposure draft regulations proposing to support the implementation of the government's Your Future, Your Super reform package. The due date for submissions is 25 May 2021

[Source: Treasury consultation 28/04/2021; Exposure draft: Addressing Underperformance in Superannuation; Exposure draft: Improving Accountability and Member Outcomes; Exposure draft: Single Default Account Exposure Draft]

Risk Management

Climate Risk

Top Story | New expert opinion cautions that 'greenwashing' could expose companies (and directors) to the risk of litigation

Key Takeouts

- A new supplementary opinion by Noel Hutley SC and Sebastian Hartford Davis provides an update on the duty of directors to consider, disclose and respond to climate-related risks in light of recent developments. In particular, the authors flag that 'greenwashing' may expose both individual directors and companies to the risk of litigation.
- The opinion includes several suggested steps that directors/companies can take to minimise/mitigate this risk.

Overview

On instruction from MinterEllison Partner Sarah Barker for the Centre for Policy Development, barristers Noel Hutley SC and Sebastian Hartford-Davis have provided an expert opinion discussing the increasing standard of care expected of directors in managing climate-related risks and providing insight into the legal risks of 'greenwashing' for both directors and companies.

A summary and discussion of the opinion is set out below. A further analysis of the practical implications of Mr Hutley's latest opinion for corporate boards, and key questions that directors and officers should now consider, has been prepared by the MinterEllison Climate Risk Governance Team for our clients. That is available here.

Identification and disclosure are no longer enough: Directors need to explain how they are managing climate risk

The updated opinion builds on earlier opinions published in 2016 and 2019 into the extent to which the duty of care and diligence imposed by s 180(1) of the Corporations Act 2001 (Cth) permits/requires directors to respond to climate change risks. You can access copies of the previous opinions here and our summaries here and here.

A key message in the 2021 opinion is that the standard of care with respect to climate change has risen and looks set to continue doing so. The authors comment that there is 'a growing sense of regulatory, investor and community pressure for directors to understand, and to convey that they understand, that the financial risks of a changing climate are to be taken seriously as economic and operational risks'.

In the authors' view, this means that in practice directors are now expected to ensure that active steps are being taken not only to identify but to manage the risks posed by climate change. The authors write,

> '…it is no longer safe to assume that directors adequately discharge their duties simply by considering and disclosing climate-related trends and risks; in relevant sectors, directors of listed companies must also take reasonable steps to see that positive action is being taken: to identify and manage risks, to design and implement strategies, to select and use appropriate standards, to make accurate assessments and disclosures, and to deliver on their company's public commitments and targets'.

'Greenwashing' constitutes an 'acute litigation risk' for directors and for companies

In light of these rising expectations, the authors observe that net zero commitments are becoming increasingly common with many directors appearing to regard such statements as 'an appropriate or necessary step in the discharge of their duties'.

However, the authors caution that where these commitments are made without 'reasonable grounds' for doing so – where the claims are effectively 'greenwashing' – both directors and companies could leave themselves exposed to the risk of litigation. They write,

> 'It is foreseeable that a company (and its directors) could be found to have engaged in misleading or deceptive conduct or other breaches of the law by not having had reasonable grounds to support the express and implied representations contained within its net zero commitment'.

Further, depending on how a commitment is phrased, the authors caution that net zero commitments may be found to constitute a representation about a 'future matter'. One implication of such a finding, is that it would mean that the person making the representation would be required to adduce evidence that they had reasonable grounds for making it.

In addition, the authors observe that individual directors could also face personal liability, if it is found that they breached their own duties of care by facilitating the making of a misleading representation.

In the authors' view this risk 'may not be adequately appreciated within corporate Australia'.

Refraining from making a net-zero commitment is not 'safer'

The authors make clear that in their view, refraining from making a net-zero or similar commitments is not necessarily a 'safer' option for companies or for directors.

> 'To be clear, in our view, risks relating to greenwashing do not mean it is safer for directors to avoid making net zero commitments…Indeed, given the developments cited above, the risks of inaction on this front appear to be profound. Nor do we think that companies can only set out such targets or commitments if they have a complete roadmap or plan for how they will be achieved. Rather, a company must have a genuine intention, on reasonable grounds, to follow through with reasonable strategic efforts and commitment of resources as may reasonably be expected to fulfil the intent implied by the announced target. A company must also take care to convey accurately the stage of its progress on the journey when such commitments are announced, updated or impacted'.

