Governance News

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

4 August 2021

Contents

Diversity

Still stubbornly pale: Study finds ASX 300 boards are lagging on cultural diversity

Report Overview | Governance Institute, Watermark Search International report: 2021 Board Diversity Index

New report finds that though ASX 300 boards are on track to reach gender parity by 2030 (based on current trends), progress on other aspects of diversity including skills diversity and cultural/ethnic diversity is much slower.

Key Takeouts

- The report looks at progress towards improving board diversity on ASX 300 boards in the broad sense – 1) gender diversity; 2) cultural diversity; 3) skills diversity; 4) age diversity; and 5) tenure – over the past six years
- Less 'male': The report found that board gender diversity has seen the greatest improvement. Based on current trends, the report predicts that all-male ASX 300 boards will be extinct by 2026 and gender parity across ASX 300 boards will be achieved by 2030.
- Persistently 'pale': Consistent with last year's report, the 2021 report found that 90% of board members are from an Anglo-Celtic background. The report predicts that based on current trends it will take 18 years for the boardroom to be reflective of Australia's cultural diversity.
- There has also been little change in the mix of skills/expertise represented on boards. Boards continue to value/prioritise financial/accounting skills. Human resources and technology skills remain rare.
- Stale? According to the report, 65.2% of directors and 72.5% of chairs have tenures of less than 10 years, the point at which the ASX Corporate Governance Council considers that it is 'healthy to ask questions about the value of directors'. As such, the report opines that 'these seem reasonably healthy numbers on the face of it'.

Report Overview

The Governance Institute, in partnership with Watermark Search International have released their latest board diversity index. The report looks at the progress that has been made toward improving five aspects of diversity on ASX 300 boards - 1) gender diversity; 2) cultural diversity; 3) skills diversity; 4) age diversity; and 5) tenure/independence - over the 2016-2021 period.

Why is board diversity so important?

The report proceeds on the basis that more diverse boards in the broad sense – boards that are ethnically/ culturally, gender, skills and age diverse – make better decisions than less diverse boards, because they bring different viewpoints to the decision making process. The report states,

> 'Greater diversity is not just fairer and more reflective of our broader society, but it is also better for business. Diverse boards will challenge proposals from more perspectives, groupthink decreases, and consequently better decisions are likely to be made'.

In addition, the report suggests that more diverse boards are likely to increase equality within the business.

The report emphasises that the pressure on boards to diversify continues to build. CEO Megan Motto states:

> 'We are seeing investors and other stakeholders increasing pressure on companies to be more reflective of the community within which they operate. Consumers are increasing the pressure, choosing to spend their dollars with diverse organisations which can demonstrate strong ethics and good culture. Internationally, we are seeing countries list diversity as a reportable benchmark for companies and firms are starting to link executive remuneration to diversity targets. Momentum is gathering and organisations really need to be on the ball'.

Some Key Findings

Board gender diversity has shown the most improvement – 'change is afoot and it's swift'

- The number of female directors has significantly increased over the past seven years with the 30% female board representation target having been reached (in aggregate terms) across the ASX 300: women account for 31% of ASX 300 board seats (up from 28% in 2020, and only 20% in 2016). The report points out that this puts Australia well ahead of other OECD countries on this measure – the World Economic Forum, Global Gender Index 2020 found that on average women hold 22.3% of board seats in OECD countries.
- Larger companies are leading the way:
  - Consistent with the 2020 report (summarised here) the 2021 report found that larger companies are more gender diverse than their smaller counterparts.
  - Women account for 35% of board seats on ASX 100 boards (up from 32% in 2020) and 34% on ASX 50 boards (unchanged on 2020).
  - ASX 201-300 boards are less gender diverse with only 27% of seats held by women.
- All-male boards?
  - The number of all-male ASX 300 boards continues to decrease. In 2020 there were 29 all male boards. In 2021, this had decreased to 14. 100% of this group are in the ASX 101-300.
  - The report predicts that based on current trends, there will be no ASX 300 companies with zero female directors by 2026.
- The report argues that there are no signs that the pace of change is slowing – rather the report considers there are signs that companies are continuing to push for increased gender diversity. For example:
  - The number of boards with 30% or more female directors continues to trend upwards: In 2016 there were 54 boards with 30% or more women. This had increased 121 in 2020 and has further increased to 161 in 2021.
  - The number of boards with 50% or more women directors also continues to trend upwards, and the number of women holding Chair roles is also increasing.
  - Based on current trends, the report predicts that 50/50 board gender parity will be reached by 2030.

