Governance News

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

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Diversity

Improving gender balance in investment management teams: FSC launches Women in Investment Management Charter

- A survey of Financial Services Council (FSC) fund manager members has identified that women make up only 25% of investment management teams on average.
- To drive improvement on the issue, the FSC has announced the launch of a Women in Investment Management Charter (Charter).
- Signatories to the Charter agree to adopt four principles: 1) appoint an investment management senior executive with responsibility/accountability for gender diversity within the investment management team; 2) to set internal gender diversity targets for the investment management division; 3) to monitor and report annually on progress against targets; and 4) 'having an intention of linking the pay of relevant staff to delivery against the gender diversity target set by the organisation'.
- To date, eight FSC members, collectively managing more than $600 billion in assets under management have signed on to the charter. They are: AllianceBernstein Australia Limited; Australian Ethical Investment Ltd; Challenger Limited; First Sentier Investors; Mercer; QIC Limited; Russell Investment Group; and State Street Global Advisors Australia Limited.

[Source: FSC media release 12/08/2021]

A group of UK Asset Owners has launched a new Diversity Charter as part of a broader project to accelerate progress across the sector

To address the lack of diversity (in the broad sense including gender, ethnicity, socio-economic background, LGBTI+, age and disability diversity) in the fund management sector and the lack of progress on the issue, a group of UK asset owners including BlackRock among others, have called on peer organisations to sign on to a new Diversity Charter.

The Charter has been launched as part of a broader Diversity Project, first launched in 2016, which is aimed at accelerating progress towards an inclusive culture across all levels of the investment and savings profession (ie across asset owners, fund managers, fund selectors, pension consultants, actuaries, trustees, wealth managers and the professional standards and trade bodies). This includes achieving specific diversity targets over the next five years (details here).

Diversity Charter

The Diversity Charter has three parts.

- The charter itself which includes three commitments intended to drive industry to achieve 'diversity balance at all levels across financial services firms'.

  Signatories to the charter commit to: a) incorporating diversity considerations into manager selection (including ensuring diversity disclosure is incorporated into new investment management agreements); b) integrating diversity into ongoing managing monitoring including surveying appointed managers annually using the diversity charter questionnaire; and 3) working with the investment industry to 'identify diversity and inclusion best practice'.
- The charter is supplemented by the Asset Manager Diversity and Inclusion Questionnaire which is intended to 'standardise complex diversity metrics beyond just gender' thereby improving the quality and comparability of information. It's intended that the results of the questionnaire will be used inform engagement efforts on improving diversity and inclusion as well as being used to track progress.
- A supporting document, the Asset Owner Charter Toolkit aims to support implementation of the Charter commitments by providing guidance on key issues eg manager selection, appointment and monitoring.

[Source: Diversity Project website]

Shareholder Activism

BHP targeted with second shareholder ESG resolution

Capital protection resolution

- Market Forces has filed an ordinary shareholder resolution at BHP calling on the company to 'manage down its fossil fuel production' consistent with its stated support for net-zero emissions and the Paris Climate Agreement. You can find the full text of the resolution and the supporting statement here.
- Why the resolution was necessary: Market Forces' considers that BHP's existing and planned fossil fuel exploration and expansion projects – for example, BHP's plans to extend the life of its Mt Arthur thermal coal mine by 19 years to 2045 - run counter to its stated net-zero ambition and importantly, expose investors to 'unacceptable' financial risk.
- Specifics: The resolution calls on the company to disclose certain information in future annual reports about its management of thermal and metallurgical coal, oil and gas assets. Specifically, the resolution calls on the company to disclose:
  - 'Details of how the company's capital allocation to thermal coal, metallurgical coal, oil and gas assets will align with a scenario in which global energy emissions reach net-zero by 2050, facilitating the efficient managing down of these assets;
  - Production guidance for the lifetime of thermal coal, metallurgical coal, oil and gas assets;
  - Plans and capital expenditure expectations for decommissioning and rehabilitating sites at the end of asset life;
  - Plans for how employees of the company will be informed of asset closures, and employee transition plans, including any compensation for job losses, training and support in seeking future employment; and
  - Details of how remaining value in the company's thermal coal, metallurgical coal, oil and gas assets will be redeployed or returned to investors'.

Second shareholder ESG resolution

- BHP was already facing another shareholder climate lobbying resolution, filed by the Australasian Centre for Corporate Responsibility (ACCR), calling on the company to strengthen its review of industry associations to ensure that any inconsistencies in their climate stance/lobbying efforts and the goals of the Paris Agreement are identified. You can find the full text of the resolution here.
- Both ordinary resolutions are contingent on the passage of a special resolution seeking to amend the company's constitution to enable shareholders to bring advisory resolutions.

Divestment plans

- Market Forces is also critical of BHP's decision to divest its Cerrejón thermal coal asset, and of the company's plans to consider further divestments. Market Forces comments,

  > 'While divestment addresses stranded asset risk exposure, it fails to manage the reputational risk associated with avoiding responsibility for employee transition support and site rehabilitation. By providing a leading example of responsibly managing down fossil fuel assets, BHP can preserve and realise the genuine value that exists in these assets, align with global climate goals, and support its workers in the transition to a decarbonised economy.'

Transition plans: (Planned) merger of BHP's petroleum business with Woodside

- In response to press speculation, BHP issued a statement confirming that it has initiated a 'strategic review' of its Petroleum business 'to reassess its position and long-term strategic fit in the BHP portfolio' and that a potential merger of the company's petroleum business with Woodside Petroleum Ltd (Woodside) is one of the options under consideration. According to the statement, though discussions with Woodside have commenced, no agreement has been reached between the parties. BHP states that a further announcement will be made 'as and when appropriate'.
- In a subsequent statement, BHP confirmed that it has entered into a merger commitment deed with Woodside to combine the companies' respective oil and gas portfolios by an all-stock merger 'to create a global top 10 independent energy company by production'. It's envisaged that on completion of the merger, BHP's oil and gas

business would merge with Woodside and Woodside would issue new shares to be distributed to BHP shareholders.

- The planned merger is still 'subject to confirmatory due diligence, negotiation and execution of full form transaction documents, and satisfaction of conditions precedent including shareholder, regulatory and other approvals'.

  [Sources: Market Forces media release 11/08/2021; BHP media release 16/08/2021; 17/08/2021]

AGL board opposes shareholder resolutions and shareholder board candidate's election ahead of the upcoming

- The Australasian Centre for Corporate Responsibility (ACCR) has filed an ordinary shareholder resolution at AGL, calling on the company to set/disclose Paris-aligned goals and targets. The resolution is contingent on the passage of a special resolution to amend the company's constitution to enable ordinary resolutions to be placed on the agenda at a company's AGM. The full text of the resolutions (resolutions 6a and 6b) together with supporting statements from ACCR are included in AGL's Notice of Meeting here.

AGL has recommended shareholders vote against both resolutions

- **Opposition to the constitutional amendment:** Broadly, the AGL board considers that the special resolution is a) unnecessary because shareholders are already provided with a number of opportunities to engage with the company; b) shareholders are able to hold the board to account for its decisions by voting for the appointment/removal of directors; and c) enabling shareholders to bring advisory resolutions could have the effect of enabling small groups of shareholders to 'promote their own interests, which do not take into account the interests of the company as a whole'.
- **Opposition to the ordinary resolution:** Though the AGL board 'recognises that accelerated action is required to address climate change', the Board does not consider that the resolution is in the best interests of AGL's shareholders because:
  - Resolution 6(b) requests that AGL commit to scope 1, 2 and 3 emissions reduction, capex and remuneration targets for the proposed demerged companies (Accel Energy and AGL Australia) that are aligned with the Paris Agreement. The board considers that it is not in a position to make these commitments for the proposed demerged companies and that doing so would 'create uncertainty about the provision of affordable and reliable electricity to our customers'.
  - AGL has in any case already made clear commitments to transition away from coal-fired power and already provides detailed disclosure around this.

You can find full details at p13-15 of the Notice of Meeting.

ACCR response

- In a statement, the ACCR expressed disappointment in the AGL board's decision not to endorse the resolutions, reiterating that the company's current strategic direction is negatively impacting both the environment and increasingly impacting shareholder returns. The ACCR also suggests that this could have consequences for the current AGL board.

  ACCR Director of Climate and Environment Dan Gocher commented:

  > 'In the same week the IPCC delivered its “final warning” to humanity via its Sixth Assessment Report (AR6), AGL has told its shareholders that it simply will not adhere to the Paris Agreement…AGL shareholders have already suffered more than 70% in losses since 2017, and this feeble response from the board suggests there will be more losses to come. AGL saw a 34% decline in net profits after tax (NPAT) in FY2021. But these losses will pale in comparison to what lies ahead if AGL continues to do nothing…Investors must be questioning the competence of the leadership at AGL. The board has overseen absolute deterioration of shareholder value and seems intent on floundering by delaying the energy transition. AGL must commit to holding an annual general meeting for both demerged companies in 2022. If it attempts to delay annual meetings until 2023, shareholders should take action to remove directors'.