'Reasonable grounds': Suggested steps to reduce the likelihood of liability arising from a net zero (or similar) commitments

The opinion sets out a number of suggested steps companies and directors could consider taking to reduce the likelihood of liability arising from net zero (and similar commitments). These include the following.

Develop a net zero strategy

The authors advise that directors should develop a net zero strategy, clearly identifying how the company plans to achieve its commitments, explaining the assumptions behind it and how they were tested, and documenting any relevant deliberations. Where appropriate, the authors suggest that qualified external advisers could be used to assist in the formulation and review of the strategy (though this will not absolve directors from liability).

This strategy should be integrated into the company's operational strategy. The authors' view is that 'An internally integrated decarbonisation strategy is likely to provide a surer footing for directors than a decarbonisation strategy contingent on unknown contingencies: such as the emergence of new technologies, or different carbon offsets, or other businesses in the company's supply chain reducing their emissions'.

Be specific

The authors advise that 'particular care' should be given to expressing the scope of commitments and the timing around when specific commitments will be achieved. t the net zero strategy should clearly explain which emissions (Scope 1, 2 or 3) it includes and also clearly state the timeframe for achieving emissions reductions. Particular care should be taken in expressing the scope or timing of a commitment.

Disclose setbacks promptly

The authors advise that if there are set-backs to achieving the strategy eg where achievement of the strategy is reliant on significant advancements in carbon capture/storage technology occurring within a specific timeframe, and they do not occur, it's important that this is communicated promptly in light of the fact that 'failure to disclose may readily constitute misleading or deceptive conduct through silence'.

> [Source: CPD media release 25/03/2021; Full text: Supplementary Opinion April 2021; Roundtable conclusions]

Top Story | New Hutley Opinion: What does it mean for directors?

MinterEllison Partner and Head of Climate Risk Governance Sarah Barker provides her analysis of the updated supplementary opinion on climate risk and directors' duties.

You can access the full text here.

Updated Hutley opinion: Superannuation funds have a duty to actively manage climate risks

Key Takeouts

- An updated legal opinion from barristers Noel Hutley and James Mack opines that trustees' existing legal obligation to act prudently and in the best financial interests of a beneficiary extends to ensuring that the material financial risks posed by climate change are effectively managed
- The opinion states that superannuation funds need to take a 'thorough approach' to understanding and managing the financial risks posted by climate change, including obtaining credible expert advice on a regular basis to inform their decisions
- Where risks are identified as too great for a particular investment, it's suggested that it may be necessary for firms to consider either shifting funds to less risky investments and/or divestment

An updated legal opinion from barristers Noel Hutley SC and James Mack, commissioned by Market Forces, discusses the scope of existing legal obligations on superannuation funds to understand and manage the material financial risks posed by climate change, in light of recent developments.

A legal obligation to manage the material financial risks posed by climate change

The opinion states that trustees' legal obligation to act prudently and in the best financial interests of a beneficiary, extends to ensuring that the material financial risks posed by climate change are effectively managed.

> 'It is clear that in order to comply with obligations under the superannuation law, a superannuation trustee needs to ensure its processes, structures and expertise are responsive to the financial risk posed by climate change. This is so because the nature of the financial risk posed by climate change to a superannuation trustee is ascertainable and also likely to be material'.

The authors observe that regulators (the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority), the Actuaries Institute, investment consultants and certain superannuation funds have each made statements consistent with this position.

The opinion also suggests that the 'large body' of quantitative analysis that has developed since 2017 - for example separate research projects conducted by JANA, Mercer, Frontier Economics and Schroders - into the financial implications of various climate change scenarios may also 'inform the nature of legal obligations'.

Active steps required

The authors consider that in light of this, compliance with existing obligations under the Superannuation Industry Supervision Act 1993 (Cth) (SIS Act), requires trustees to both: a) take steps to understand the risk the risk posed by climate change to investments; and b) to manage any identified risk.

The authors make clear that they consider that, 'understanding' the risk posed by climate change requires a 'thorough approach' and entails taking 'active steps' (though exactly what steps will depend on the nature of the investments).

Understanding the risk

Broadly, the authors consider that where an investment is held directly, trustees should seek credible, detailed advice on whether/the extent to which the investment will be exposed to the financial risks of climate change.

Where an investment is held indirectly (eg in the form of shares), the opinion suggests that it is 'not enough for a trustee to rely on investment managers who, in turn, rely on an omniscient and supposedly efficient market to factor in risk'. Rather, a trustee should,

> 'commission and consider expert advice which is capable of informing the trustee of the financial risk. This advice needs to be renewed and revisited such that the trustee is continually apprised of the scope of any financial risk posed by climate change. A trustee should ensure that advisors such as accountants, actuaries and consultants are themselves sufficiently qualified to identify the financial risk posed by climate change'.

Managing the risk

Once the scope and degree of risk has been ascertained, the authors consider that the risk should be managed in the way other financial risks are managed, consistent with the processes and structures set out in existing standards eg APRA Prudential Standard SPS 530 Investment Governance, and taking into account 'emerging' standards/practices (eg scenario analysis). Paragraph 10 (at the bottom of page 6 of the advice) provides detailed discussion of the authors' views on the specific steps that may be required to comply with SPS 530.

> [Note: Since the revised opinion was publicly released, the Australian Prudential Regulation Authority (APRA) has released draft guidance – [Draft] Prudential Practice Guide CPG 229 Climate Change Financial Risks (CPG 229) - on managing the risk of climate change for consultation. The proposed guidance is intended to assist all APRA-regulated entities in managing climate-related risks and opportunities as part of their existing risk management and governance frameworks (which appears to be consistent with the approach put forward in the revised opinion). The due date for submissions on APRA's draft guidance is 31 July 2021. You can find a short overview of the proposed draft guidance in a separate post in this issue of Governance News.]

Divestment may need to be considered

The authors consider that trustees should seek advice on the 'structural nature of any identified risk and whether, having regard to an investment horizon, the risk is diversifiable'.

Where a risk for a particular investment is found to be 'too great for a particular investment objective', the authors state that a trustee will need to consider either reallocating funds to less risky investment options/asset classes and/or divestment.

The role of the board

The authors make clear that they consider that putting in place the necessary internal framework to ensure that consideration of material climate risk is integrated into decision making – that trustees understand and manage the risks of climate change - is a matter for the board. The authors write,

> 'In our view, it is the board of a superannuation trustee that is required to take the steps to understand and then manage the risk. This does not mean that a board is required to involve itself in the minutiae of investment decisions. To the contrary, it means that a board is required to ensure that the structures and processes of the trustee are capable of understanding and then managing the financial risk posed by climate change'.

The authors consider that this is consistent with the approach in SPS 530 which states that the board is 'ultimately responsible' for investment governance as well as with the duty of directors to act prudently and in the best interests of beneficiaries by force of the statutory covenants in s 52A of the SIS Act.

[Sources: Market Forces media release 22/04/2021; Full text opinion: Superannuation Trustee Duties and Climate Change 16/02/2021]

Australia is committed to reaching net zero 'as soon as we possibly can': The Prime Minister has reiterated the importance of focusing on 'how' rather than when net zero will be achieved

In his address to the Leaders' summit on Climate, Prime Minister Scott Morrison spoke about what he described as Australia's 'strong track record of setting, achieving and exceeding' emissions reduction targets the actions being taken to limit global warming to 1.5 degrees.

Australia is meeting and exceeding its existing commitments

- Mr Morrison said that Australia has 'met and exceeded' its 2020 Kyoto commitments and is 'well on the way' to 'meet and beat' our Paris commitments, having already reduced emissions by 19% on 2005 levels.
- Mr Morrison said that achieving Australia's 2030 emissions reduction target will see emissions per capita fall by almost 50% and emissions per unit of GDP fall by 70%.

On 'the pathway to net zero'

- Mr Morrison said that Australia is committed to reaching net zero emissions 'as soon as we possibly can' but did not commit to any timeframe for achieving this goal. Though he did flag that the government intends to update Australia's Long Term Emissions Reduction Strategy for COP26 later in the year
- Rather he said that Australia's focus is on how the goal will be achieved. Though Mr Morrison said that Australia is 'on the pathway' to net zero, he stopped short of setting a timeframe for achieving that goal. Instead he said that the government's focus is necessarily on how the goal will be achieved – that is, on the development of the necessary new technology.

Technology-led pathway

- Mr Morrison said that the government is prioritising investment in new technologies - clean hydrogen, green steel, carbon capture and energy storage – as a practical means of supporting and accelerating development and building expertise. Mr Morrison commented,

  > 'Mr President, in the United States you have the Silicon Valley. Here in Australia we are creating our own 'Hydrogen Valleys'. Where we will transform our transport industries, our mining and resource sectors, our manufacturing, our fuel and energy production'.