Non-board endorsed director standing for election

- 18 year old climate activist and AGL shareholder Ashjayeen Sharif is running for the AGL board with the endorsement of Greenpeace Australia.

- In an open letter outlining his reasons for self-nominating as a board candidate, Mr Sharif sets out his concerns around the company's current approach to managing climate-related risk and the adverse impacts he considers this is having on both the climate and company's bottom line. In a preface to the letter, published on the Greenpeace Australia website Mr Sharif writes:

  'The AGL board's commitment to coal isn't just costing the climate - it's costing shareholders too. By committing to coal they've missed the enormous business opportunities of becoming a renewable energy provider. The result has been the destruction of $12 billion in shareholder value and a 70% drop in share price over the past few years'.

- In short statement (included in the Notice of Meeting), Mr Ashjayeen Sharif makes clear that if elected, he intends to push for AGL to accelerate the transition to becoming a 100% renewable energy provider.

  'AGL is Australia's biggest climate polluter. As a young person I am determined to ensure this company is no longer a threat to my generation and to a healthy planet. As a director, I would advocate strongly for AGL to replace its dirty coal-burning power stations by 2030 and transition to become a provider of 100% renewable electricity, while looking after workers in the transition process. I'm very confident this will also increase AGL's profitability as the world shifts rapidly to renewable energy.'

- Greenpeace Australia, has invited the public to sign a petition in support of Mr Sharif's election.
- The AGL board has recommended shareholders vote against Mr Sharif's election (detailed reasons are included at p8 of the Notice of Meeting) because it considers that his 'skill set and experience would not add to the effectiveness of the Board'. However, the board also reiterates its commitment to identifying a suitable board candidate with ESG/climate expertise.
- The AGM will be held on 22 September 2021. Should the company receive a second 'strike' against the remuneration report, the board could face a spill resolution.

  [Source: AGL Notice of Meeting 2021; Greenpeace Australia media release 16/08/2021; ACCR media release 12/08/2021]

Shareholder climate resolution filed at CBA

- Market Forces has filed an ordinary shareholder resolution at CBA calling on the bank to: a) stop funding the expansion of the fossil fuel industry; and b) set targets to reduce fossil fuel exposure; and c) set targets to reduce fossil fuel exposure consistent with net zero by 2050. The full text of the resolution and supporting statement is here. The ordinary resolution is contingent on the passage of a special resolution to amend the company's constitution to enable ordinary resolutions to be placed on the agenda at a company's AGM.
- Reasons for filing the resolution: Market Forces argues that CBA has 'watered down' its stated climate commitments in various ways including opening the door to funding future new oil, gas and metallurgical coal projects and failing to hold fossil fuel clients to account for meeting climate expectations (eg publishing transition plans).
- Support for similar resolutions is increasing: Market Forces observes that support for similar resolutions filed at other major banks has been increasing. For example, in 2020, support for similar resolutions at ANZ and NAB received 28.7% and 26.3% (respectively).
- The CBA AGM will be held on 13 October 2021. The CBA board has not yet released its voting recommendations on the resolutions. These will be included in the Notice of Meeting which will be released in September.

  [Source: Market Forces media release 11/08/2021]

Meetings and Proxy Advisers

Top Story | Status update meeting and execution requirements: TLA Bill now law

Treasury Laws Amendment (2021 Measures No. 1) Bill 2021 received Assent on 13 August 2021 and is now in force. The legislation as passed, is substantially the same as the Bill originally introduced, with some key exceptions.

You can find a short overview of the changes here.

Treasury Laws Amendment (COVID-19 Economic Response No 2) Act 2021 now in force

- Treasury Laws Amendment (COVID-19 Economic Response No. 2) Act 2021 received Assent on 10 August 2021 and is now in force.
- Schedule 4 of the Act enables the Minister to make a determination to change arrangements for documentary requirements under Federal legislation, including requirements concerning the giving of information and the signature, production and witnessing of documents on a forward or backward looking basis. This new power will remain in place until 31 December 2022
- Importantly. this may provide a mechanism through which the government could act, should the temporary changes included in Schedule 1 of the Treasury Laws Amendment (2021 Measures No. 1) Bill 2021 (which received Assent on 13 August 2021) (summary here) expire before permanent measures are in place.

[Source: Treasury Laws Amendment (COVID-19 Economic Response No. 2) Act 2021]

ASX has issued a reminder to listed entities to allow sufficient time for ASX to review draft notices of general meeting

- Under Listing Rule 15.1.7, draft notices of general meeting containing resolutions for that Listing Rules purposes need to be reviewed by the ASX before being sent to security holders. ASX has issued a reminder to listed entities to allow sufficient time for this to occur - 'ASX may take 5 business days to advise whether it objects to a draft document and may extend that deadline if it needs further time to review the document'.
- In addition, ASX reminds entities that if waivers from any Listing Rules in connection with the notice of AGM is required, additional time should be allowed.

[Source: Listed@ASX Compliance Update no. 07/21 18/08/2021]

Institutional Investors and Stewardship

New York State Retirement fund to divest shares in a further five coal producers (including an Australian listed company), and has put a further 42 companies on notice

The New York State Common Retirement Fund (Fund) has announced that as part of its broader Climate Action Plan to transition the Fund's investment portfolio to net zero emissions by 2040, the fund has:

- **'Restricted investments' in five coal producers, and will look to divest shares held in the companies over time.** The companies are: Whitehaven Coal Ltd, New Hope Corp, PT Indo Tambangraya Megah Tbk, Semirara Mining and Power Corp and Shanxi Coking Coal Energy Group Co. According to the statement, the Fund will not 'directly purchase or directly hold debt or equity securities, or invest through an actively managed account or vehicle, in these coal companies'. The statement adds that the Fund will look to divest the securities it currently holds in the companies 'in a prudent manner and timeframe'.

  This decision follows the Fund's decision in 2020 to divest from 22 coal producers.

- Put a further 42 companies on notice:
  - The Fund is conducting a review of the extent to which a further 42 publicly traded shale oil and gas companies including Marathon Oil Corp, ConocoPhillips and Hess Corp, are prepared for the transition to a low carbon economy. The Fund has requested that each of the 42 shale oil and gas companies provide additional information, within 60 days, to demonstrate how they are developing, adopting, or implementing low-carbon transition strategies.
  - Each of the companies targeted in the review derives over 10% of its revenue from crude oil and gas production from shale, and is considered by the Fund to be facing increased financial risk as a result of 'diminishing cost competitiveness, increasing climate regulation and declining fuel demand'.

New York State Comptroller Thomas P DiNapoli commented:

> 'A low-carbon economy is already becoming a reality and companies that aren't prepared for it could pay a heavy financial cost…Shale oil and gas companies face significant economic, environmental and regulatory challenges. We will carefully review these companies and may restrict investments in those that do not have viable plans to adapt.'

[Source: New York State Common Retirement Fund media release 12/08/2021]

Regulators

Top Story | Hayne implementation: ASIC to adopt a 'reasonable approach' to implementation of upcoming reforms

Six reforms due to commence in October

Six significant Hayne related reforms – 1) design and distribution obligations (DDO); 2) restrictions on the unsolicited selling of financial products (hawking); 3) a deferred sales model for add-on insurance products; 4) new reference checking and information sharing requirements for financial advisers and brokers; 5) new requirements around how breaches are reported to ASIC; and 6) new requirements around how disputes are managed internally - are due to come into effect in October 2021.

In light of this, the Australian Securities and Investments Commission (ASIC) has issued a short statement briefly outlining the reforms, and its approach to compliance during the early stages of implementation.

ASIC to take a 'reasonable approach'

ASIC makes clear that it does not intend to take a hard line approach, provided that firms are 'acting in good faith' to implement the changes. ASIC states:

> 'we recognise there will be a period of transition as industry finalises implementation of additional compliance measures, and ASIC will take a reasonable approach in the early stages of these reforms provided industry participants are using their best efforts to comply...ASIC's initial approach extends to technical or inadvertent breaches, where firms have systems changes underway and act quickly to address problems as they arise… We want to ensure the reforms are successfully implemented – and that means we will continue to work with industry, and build on the efforts by industry associations and individual licensees in preparing for these reforms.'

Having said this, the statement also underlines ASIC's willingness enforce compliance where it is judged necessary to do so. ASIC states:

> 'where firms are not acting in good faith or where we detect conduct causing actual harm, we will not hesitate to enforce the law'.

In adopting this approach, ASIC states that it will take into account the context in which firms are operating including: the scale of reforms, 'challenges arising from the current operating environment' and the fact that industry will not receive the final guidance on two measures (including breach reporting measures) until relatively close to the start date.

Welcome news for the advice sector

In a short statement, the Stockbrokers and Financial Advisers Association (SAFAA) welcomed ASIC's announcement, especially in light of the scale of the changes and the ongoing challenges facing SAFAA members in the current operating environment.