- Mr Morrison said that Australia's 'journey to net zero' is being led by 'pioneering' resource companies as well as by the agricultural and marine sectors with a number of projects receiving government support in the form of significant funding.
- Mr Morrison said that Australia would like to 'work with others on the "how" through our new international technology partnerships program'.

'Bankable' reductions in emissions

- Mr Morrison closed by saying that Australia is committed to meeting its stated emissions-reduction goals.

  > ' My Government is committed to playing its part in making COP26 a success in Glasgow, and you can always be sure that the commitments Australia makes to reduce greenhouse gas emissions are bankable. We have proven performance, transparent emissions accounting and transformative technology targets to unlock pathways to net zero. Future generations, my colleagues and Excellencies, will thank us not for what we have promised, but what we deliver. And on that score Australia can always be relied upon'.

  [Sources: Prime Minister Scott Morrison remarks to climate summit 22/04/2021]

Calls are growing for Australia to set more ambitious emissions reduction targets following the Prime Minister's address to the Leaders' summit on Climate

Following the Prime Minister's address to the Leaders' Summit on Climate, a number of environmental groups, political leaders and the Investor Group on Climate Change have called on the government to step up its climate commitments.

- In a statement the Climate Council called for Australia to follow the US in setting a more ambitious interim emissions reduction target, suggesting that failure to do 'serves to future isolate us [Australia] internationally'.
- Similarly, Greenpeace Australia spokesperson Nelli Stevenson commented that Australia is lagging its international peers on climate as did (separately) Leader of the Australian Greens Adam Bandt; and the Investor Group on Climate Change (IGCC).
- The IGCC's statement also observes that presently, New Zealand is also lagging other major countries on climate (though the New Zealand's Climate Change Commission is currently reviewing 'the nation's end-of-decade goal' while Australia has as yet, not announced its intention to do so).
- The ICGG also suggests that Australia and New Zealand's lack of ambition, could have financial impacts for both countries. In light of the ambitious targets/action being taken by the US, the IGCC suggests that Australia and New Zealand 'risk falling behind in the global race to attract private capital investment in net zero emissions industries and infrastructure'.

Separately, Shadow Minister for Foreign Affairs Penny Wong and Shadow Minister for Climate Change and Environment Chris Bowen have also called on the government to follow the US in setting more ambitious targets or risk 'missing out on the jobs, the opportunities and economic growth that come from being a world leader in the industries of tomorrow'.

[Source: [registration required – accessed via LexisNexis Capital Monitor] Climate Council media release 23/04/2021; Greenpeace Australia 23/04/2021; Investor Group on Climate Change media release 23/04/2021; Australian Greens Leader Adam Bandt media release 23/04/2021; Joint media release Shadow Minister for Foreign Affairs Penny Wong, and Shadow Minister for Climate Change and Energy Chris Bowen 22/04/2021]

Government announces funding for a raft of climate projects

Ocean management initiatives

In a joint statement, Prime Minister Scott Morrison, Minister for the Environment Sussan Ley and Minister for Energy and Emissions Reduction Angus Taylor announced 'an additional $100 million' in funding for an ocean management initiative aimed at supporting Australian Marine Parks, expanding the Indigenous Protected Areas into Sea Country, restoring blue carbon ecosystems and protecting 'iconic marine species.'

According to the statement, the investment is expected to 'create jobs, engage coastal and Indigenous communities and the private sector, deliver actions to improve environmental outcomes for species and ecosystems, and provide a clear pathway for working with all sectors to realise Australia's ocean potential'.

Carbon off-set scheme funding

The government has also committed an additional $59.9 million in funding to develop a high-integrity carbon offset scheme in our Indo-Pacific region.

According to the statement, the new funding is in addition to the $1.1 billion the government has said it will invest in low emissions energy technologies such as hydrogen and carbon capture and storage, and is in addition to the $18 billion of investment the will spend the next 10 years, in line with the strategy outlined in the Technology Roadmap, to drive investment in low emissions technologies.

[Source: Joint statement, Prime Minister Scott Morrison, Minister for the Environment Sussan Ley and Minister for Energy and Emissions Reduction Angus Taylor 23/04/2021]

Low emissions technology funding

In a joint statement, Mr Morrison and Mr Taylor announced a new $565.8 million commitment to generate 'up to 2500' jobs through technology partnerships with other nations, in which Australia will co-fund research into low emissions technology and demonstration projects.