SAFAA CEO Judith Fox commented:

> 'SAFAA has been warning government and ASIC about the impact of this regulatory blizzard for some time. We are particularly pleased that ASIC acknowledges the regulatory reforms require significant change to business systems and processes and take effect at the same time industry is facing other challenges including those resulting from COVID-19 and renewed lockdowns…Our member firms have had to implement significant system changes to accommodate these reforms, which in turn have raised questions of resource constraints. Firms have limits to their capacity to expand their technology teams, both financial and human resource-related….Our members are doing all they can to prepare for these changes but the impact of lockdowns on their capacity to meet these legislative deadlines is weighing heavily on them'.
>
> [Sources: ASIC media release 12/08/2021; SAFAA media release 12/08/2021]

Climate Risk: ASIC and APRA have faced queries from a parliamentary joint committee on the extent to which they may be contributing to the withdrawal of capital from carbon intensive industries

Key Takeouts

- Questions to ASIC and APRA largely centred on their expectations of regulated entities and the extent to which these expectations/guidance may be constraining financing of/investment in certain sectors eg the coal sector.
- The key message from both regulators was that they **do not** prescribe the approach companies should take/direct decision making. The Committee heard that APRA is chiefly concerned with ensuring material risks (including climate risk) are identified and well managed, while ASIC is concerned with ensuring that material risks are 'properly' disclosed to the market.
- The Committee heard that ESG is increasingly a mainstream rather than niche issue.
- The Committee also heard that international pressure is building on companies to take into account, and disclose material climate risk.

The Parliamentary Joint Committee on Corporations and Financial Services held a public hearing as part of its inquiry into the prudential regulation of investment in Australia's export industries on 13 August 2021.

Questions to representatives from both the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) largely centred around their respective roles in providing guidance on/setting expectations for regulated entities around the management of climate risk and the extent to which this may be impacting the ability of certain companies/certain sectors to secure finance.

A high level summary of some of the key themes touched on in the discussion is below. The full transcript of the hearing can be accessed here.

Opening statements to the Committee

In his opening statement to the Committee, APRA Chair Wayne Byres made three points:

- Ensuring entities manage risk effectively is key to APRA's oversight role in that APRA is tasked with ensuring that regulated entities identify and manage risk to 'reduce the possibility that they might fail to meet their financial promises, particularly to bank depositors, insurance policyholders and superannuation fund members'.
- In carrying out its supervisory responsibilities, APRA adopts a principles based (as opposed to a prescriptive) approach.
- Commenting specifically on APRA's work in the area of climate-related risks, Mr Byres said that APRA's role is to ensure that financial institutions are 'aware of, and thinking about how to respond to, the financial risks and opportunities arising from climate change'. Mr Byres highlighted two current projects that the regulator is working on in this context.
  - APRA recently released draft, principles-based, cross-industry guidance on managing the financial risks of climate change (draft CPG 229) for consultation with the aim of assisting regulated entities to assess and respond to climate-related financial risks. Mr Byres emphasised that the guidance is not prescriptive. He stated that it 'neither promotes nor prohibits specific investment lending or underwriting decisions; it simply seeks to support well-informed decision making'.
  - APRA is also currently working with the five largest banks on a climate vulnerability assessment. Mr Byres said that the aim of this work is to 'measure the financial risks to banks, the financial system and the economy posed by climate risk, to understand how the banks will respond and to improve climate-risk-management capabilities within the banks'. Mr Byres said that APRA expects to report on the outcomes of this project 'in the new year'.

In a short opening statement, ASIC Commissioner Cathie Armour outlined ASIC's role in promoting a strong financial system, promoting investor confidence and participation and taking action to enforce the laws that ASIC is administers. Referring to the Committee's terms of reference for the inquiry, Ms Armour said that ASIC considers that its work in the disclosure and reporting is most likely to be of interest to the Committee.

The regulators are not prescribing how companies should make decisions

A key theme to emerge from both APRA and ASIC's appearance before the Committee was that neither regulator seeks to prescribe what decisions companies should make or how they should invest. Neither regulator directs regulated entities not to invest in any sector, including the coal sector.

APRA made clear that its primary focus is ensuring that risks, including climate related risks, are identified and well-managed by the entities it oversees. That is, that firms are aware of and consider material risks.

Asked whether APRA specifies (for example in its draft guidance on climate risk) any sectors in which APRA-regulated institutions should not invest eg the thermal coal export sector, Mr Byres responded by stating: 'I can be really clear on that, Chair. The answer to your question is no'.

Later in the hearing, APRA was again asked to comment on reports from industry that its approach effectively requires APRA-regulated entities to 'adopt a low risk approach' to the coal sector. Mr Byres rejected this, characterising it as an unfair representation of APRA's requirements. Asked whether industry was using APRA as an 'excuse' for its decision not to lend to resource companies, Mr Byres expressed agreement.

Asked whether APRA considers that the coal sector is a sector 'where there is transition risk', Mr Byres said that the energy sector is 'absolutely an area that need to be looked at' but that the regulator has 'been at pains not to call out specific industries or name specific industry sectors'. APRA considers that transition risk should be considered by companies, but ultimately, APRA's position is that any commercial decision by an individual entity should be made based on their own business considerations.

Asked whether APRA had identified 'overexposure or a lack of management' of climate risk to date, Mr Byres confirmed that the regulator has not. Mr Byres added that should this become necessary, the regulator might intervene. Mr Byres said:

> 'in some sectors of the financial system—the insurance sector, in particular—managing climate related exposures has been a bread-and-butter issue for many decades. This is because there are large parts of Australia that are prone to natural catastrophe events, particularly in the northern parts of the country. For insurers that are ensuring property et cetera in that part of the world, we do look very closely at how they're managing those risks. We make sure they've got adequate protections in place, including reinsurance. If we thought that those were not being managed, we might well intervene to do something about it. But I think, on the whole, the general insurance sector is probably leading the way in terms of their understanding of some of these issues. As I said, it's their bread and butter and has been for quite some time'.

Similarly, ASIC made clear that there is nothing in ASIC's guidance that would prevent individual ASIC-regulated entities from investing in/participating in certain sectors.

Ms Armour stated that ASIC's primary focus in is on ensuring that ASIC-regulated entities are providing accurate, timely disclosure about the risks, including material climate risks, to their business and the products that they issue. Mr Armour stated,

> 'We have flagged to them that there's an expectation - we have an expectation - that they consider whether climate risk poses a material risk for their business and, if it does, that that is described and disclosed. But there are plenty of other risks that we have also flagged. We have an expectation they're considered'.

Transition timeframe for the coal sector

A number of questions to both regulators concerned the possible timing of the transition to renewable energy.

Mr Byres was asked to comment on the likely period of transition, over which the coal sector could be expected to be 'phased out'. Noting that 'a lot of finance is offered in three year terms or five year terms' Mr Byres was asked to comment on whether APRA sees 'a risk that the coal sector is going to close in the next three to five years'.

Mr Byres responded that the timing of the transition is uncertain, but that a three to five year timeframe 'seems a very short timetable'. Mr Byres went on to observe however that the 'economics' of the industry could change rapidly. He said:

> 'What can change, though, much more quickly is the economics of the industry. As government policies change, as prices change, as investment demand changes, economics can change rapidly, and what can be a viable company one day can be rapidly impacted by, as I said, changes to government policy, changes to market prices, et cetera'.

Similarly a number of questions to ASIC centred around this issue and whether ASIC's stance was contributing to industry's reluctance to 'do business' with certain sectors.

Ms Armour commented that ultimately business decisions made by ASIC-regulated entities are decisions for individual entities.

> 'Whether or not a bank or other investor chooses to do business with a particular sector is a commercial decision from our perspective. From the point of view of the thermal coal business, say, that's a listed Australian company, our expectation is that the directors of that company are giving consideration to whether or not there are climate risks that are relevant to its business'.

Implementation of mandatory TCFD disclosure requirements could impact Australian companies

Noting moves in other jurisdictions (eg the US and New Zealand and potentially Japan) towards mandating TCFD-aligned disclosure, ASIC Commissioner Cathie Armour was asked to comment on the possible implications for Australian companies.

Ms Armour opined that for mandatory requirements to be introduced in Australia, there would need to be a legislative requirement in place and that in the absence of this requirement Australian regulators currently recommend that entities report in line with the TCFD recommendations (though doing so is not mandatory).

However, Ms Armour suggested that if investors in Australian companies/capital providers to Australian companies were to become 'used to a system where companies are providing information about investment or about their business based on the TCFD requirement' then this could have implications for Australian companies (despite the fact that TCFD disclosure is not a mandatory requirement).

> 'Whether or not it [TCFD aligned disclosure] is strictly mandated here, there may well be an expectation from people in other countries used to dealing with a mandate - that information is provided in the same way by [Australian] companies to those investors. We have already seen quite a demand by international investors for information about climate related risks of Australian companies'.

Ms Arnour further suggested that this international pressure may increase over time.

Adding to this, ASIC Senior Executive Leader, Corporations Claire LaBouchardiere suggested in addition to these indirect pressures, some Australian companies or subsidiaries of Australian companies may be directly subject to foreign disclosure requirement (though the extent to which this may be case, is as yet unclear).

Later in the hearing, a number of questions to ASIC focused on the influence that international investors may be wielding in the Australian market and the possibility that international investors may 'be asymmetrically affecting Australian investors' decision making.

Mr Armour said that there are a range of considerations driving/impacting investment decisions and that ASIC's key focus is 'making sure the material information about a business is available so that the investors…are able to have the range of information so they can make the investment based on their own assessment of the issues and their own assessment of what's important to them and their portfolio'.

The role of investor activism

A number of questions to both regulators focused on the role of 'investor activists' in influencing decisions around investing in/financing certain high carbon sectors eg the coal sector.

Asked to comment on whether APRA has a view on the role of investor activism in persuading APRA-regulated entities not to invest certain sectors, Mr Byres said that boards are 'very conscious' of the issue and the need to address the needs of a range of competing stakeholders, including activists though he stated that this is not something that APRA has looked into in detail.

Mr Byres added that concern about/interest in transition risk and/or ESG issues more generally are increasingly mainstream issues of interest to a range of stakeholders - 'I don't think it's just something that you can put in a category and say it's of interest to activists. It's increasingly a mainstream issue that's being discussed in all sorts of forums'.

Mr Byres further opined that APRA does not view the risk of investor activism as 'a significant one that would require intervention just at the moment'.

ASIC was also asked a number of questions around its role in monitoring the influence of activist investors. Senator Van suggested that the threat posed by activists is having a 'strong chilling effect on the behaviour of companies, and this is impacting industries that Australia needs as export industries'. Ms Armour said that ASIC would be happy to investigate any individual matters on a confidential basis.

> [Source: Transcript: Joint Standing Committee on Trade and Investment Growth: Prudential Regulation of Investment In Australian Export Industries, public hearing 13/08/2021]

Financial Services

Hayne implementation: Both industry associations and consumer groups have raised concerns about the proposed CSLR

Key Takeouts

- **Context:** Hayne recommendation 7.1 recommended that the government should establish a compensation scheme of last resort (CSLR) in line with the prior findings of the Ramsay Review.
- **Draft legislation to establish a CSLR:** The government released a package of draft legislation proposing to establish a CSLR together with a proposal paper setting out its proposed approach to various aspects of the operation of the scheme (eg scope, eligibility) for consultation on 13 July 2021. Consultation closed on 13 August 2021. You can find a summary of the proposed reforms in Governance News 21 July 2021 at p11.
- **Proposed timing**: Were the draft legislation package enacted in its current form, it would commence on the later of 1 January 2022; and the day after the Financial Services Compensation Scheme of Last Resort Levy Bill 2021 receives the Royal Assent. The package would not commence if the Financial Services Compensation Scheme of Last Resort Levy Bill 2021 is not passed. The government intends that the regulations (which have not yet been consulted on) and the legislation to enact the scheme will be legislated by Q4 2021- Q1 2022. It is as yet unclear when the scheme would start processing applications for compensation.
- **Industry associations have flagged concerns:** Though supportive in principle, of a CSLR, 12 industry associations/representative bodies have raised concerns about the proposed design/approach calling among other things for the scope of the scheme to be narrowed and for the approach to funding to be rethought.
- **Separately Consumer groups have also raised concerns** about the design and scope of the regime (though for different reasons). Among other things, the groups have called for the scope of the scheme to be broadened.

Joint ABA, AFIA, ICA and COBA submission calls for the scheme to be narrowed

In a joint submission, the Australian Banking Association (ABA), Australian Finance Industry Association (AFIA), Insurance Council of Australia (ICA) and the Customer Owned Banking Association (COBA) argues that the proposed approach 'fails to meet the mandate established by the Ramsay Review', primarily (but not solely) because the proposed scope of the scheme is broader than was intended/recommended.

The group considers that this is 'ill-advised given the recent experience of overseas schemes'.

In light of this, the submission makes several recommendations to narrow the scope/application of the scheme. These are as follows.

- **The submission argues that the CLSR should initially be restricted to financial advice failures**, in line with the recommendation of the Ramsay Review. The submission suggests at some later point, consideration could be given to expanding the scope of the regime 'if the evidence warrants it'. Pointing to overseas experiences of implementing similar schemes including in the UK context (an appendix to the submission discusses this in detail), the group argues that failure to narrow the scheme as recommended will expose it to 'to significant financial liability and undermine its future sustainability'. The submission calls on the government to publish 'the evidence that it has relied upon to justify widening the scope of the scheme beyond that proposed by the Ramsay Review' for example, any 'underlying data on the volume and value of unpaid determinations since September 2017'.
- **The CSLR should not be supported by other preventative measures:** The submission argues that 'a CSLR will not fix the underlying causes of unpaid determinations and may, in some cases exacerbate those causes'. In light of this, the submission argues that the government should be introducing separate measures on a parallel basis to prevent determinations going unpaid. It's suggested that these additional measures could include both: a) 'imposing enhanced financial requirements and ensuring that financial services entities hold appropriate levels of professional indemnity insurance'; and b) tasking ASIC will undertaking 'regulator risk-based reviews of licensees to ensure that they have adequate financial and compensation arrangements in place'.
- **The proposed approach to structuring the costs of the scheme should be revisited.** The submission observes that the projected $6.3 million cost of establishing the scheme is 4000% more than the estimated costs presented to the Ramsay Review. In addition, the submission raises concerns about the reasonableness of the expectation that

the administrative costs of the CSLR will account for 45% of its annual ongoing operating costs. The submission calls on the government to 'review the proposed cost structure of the scheme in order to maximise its efficiency'.

- **Unpaid determinations that have accumulated prior to the commencement of the scheme should be government funded,** as opposed to being funded through a one-off levy on the ten largest financial firms as proposed. This submission argues that this is 'appropriate', given that: a) the CSLR is intended to be prospective in nature; and b) the financial risk that an unspecified and uncapped levy would pose for large financial institutions (and their shareholders) is unacceptably high. The submission also argues that large financial institutions are subject to a higher level of regulatory oversight than smaller institutions and are 'very unlikely to become insolvent'. The submission observes that the government has previously announced its intention to make $30 million available to consumers/small businesses with unpaid determinations dating back to 2010 (because the payments are not recoverable as the financial firms have become insolvent). The submission suggests that this funding should be extended to cover all unpaid determinations ahead of the commencement of the CSLR.
- **The proposed mechanism for adjusting the levy amount should be rethought:** The submission observes that under the proposed approach, the Minister would have power to direct that a special levy be imposed and/or that compensation paid to customer be reduced/spread over multiple years, where annual compensation paid under the proposed CSLR looks likely to exceed the levies raised. The submission argues that this is 'not appropriate, as it essentially empowers the Minister to decide to levy an unspecified amount on any firm or to reduce customer's compensation without consultation, an explanation of the decision or a right of redress'. The submission argues that the 'governance of the scheme must be clear and independent – especially as the scheme has the explicit objective of supporting ongoing confidence in the financial system's dispute resolution framework'.

A further eight industry bodies/associations representing advisers have raised concerns about the design of the proposed CSLR

In a separate statement a further eight industry bodies – the Chartered Accountants Australia and New Zealand (Chartered Accountants ANZ); CPA Australia; Financial Planning Association of Australia (FPA); Institute of Public Accountants (IPA); SMSF Association (SMSFA); Association of Financial Advisers (AFA); Stockbrokers and Financial Advisers Association (SAFAA) and the Boutique Financial Planning Principals Association Inc – have expressed their opposition to the proposed scheme (as currently designed, though they support the establishment of a CSLR in principle) and flagged their intention to submit separate submissions detailing their concerns.

Key concerns raised in the statement include the following.

- Consistent with the joint submission outlined above, the group does not support 'the way the scheme is structured to include Australian Financial Complaints Authority's (AFCA) outstanding expenses in addition to failing to address the causes of unpaid consumer compensation'.
- Also consistent with the joint submission outlined above, the group has concerns about the projected costs of the scheme and the sustainability of the scheme looking forward. In particular, the group sees that the proposed funding model will add to the existing pressures on the affordability of advice and unfairly add to existing pressures on individual advisers. The statement comments:

  > 'ASIC fees for financial advisers have increased by more than 230% over the past three years. Most financial advisers are sole traders or small businesses who cannot afford the rising costs associated with increased regulation. Others are authorised representatives of groups who participate in other compensation schemes, which adds duplication. COVID impacts and Australia's ageing population mean the nation's advice needs are growing, yet escalating regulatory costs have already caused a mass exodus of advisers from the industry. The total number of financial advisers has fallen below 20,000 and will not be enough to meet this increasing demand. We anticipate the proposed scheme will further reduce adviser numbers'.

- The group also argues that as currently designed, the responsibility for consumer losses/complaints would not be borne by some industry participants (eg product manufacturers). The statement argues that the effect of this will be that 'manufacturers whose products are poorly designed and improperly fail won't have to contribute to the compensation scheme'. Ultimately, the group intends to call on the government to amend the draft legislation to 'ensure the proposed scheme can only be used as a last resort, is appropriately calculated and applies to all financial service industry participants'.