According to the statement, the additional funding is expected to 'advance and support the goals of the Technology Investment Roadmap and facilitate deployment and export of home-grown low emissions technology and energy'.

The statement adds that Australia is already collaborating with a number of other countries (Germany, Japan, Korea, Singapore, the UK and the US) on new technology projects and this collaboration is expected to 'ramp up' ahead of the COP26 conference.

[Source: Joint media release Prime Minister Scott Morrison and Minister for Energy and Emissions Reduction Angus Taylor 22/04/2021]

In Brief | Engagement sessions: In the lead up to the 26th United Nations Climate Change Conference (COP26) in November 2021, The Department of Foreign Affairs and Trade is holding a series of stakeholder information and discussion sessions. DFAT says that the sessions will provide participants with information about the conference and that the feedback provided will be used to help inform the government's approach to the climate change negotiations and action agenda

[Source: Department of Foreign Affairs and Trade media release]

In Brief | Increased climate commitment: The US is aiming to reduce carbon emissions by 50-52% on 2005 levels by 2030, Ceres has applauded the more ambitious goal, commenting that it places the US 'on a credible pathway' to achieving net zero emissions by 2050

[Source: Ceres media release 22/04/2021]

Culture

#IStandForRespect pledge: 100+ CEOs have so far signed pledge to end workplace sexual harassment

Over 100 CEOs have so far signed the Diversity Council of Australia's #IStandForRespect pledge which commits them to:

- 'Stand against gendered harassment and violence in all its forms'; and
- Take steps within their own organisations to address sexual/sex-based harassment

The full list of signatories to the pledge is here.

Diversity Council of Australia CEO and founder of the initiative Lisa Annese commented that signing the pledge provides a public platform for leaders to show their commitment to addressing the issue.

Ms Annese also underlined the substantial financial costs to business of failure to stamp out harassment.

> 'Sometimes, the personality that will predate and sexually harass will likely bully and intimidate and cause serious cultural damage to a business. Ironically, they are often allowed to do so because they are seen as "untouchable" or "rain-makers" in an organisation. No one makes it rain worth almost four billion dollars – which is what sexual harassment costs in terms of productivity loss and having to replace and rehire the people who are on the wrong side of a harasser. The bottom line is this: businesses can't afford not to tackle sexual harassment. The #IStandForRespect pledge is a starting point, a way for them to be part of the change that will come.'

[Source: Diversity Council of Australia media release 22/04/2021]

Cybersecurity, Technology and Privacy

RBNZ has released cyber resilience guidance

Following consultation, the Reserve Bank of New Zealand (RBNZ) has published guidance for all RBNZ regulated entities, outlining its expectations around cyber resilience.

The principles based guidance is intended to provide 'an overarching framework' for the governance and management of cyber risk, which entities are expected to tailor to their own circumstances. RBNZ states,

> 'This guidance has not been designed as a checklist for cyber resilience minimum requirements. Instead, entities should design and develop their own cyber resilience framework that adequately addresses the specific cyber threats they individually face'.

RBNZ's expectation is that entities that need more detailed guidance on specific aspects of cyber resilience refer to detailed guidance developed by New Zealand's cybersecurity agencies (eg the New Zealand Information Security Manual (NZISM)).

Among other things, the guidance has a strong focus on the role of good governance practices/processes and the role of the board and senior management in the management/oversight of cyber risk and in supporting institutional cyber resilience.

The full text of the guidance is here.

Recent data breach – independent report to be released in early May

The release of the guidance follows the recent illegal data breach of a third party file sharing application used by the RBNZ. The RBNZ has said that the independent report into the banks' systems and processes being undertaken by KPMG as part of the response to the breach will be released in 'early May'.

The RBNZ states that it is 'committed to continuing our own improvements in this area and sharing any relevant lessons with the firms that we regulate'.

[Sources: Reserve Bank of Australia media release 28/04/2021; Guidance on Cyber Resilience April 2021]

Insolvency and Restructuring

In Brief | Consultation on consequential amendments to small business insolvency reforms: Following the introduction of new insolvency processes for small businesses at the beginning of the year, Treasury has released proposed draft amendments to primary and subordinate legislation for a short period of consultation. The proposed changes are intended to support the new insolvency processes. The deadline for submissions is 7 May 2021.

[Source: Treasury consultation 23/04/2021]

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