The case for expanding the scheme: Consumer groups have also raised concerns about the proposed approach (though on different grounds)

- In a joint submission nine consumer groups - Consumer Credit Legal Service (WA) Inc; CHOICE; Consumer Action Law Centre (CALC); Financial Counselling Australia (FCA); Financial Rights Legal Centre (FRLC); Indigenous

Consumer Assistance Network (ICAN); Super Consumers Australia; Uniting Communities Consumer Credit Law Centre SA (CCLCSA); Victorian Aboriginal Legal Service (VALS) – have raised concerns about the proposed scope and design of the CSLR.

- Broadly, the submission argues that if the purpose of the CSLR is to 'stop people from falling through the cracks' then the scheme needs to be designed .to eliminate 'cracks' from the outset. In a statement, consumer group CHOICE suggested that the proposed approach will see a number of victims fail to receive full compensation or go uncompensated. CHOICE states:

  'The proposals now released by the Government will disappoint victims by capping compensation at $150,000 and failing to cover compensation from financial scandals in areas like managed investment schemes and funeral insurance. This will see many people go uncompensated.'

- Accordingly, the submission includes 16 recommendations which consumer groups argue would serve to strengthen the proposed scheme. These include significantly broadening the scope of the regime and aligning the proposed CSLR compensation cap with AFCA's compensation cap.

Recommended changes

Recommended changes include the following:

- **Broadening the scope of the regime:**
  - The submission calls for the scope of the proposed CSLR be broadened to include 'any financial services and products that come within AFCA's jurisdiction'.
  - If the scheme is not broadened in this way, it's submitted that funeral expenses policies; managed investment schemes and debt management firms should be 'prioritised' to be included in the scheme.
  - The submission calls for the CSLR to be expanded to include unpaid compensation awards from court and tribunal decisions. It's submitted that if the government decides not to implement this, that the government 'must commit to collect data on the number and amount of unpaid determinations'.
  - The submissions calls for the CSLR to be expanded to include voluntary AFCA members. If this recommendation is not adopted, it's submitted that a 'special exemption should be made to include the Aboriginal Community Benefit Fund given it became a member of AFCA as a result of regulatory action'.
- **Lifting the compensation cap:** The submission recommends that the CSLR compensation cap be aligned with AFCA's compensation cap. It's further submitted that if this does not occur, that the CSLR cap should be subject to indexation (if the cap legislated is lower than AFCA's compensation cap).
- **Recommendations concerning the role of the CSLR operator (and AFCA):** A number of recommendations in the submission concern the role/operation/composition of the CSLR operator. These include that:
  - The board of the CSLR operator should have an independent chair, with an equal number of consumer and industry directors.
  - The CSLR operator should have 'broad discretion to interpret when a firm is "unable to pay" compensation, including when a firm delays or ignores payment to a claimant'. It's further submitted that ASIC should be 'empowered to cancel the licence of a firm that delays or ignores payment of compensation to a consumer or small business as determined by AFCA'.
  - The CSLR operator 'should have the discretion to waive the 12-month notification requirements in special circumstances, especially when people have experienced or are experiencing vulnerability'.
  - Both the CSLR operator and AFCA should have a 'duty to be proactive in contacting people who are owed compensation'.
  - The CSLR operator should 'establish clear processes that mean claimants face minimal barriers to receiving compensation'.
- **Recommendations around ministerial discretion**: The submission recommends that:
  - the Minister should 'only have the power to **increase** levies or determine that a class of claims be spread over more than one financial year'. It's further submitted that where a class of claims will be paid over more than one financial year, the maximum time period should be capped at three years with payments to people in hardship prioritised.
  - The Minister should have the power by regulations to increase the annual scheme cap above $250 million

    [Sources: Joint submission on the proposed Compensation Scheme of Last Resort from the Australian Banking Association (ABA), Australian Finance Industry Association (AFIA), Insurance Council of Australia (ICA) and the Customer Owned Banking Association (COBA) 13/08/2021; FPA media release 13/08/2021; Consumer groups joint submission on the proposed compensation scheme of last resort]

Hayne implementation: Consumer groups recommend 10 changes to strengthen the proposed FAR arguing that as currently drafted it is 'deficient in many important areas'

Key Takeouts

- Consultation on draft legislation proposing to implement the Financial Accountability Regime (FAR) closed on 13 August 2021. You can find an overview and discussion of the key changes here.
- In a joint submission, four consumer groups have recommended 10 key changes to strengthen the proposed regime and help ensure it meets its policy objectives.
- Recommended changes include: a) expanding the scope of the regime to apply to senior managers; b) reinstating (as proposed in the original policy proposal) civil penalties for individuals who breach their FAR obligations; and c) amending the deferred remuneration requirements in the draft Bill to require that 100% of variable remuneration be subject to clawback over a seven year period.

In a joint submission, consumer advocates CHOICE, the Consumer Action Law Centre (CALC), Financial Counselling Australia (FCA), and Super Consumers Australia (Super Consumers) argue that as currently drafted the proposed Financial Accountability Regime (FAR) will 'be unlikely to hold finance executives to account for their actions' or 'significantly improve corporate culture in Australia'.

Ten recommendations to strengthen the proposed FAR

The submission includes 10 recommendations that consumer groups consider necessary if the policy intent behind the reform is to be achieved.

10 RECOMMENDED CHANGES	RATIONALE
Recommendation 1: Amend s 3 of the draft Bill to state that the object of the legislation is 'to provide for accountability obligations that will prevent misconduct and ensure that customers are treated fairly.'	▪ The submission argues that as currently drafted the stated objectives of the draft Bill are 'deficient' because no reference is made to the underlying principle of why the reforms are necessary. It's submitted that the objectives should be revised to ensure that they reflect that accountability obligations are in place to 'ensure executives and entities who employ them are to be held to account when misconduct occurs'. ▪ The submission argues that codifying this principle in the objectives of the legislation will 'signal to financial entities and their senior leaders the rationale for these measures and provide context for courts and regulators interpreting the law over time. This will help ensure that the focus of the FAR regime always remains on protecting people from harm, and not be a box-ticking, compliance exercise.'
Recommendation 2: A new accountability obligation in s 18 and s 19(1) of the draft Bill should be included which would require accountable entities and persons to 'pay due regard to the interests of customers and treat them fairly.'	▪ The submission argues that an explicit focus on the fair treatment of customers is a 'missing link in the current drafting of the legislation'. ▪ The submission observes that the inclusion of this proposed conduct or accountability obligation would mirror the obligations in the UK Senior Manager Regime (on which the Australian model was originally based) and reflect international best practice.
Recommendation 3: Financial penalties for individuals who breach FAR obligations (that were included in the	▪ It's submitted that the inclusion of civil penalties for individuals would align with community expectations.

10 RECOMMENDED CHANGES	RATIONALE
original FAR proposal) should be reinstated. The submission recommends that penalties should be the greater of: a) 5,000 penalty units (currently $1,050,000); or b) three times the benefit obtained or detriment avoided.	▪ The submission observes that the UK Senior Managers Regime, which includes civil penalties, is 'viewed by the regulators as a wide-ranging success'. ▪ It's further submitted that individual penalties should be 'set at a level which deters non-compliance and is seen as more than the cost of doing business'. The submission argues that maximum penalties for entities and accountable persons under the FAR should align with the maximum penalty framework under the Corporations Act 2001 (Cth), Australian Securities and Investments Commission Act 2001 (Cth), National Consumer Credit Protection Act 2009 (Cth) and Insurance Contracts Act 1984 (Cth).
Recommendation 4: The draft Bill should be amended to require 100% of an accountable person's variable remuneration to be subject to deferred remuneration obligations.	▪ It's submitted that the proposed deferred remuneration requirements need to be 'significantly bolstered' in order to align with international best practice and be effective in discouraging inappropriate risk taking/short term approach to decision making.
Recommendation 5: The draft Bill should be amended to require a deferral remuneration period of seven years, with the option of extending the period by three years if there is an outstanding regulatory investigation at the end of the normal seven-year clawback period.	
Recommendation 6: The scope of proposed accountability obligations should be expanded to include all executives and senior management of accountable entities. The submission suggests that it may be appropriate for obligations for senior managers to differ from those applying to executives, given their different levels of responsibility within the organisation.	▪ It's submitted that as drafted, the FAR may only apply to a very few individuals and that this is 'not wide enough coverage to improve corporate conduct nor drive positive cultural change'. ▪ The submission argues that extending the FAR to apply to senior managers (who are responsible for making many operational decisions with potential to result in poor customer outcomes) will achieve 'greater accountability and responsibility for misconduct across the industry.' ▪ The submission comments that expanding the scope of the proposed FAR as recommended, would be in line with the UK approach.
Recommendation 7: Amend the draft Bill to ensure that accountable persons who are banned for breaching their FAR obligations are prohibited from being employed in a leadership position in any AFSL or ACL-holding firm.	▪ Under the draft Bill, ASIC and APRA have power to disqualify and executive for breach of their FAR obligations. Further, a person who has been disqualified could not hold a position as an accountable person in another accountable entity. ▪ The submission argues that this drafting is too narrow because it may enable financial institutions to 'shift disqualified persons within the corporate group away from the narrow range of accountable persons - thereby avoiding the spirit of the regime'. It's submitted that amending the draft Bill as recommended, would address this concern.
Recommendation 8: The submission recommends that the draft Bill should set out when the FAR will be extended to apply to AFSL and ACL holding firms. It's	▪ In its response to Hayne Commission the government made a commitment to implement a 'new ASIC-administered accountability regime' for AFSL and ACL holders.

10 RECOMMENDED CHANGES	RATIONALE
further recommended that the FAR should commence no later than 1 January 2023.	▪ It's submitted that the draft Bill should specify the timeframe for extending the FAR to AFSL and ACL holders. ▪ It's further submitted that the FAR should commence no later than 1 January 2023 to provide stakeholder with necessary certainty and 'drive some pre-emptive improvements in corporate conduct.'
Recommendation 9: Only APRA and ASIC should have power to exempt entities from the new regime (ie the Minister should not hold this power)	▪ Referencing the Explanatory Memorandum, the submission observes that its envisaged that the Minister will have power to exempt entities/classes of entities from the FAR. ▪ The submission argues that this is not appropriate an appropriate mechanism because there is 'a risk of unreasonable political influence', given the influence the financial services industry holds over political parties in Australia.
Recommendation 10: The benchmark for the 'enhanced compliance' classification should factor in consideration of the risk of consumer harm (in addition to the complexity of the entity).	▪ It's submitted that the Hayne Commission demonstrated inappropriate behaviour was not limited to large, complex financial institutions but extended to entities of varying sizes. ▪ In light of this, the submission argues that the government should reconsider how the benchmark for triggering higher regulatory expectations should be determined. It's suggested that 'the complexity of an organisation may be better reflected in the number of employees, and risk of harm may have geographic or product dimensions. The risk of harm could be calculated by AFCA complaints data or number of investigations by a regulator into a firm'.

[Source: Consumer group joint submission: Financial Accountability Regime]

Hayne implementation: AIST suggests improvements to the proposed Financial Accountability Regime (FAR)

Context

Consultation on draft legislation proposing to implement the Financial Accountability Regime (FAR) closed on 13 August 2021. You can find an overview and discussion of the key changes here.

AIST submission recommends several 'improvements' to the proposed FAR

The Australian Institute of Superannuation Trustees (AIST) has released its submission to the FAR consultation.

Broadly, though the AIST supports the introduction of the proposed FAR, it considers that the government's proposed approach could be improved in certain respects.

Suggested 'improvements'

- **Facilitating identification of deregistered persons:** The AIST suggests that trustees should be able to check (by using an online search tool) whether an individual who is being considered for a role as an accountable person has already been deregistered in Australia, and potentially in other jurisdictions eg the UK, the US and Canada.
- **Minister's rule making power should be narrowed** to provide greater certainty around the operation of key aspects of the scheme: The draft legislation envisages that the Minister will set rules around key aspects of the FAR including: the metric for enhanced obligations to apply, the list of 'prescribed positions' and the threshold for deferral of remuneration requirements to apply. The AIST questions the rationale behind this approach, observing

that giving the Minister such broad powers runs contrary to the 2015 Australian Law Reform Commission Report. The AIST submission calls for the scope of the power of the Minister to make rules under the FAR legislation be narrowed 'with the aim of creating greater clarity and certainty of FAR's application to the superannuation sector and prescribed roles within the sector'.

- **Proposed directions power and related secrecy provisions should be reconsidered.** The AIST raises concerns that as currently drafted, the proposed directions power and 'related secrecy provisions' would enable the regulator to determine that secrecy arrangements are appropriate in certain circumstances. The submission argues that this approach is inconsistent with the finding in the APRA Capability Review that the regulator should depart from a 'closed door approach' and on this basis, argued that they should be 'reconsidered'.
- **Accountable entities and significant related entities:** The submission raises concerns about what the AIST considers to be a lack of detail around how the proposed FAR will apply in the profit-to-member context. Accordingly, the AIST states that it has requested that an example be provided on how FAR will apply to significant related entities which includes commentary. According to the submission, this information has been provided by Treasury and the submission expresses the view that 'with further work this can be resolved'. The submission also raises concerns about the lack of clarity around how the materiality thresholds will work in practice in the superannuation context and has suggests that additional commentary would be useful.
- **Implementation Timetable:** The AIST welcomes the intention that FAR will commence for RSE licensees from the later of 1 July 2023 or 18 months after Assent, observing that implementation of the reforms (especially in light of the other regulatory reforms impacting the sector) will take considerable time and resourcing. The submission states that 'it would be easy to underestimate the amount of work involved for the regulator and AIST urges that due consideration to be given to project planning and resourcing so that bottlenecks can be avoided'.
- **Deferred remuneration obligations:** The submission reiterates and underscores the importance of ensuring consistency between FAR requirements and those in the (as yet still draft) APRA standard CPS 511.
- **End-to-end product responsibility and design and distribution obligations (DDO):** The submission calls for 'greater clarity and detail' around regulatory expectations in this context. The submission suggests that 'worked examples and case studies of this would assist in implementation'.
- **Five year review:** The AIST suggests that it would 'be appropriate' for the planned five year implementation review of the reforms, to include a 'review the criteria for entities captured by the regime to ensure they remain relevant'

  [Source: AIST submission to Treasury Financial Accountability Regime 12/08/2021]

Supporting Hayne implementation: FSC consults on possible options for the removal of occupational exclusions within default life insurance policies in MySyper offerings

Context

- Hayne Recommendation 3.5 recommended that a person should have only one default superannuation account and that 'machinery should be developed for "stapling" a person to a single default account'.
- Schedule 1 of Treasury Laws Amendment (Your Future, Your Super) Act 2021 (YFYS Act) implements the government's response to this recommendation. New single default account amendments will apply in relation to employees who commence employment on or after 1 November 2021. Treasury Laws Amendment (Your Future, Your Super - Single Default Account) Regulations 2021 support the amendments introduced by Schedule 1 of the YFYS Act by setting out the requirements that a fund must meet to be a stapled fund and procedural matters relating to requests to and responses from the Commissioner of Taxation about stapled funds.
- Issue: Currently, some default life insurance in MySuper products may include exclusions that apply to certain occupations that could prevent a member who works in one of those occupations from claiming under their policy (despite paying insurance the necessary premiums). The Financial Services Council notes that concerns have been raised that the introduction of stapling could potentially lead to members being stapled into funds where they are ineligible to claim because of their occupation.

Consultation on implementation of a prohibition on the use of occupational exclusions

To address these concerns, the Financial Services Council (FSC) has released a policy paper for consultation, proposing to implement a prohibition on the use of occupational based exclusions in default life insurance policies in MySuper offerings. That is, a prohibition on 'the use of any terms in MySuper group life policies that would cause a

claim to be declined in default group life insurance in superannuation on the basis of a change in the occupational classification of the member'.

The consultation paper seeks feedback on three possible options to implement this.

- Implementation of a prohibition on the use of these terms on life insurers through an Appendix to the FSC's Life Insurance Code of Practice (Code). The policy paper comments that this approach could entail 'complexity' because the Code is mandatory for life insurers but not for superannuation trustees.
- The introduction of an enforceable FSC Standard requiring all FSC members to remove the exclusions from existing policies and not to include them in new group policies. The policy paper comments that not all superannuation trustees are members of the FSC.
- The FSC issuing industry guidance for stakeholders to consider when designing their group policies.

In putting forward these options, the FSC makes clear that the proposed prohibition (if implemented) would be limited the use of occupational based exclusions in default life insurance policies in MySuper offerings. Other issues - other types of life insurance; the use of non-occupational based/other exclusions; the way in which benefits are designed (ie the use different scales of default cover for different occupations) and the issue of funds electing not to offer default life insurance to certain members because of their occupation – are not in scope of the consultation.

Consultation with Regulators

The FSC states that the consultation process will include consulting with the relevant regulators – the Australian Competition and Consumer Commission (ACCC), Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA).

Timeline?

- Transitional arrangements: The FSC proposes that a one-year transitional period from the date the measure is implemented, to provide superannuation trustees and life insurers time to amend existing group policies.
- The deadline for submissions is 3 September 2021.

[Source: FSC media release 12/08/2021]

A tougher approach: APRA has finalised its approach to licensing and supervision of new ADIs

Following consultation, the Australian Prudential Regulation Authority (APRA) has finalised its revised approach to licensing and supervising new authorised deposit-taking institutions (ADIs).

APRA states that its final position if 'largely consistent' with the approach proposed in consultation and 'is simply a formalisation of existing practice'.

Three key changes

APRA highlights the following as key changes:

- before being granted an ADI licence, restricted ADIs are required to 'achieve a limited launch of both an income-generating asset product and a deposit product'
- new entrants are 'expected to have a more advanced contingency plan to respond to financial stress, including an option to execute the ADI's orderly and solvent exit from banking business'
- the revised approach provides 'increased clarity around capital requirements at different stages for new entrants, aimed at reducing volatility in capital levels and facilitating a transition to the methodology for established ADIs over time'.

There is no transition period – the changes have immediate effect.

[Source: APRA media release 11/08/2021; Response paper - APRA's approach to new entrant authorised deposit-taking institutions; Information paper - ADIs New entrants - a pathway to sustainability; Guidelines - Licensing Locally-incorporated ADIs; Guidelines - Overseas Banks Operating in Australia]

Use of unfair contract terms: ASIC cautions insurers on the use of unfair contract terms following a recent Federal Court decision

- In Australian Securities and Investments Commission v Bank of Queensland Limited [2021] FCA 957 (ASIC v BoQ) the Federal Court declared that certain terms in 11 standard form contracts that the Bank of Queensland (BoQ) entered into with small business customers are unfair.
- BoQ and ASIC filed joint submissions and jointly proposed declarations and orders to resolve the proceedings – they agreed certain terms to be unfair. Paragraph 41 of the judgment lists the terms in question:
  - 'indemnification clauses that apply to losses not caused by a customer's default and that have the effect of limiting the Bank's vicarious liability for its agents'
  - 'event of default clauses that allow the Bank to unilaterally determine whether a default has occurred'
  - 'event of default clauses that do not permit the customer to remedy a default capable of remedy and which create defaults based on events which may or may not involve any material change in credit risk'
  - 'event of default clauses that create defaults based on events that may or may not involve any material change in credit risk'
  - 'unilateral variation clauses which permit the Bank to vary the upfront price of the contract, the financial services to be supplied under the contract and other terms of the contract'
  - 'conclusive evidence clauses that have the effect of imposing an evidential burden on the customer in proceedings relating to the contract' and allow the Bank (but not the customer) to 'terminate the contract if the customer does not pay an amount stated in a certificate by a stated date'.
- There was no allegation by ASIC that the bank 'relied on the impugned terms in a manner that is unfair, or that has caused any customers to suffer loss or damage'.
- The Court declared that these unfair terms are void from the start of the contracts and ordered that they be replaced with new, fair terms.

  The Court held that making the declarations was appropriate because [at para 78-79]

  > 'they serve to record the Court's disapproval of the contravening conduct, vindicate the claim by ASIC that the Bank had contravened the Act, assist ASIC to carry out the duties conferred upon it by the Act, and deter other corporations from entering into contracts containing unfair terms: ASIC v Bendigo at [90]; Australian Competition and Consumer Commission v Coles Supermarkets Australia Pty Ltd [2014] FCA 1405 (ACCC v Coles) at [78]. 79 Finally, there is also utility in making the declarations because they serve to enliven the Court's power under s 12GNB to make orders that are sought: ASIC v Bendigo at [91]'.
- The decision follows the decision in ASIC in Australian Securities and Investments Commission v Bendigo and Adelaide Bank Limited [2020] FCA 716 which dealt with similar issues/where similar relief was sought. The approach adopted by the Court in ASIC v BoQ consistent with the approach in this earlier case.

A reminder for insurers

ASIC Commissioner Sean Hughes has said that the decision should serve as a 'timely reminder for insurers'. Commissioner Hughes commented:

> 'Now that unfair contract term protections apply to insurance contracts for consumers and small business, we expect all insurers to have reviewed all standard form contracts for fairness'.
>
> [Sources: ASIC media release 13/08/2021; Australian Securities and Investments Commission v Bank of Queensland Limited [2021] FCA 957]

Consultation on the proposed extension of the financial reporting and auditing requirements in Chapter 2M of the Corporations Act to RSEs

Key Takeouts

- The government is consulting on proposed reforms that if legislated, will require registrable superannuation entities (RSEs) to prepare, and lodge audited financial reports with the Australian Securities and Investments Commission (ASIC).
- Announcing the changes, Senator Jane Hume said that the purpose of the proposed changes is to increase transparency of financial information and to support enhanced regulatory oversight of superannuation funds.
- The due date for submissions is 8 September 2021.

Treasury is consulting on draft legislation – [Exposure Draft] Treasury Laws Amendment (financial Reporting and Auditing Requirements for Registrable Superannuation Entities) Bill 2021 – proposing to extend the financial reporting and auditing requirements in Chapter 2M of the Corporations Act 2001 (Cth) to registrable superannuation entities (RSEs).

The due date for submissions is 8 September 2021. Generally, it's proposed that the reforms would apply to income years beginning on or after 1 July 2022.

Key (proposed) changes

Proposed new record keeping requirements

- The draft Bill proposes to introduce new requirements for RSEs to keep financial records for seven years after the transactions covered by the records are completed. Financial records include: 'invoices, receipts, orders for the payment of money, bills of exchange, cheques, promissory notes and vouchers; documents of prime entry; and working papers and other documents needed to explain the methods by which financial statements are made up and adjustments to be made in preparing financial statements'.
- It's proposed that records could be kept electronically and stored outside Australia (subject to certain conditions).
- Strict liability offence: It's proposed that failure to comply with the new record keeping requirements would be an offence punishable with two years imprisonment.
- Timing: It's proposed that the changes will apply to records required to be kept for a year of income beginning on or after 1 July 2022.

Proposed new reporting requirements

It's proposed that RSE licensee for an RSE would be required to:

- prepare and lodge with the Australian Securities and Investments Commission (ASIC) within a specified timeframe, both half year and full year financial reports (which includes directors' reports and financial statements for the entity and each sub-fund), together with an auditor's reports for each financial year and half-year. It's proposed that these new financial reporting requirements would apply in addition to existing financial reporting obligations requiring the trustees of a registrable superannuation entities to prepare and lodge certain financial information with APRA. It's proposed that ASIC would have power to enforce compliance through issuing directions to lodge reports (where necessary).
- publish the financial and directors' reports for the entity for a financial year and the associated auditor's report on the entity's website (RSE licensees would not be required to make financial reports for each half-year publicly available on the entity's website).
- publish with the notice to the annual members' meeting details of how to access the financial and directors' reports for an entity for a financial year and the relevant auditor's report
- provide financial reports for a financial year and half-year to members upon request

Proposed audit requirements

It's proposed that:

- an RSE licensee will need to appoint an individual auditor (RSE auditor) to conduct an audit of a registrable superannuation entity.

- RSE licensees will need to appoint an auditor within one month of the entity being registered as a registrable superannuation entity. Transitional provisions will apply for entities already registered prior to the date that the new requirements in the Bill commence.

The draft Bill would also introduce requirements for appointed auditors to:

- prepare an auditor's report for an audit or review of an entity's financial report for a financial year and half-year
- report suspected contraventions to the Regulator
- meet auditor independence and rotation requirements
- (if required) prepare, lodge and publish auditor transparency reports.

The Bill also proposes to introduce rotation requirements for auditors: individual RSE auditors would not be able to 'play a significant role in the audit of a registrable superannuation entity for more than five (out of seven) successive years' (without approval).

Rationale for the proposed changes

The draft explanatory materials observe that currently superannuation funds are subject to less stringent financial reporting obligations than public companies and registered schemes. In particular, there is no requirement for RSEs to prepare/lodge financial reports or to make them publicly available to members.

The draft explanatory materials set out five justifications for the proposed changes.

- 'improve the quality and transparency of financial reports prepared for registrable superannuation entities;
- improve public access to, and facilitate industry analysis and scrutiny of, financial reports prepared for registrable superannuation entities;
- increase the accountability of RSE licensees in the preparation of financial reports;
- ensure registrable superannuation entities are subject to financial reporting and auditing requirements that are consistent with the requirements that currently apply to companies and registered schemes; and
- strengthen enforcement and monitoring of an entity's compliance with their duties and obligations in relation to financial reporting'.

[Sources: Treasury consultation: Financial and auditing requirements for superannuation funds; Draft Bill; Draft explanatory materials; Minister for superannuation, financial services and the digital economy Jane Hume media release 12/08/2021]

Superannuation portfolio holdings disclosure: Consultation on draft regulations

- Context: Treasury Laws Amendment (Your Future, Your Super) Act 2021 included amendments to the 'portfolio holdings disclosure' regime to ensure that information is available to members about the portfolio holdings of superannuation funds.
- Consultation on draft regulations: Following an initial round of consultation as part of the 'Your Future, Your Super' Regulations during the period 28 April 2021 to 25 May 2021, Treasury has released draft regulations for another round of consultation which are intended to support the transparency measures introduced by the YFYS Act by prescribing the manner in which information provided under the portfolio holdings disclosure regime must be organised.

Key changes

The draft regulations have been amended to:

- include a new requirement for the information to be 'easily downloadable' from funds' websites in a delimited format;
- allow cash and bank bill investments to be aggregated by the relevant institution;
- remove the requirement to disclose maturity dates and counterparty name for derivatives; and
- clarify (in the explanatory statement) that superannuation entities (RSEs) have the option to provide supplementary information about the portfolio holdings of the RSE's products in a separate public disclosures (in addition to the mandatory disclosures).

Announcing the consultation, Minister for Superannuation, Financial Services and the Digital Economy Jane Hume said that the changes in the draft regulations would bring Australia 'into line with global best practice'.

Timing

- The due date for submissions is 31 August 2021.
- It's proposed that the amendments will apply in relation to reporting days that occur on or after 31 December 2021 or the commencement of Schedule 1 to the Regulations (which will commence the day after the Regulations are registered), whichever is later.

[Source: Treasury Consultation: Superannuation Portfolio Holdings Disclosure; [exposure draft] Regulations; [Exposure draft] explanatory materials]

In Brief | MySuper performance testing: APRA has released an information paper outlining its approach to administering the annual performance test for superannuation products and outlining its methodology for combining investment performance in the performance test

[Source: APRA media release 16/08/2021]

In Brief | More time: APRA has published additional FAQs to provide further guidance to RSE licensees on the reporting standards for Phase 1 of the Superannuation Data Transformation project. The update includes an extension to the timeframe for the initial submission of 30 June 2021 data related to trustee-directed products from 30 September 2021 to 28 October 2021 'to allow sufficient time to implement reporting'

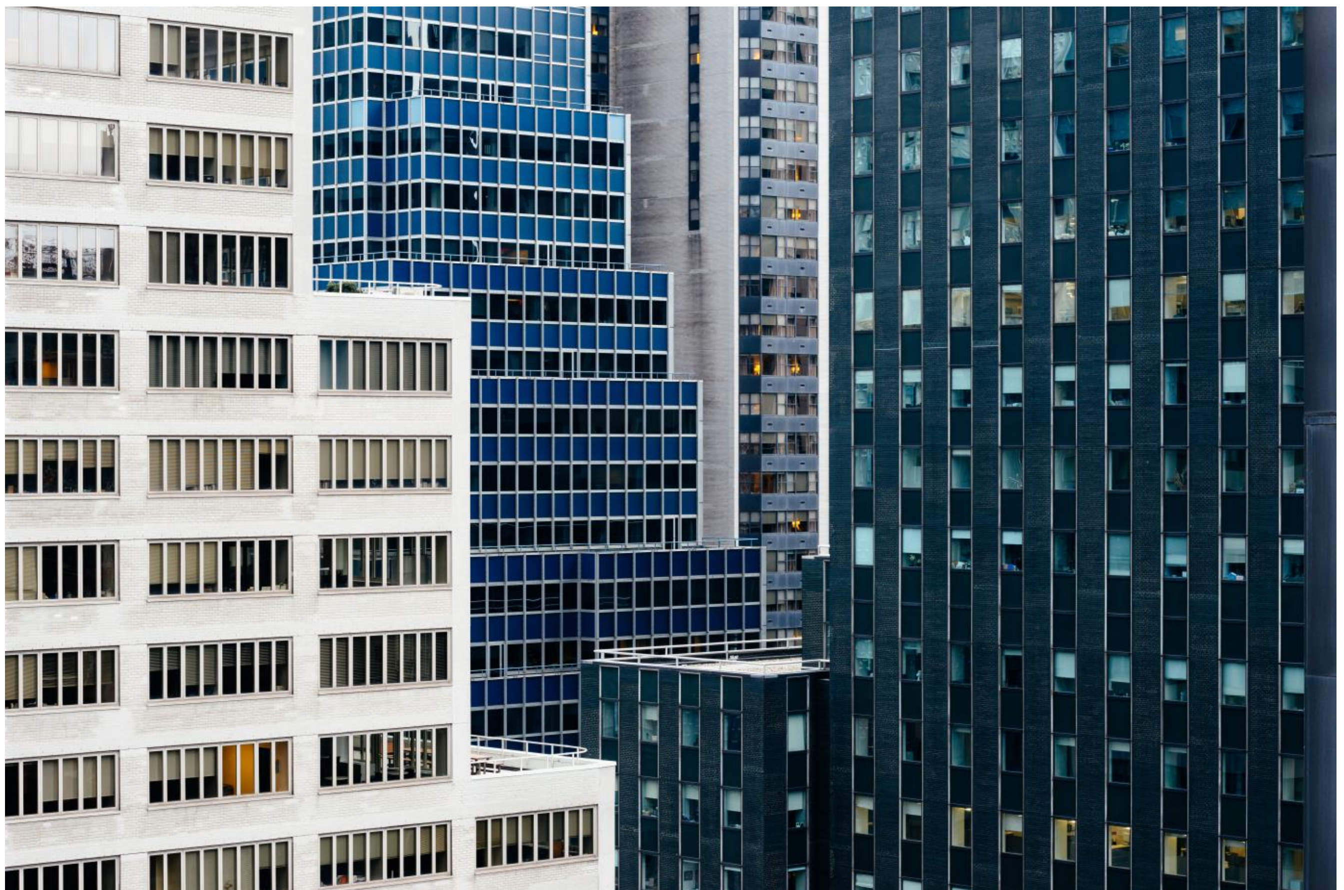
[Source: APRA media release 16/08/2021]

Insolvency and Reconstruction

ASIC prosecuted 124 people in H1 2021 for failure to assist registered liquidators

- The Australian Securities and Investments Commission (ASIC) has announced the during the period 1 January 2021 to 30 June 2021 124 people have been prosecuted for failing to assist registered liquidators as required under the Corporations Act 2001 (eg for failing to provide access to company books and/or failing to submit a reporting on company activities and property)
- ASIC took action following reports of misconduct being lodged by registered liquidators of the companies under the liquidators assistance program. The 124 people were prosecuted summarily in local and magistrates' courts by ASIC and the Commonwealth Director of Public Prosecutions. The prosecutions resulted in fines and costs totalling $341,407.

[Source: ASIC media release 16/08/2021]



Risk Management

Top Story | Expanding the Consumer Data Right

Treasury has released a new consultation paper that explores the expansion of the CDR to industries including insurance, groceries, health and education. MinterEllison has released an article summarising the proposals and providing insights into the possible implications. You can access the full text here.

Consultation on proposed expansion of the CDR to the energy sector

Treasury has released package of proposed consumer data right (CDR) changes to expand the CDR to the energy sector - exposure draft amendments to the Consumer Data Right rules (version 4 of the rules), exposure draft regulations, explanatory materials and a Policy Paper seeking feedback on the proposed staged approach to the roll out of the CDR to the energy sector (among other issues) - for consultation.

The draft rules also include proposed minor amendments to ensure that the rules operate as intended.

Proposed timing?

As flagged, the government is seeking feedback on the proposed approach to implementation.

Consistent with the implementation of CDR in the banking sector, it's proposed that the CDR will be rolled out in stages starting with 'participants that will provide the greatest coverage': Australian Energy Regulator, AEMO, and the three largest energy retailers: Origin Energy, AGL Energy and Energy Australia) from 1 October 2022. The Victorian Department of Environment, Land, Water and Planning (DELWP) would also be included in this group (from a date yet to be determined).

The CDR would be extended to all other retailers from 1 October 2023.

The due date for submissions is 13 September 2021.

[Source: Treasury Consultation: Consumer Data Right rules amendments (version 4) 17 August 2021 – 13 September 2021]

Cyber breach disclosure: Pearson pays $1 million to settle SEC charges

The Securities and Exchange Commission (SEC) has announced that London-based educational publisher Pearson has agreed to pay $1 million to settle charges that it: a) knowingly misled investors about the extent of a 2018 data breach involving the 'theft' of the personal information of 'millions' of students as well as administrator log-in details for 13,000 school, district and university customer accounts; and b) had 'inadequate disclosure controls and procedures' in place.

Details

SEC found that the company, contravened Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 and Section 13(a) of the Exchange Act of 1934 and Rules 12b-20, 13a-15(a), and 13a-16 by:

- inaccurately referring to the breach in its 2019 semi-annual report as a 'hypothetical risk' when the company knew at the time that the breach had already occurred
- under-reporting the extent of the breach in a later statement by:
  - inaccurately stating that certain personal information eg date of birth and email addresses may have been exposed when the company knew at the time that the records had been 'stolen'
  - omitting the other known information about the extent of the breach (omitting to mention that student data, usernames and hashed passwords had also been stolen)
- inaccurately reporting that it had 'strict protections' in place to protect data when it had been notified of the need to patch the 'critical vulnerability' six months previously and had not done so.

SEC's order also found that information flows within the company were flawed in that Pearson's disclosure controls and procedures 'were not designed to ensure that those responsible for making disclosure determinations were informed of certain information about the circumstances surrounding the breach'.

Chief of the SEC Enforcement Division's Cyber Unit commented:

> 'Pearson opted not to disclose this breach to investors until it was contacted by the media, and even then Pearson understated the nature and scope of the incident, and overstated the company's data protections. As public companies face the growing threat of cyber intrusions, they must provide accurate information to investors about material cyber incidents.'

As part of the settlement, Pearson has also agreed to 'cease and desist' from repeating the conduct. The terms of the settlement do not require Pearson to admit or deny the SEC's findings.

[Source: SEC media release 16/08/2021]

In Brief | Labor has reintroduced a Bill – the Ransomware Payment bill 2021 (No 2) – that if passed, would mandate reporting of ransomware payments and other key details of ransomware attacks by in-scope companies

[Source: Ransomware Payments Bill 2021 (No. 2)]

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