The pool of female directors is expanding?

The report suggests that there are signs that the pool of female board candidates is expanding.

The report found that though there is a 'significant concentration' of female directors holding multiple seats - approximately 29% of female directors hold 51% of female-occupied board seats – this appears to be shifting. In 2020, 19% of female directors held 47% of female occupied board seats.

Cultural (ethnic) diversity is 'modest at best'

- The report found that consistent with the 2020 report (summarised here), most ASX 300 board members (90%) are from an Anglo-Celtic background.
- ASX 100 boards have the highest representation of directors from non-European backgrounds at 18%. This decreases to 3% on ASX 101-200 boards. Interestingly, the figure is slightly higher at 8% for ASX 201-300 boards.
- Looking forward, the report predicts that based on current trends it will take 18 years for the proportion of ASX 300 directors with non-Anglo/European backgrounds to increase to 20% across (which would be more consistent with Australia's general population).

Boards are continuing to prioritise accounting/finance skills

The report found that there was little change in the skills/experience represented on boards as compared with previous surveys.

- Accounting, banking and finance skills continue to be the most strongly represented with 34.4% of directors holding these skills (down from 35% in 2020). The report predicts however, that based on current trends, this proportion will decrease over time to 30% by 2030.
- The proportion of directors with legal skills remained stable (as compared with last year) at 6.5%.
- The report highlights the steady increase in the number of board members with mining/energy/resources experience over the past seven years, as a reflection of the importance of the Resources sector to the Australian

economy. The proportion of directors with these skills has increased from 9.1% in 2016 to 13.4% in 2020 to 14.3% in 2021.

- The proportion of directors with technology skills was up very slightly on 2020 at 6.6% (up from 5.8%).
- The proportion of directors with HR skills remained very low and in fact decreased from 0.8% in 2020 to 0.7% in 2021.
- Female directors tend to hold more qualifications than their male counterparts. For example: 8.4% of female board members hold a PhD (vs 5% of male directors); 22.1% of female board members hold an MBA (vs 16.9% of male directors) and 60.7% of female directors hold a governance qualification (vs 32.1% of male directors).

Age Diversity – directors are getting (marginally) older

- The report found that the average age of directors has remained fairly constant over the past four years at 60.1 years overall.
- Female directors tend to be younger on average than their male counterparts: the average age for female directors is 57.1 years vs 61.5 for male directors.
- The age range across ASX listed company boards was similar across the board at between 19-20 years.

Tenure/board independence

- Overall, the report found that the highest concentration of independent directors is in larger companies (though the overall concentration is fairly high across the board).
- Consistent with the previous report, most (45.4%) of ASX 300 directors have been on the board for four years (or less).
- Interestingly, the statistics appear to show that a number of directors in the 5-9 year tenure range in 2020 have stayed on in 2021, pushing up the proportion of directors now in the 10-14 year tenure range considerably: According to the report: 19.8% have been on the board 5-9 years (down from 36.9% in 2020) and 31.9% have been on the board 10-14 years (up from 11.5% in 2020).
- The proportion of directors who have been on the board more than 15 years decreased on last year: According to the report, 1.7% have been on the board 15-19 years (down from 3.3% in 2020) and 1.2% have been on the board for 20 years of more (down from 2.3% in 2020)

Looking at Chair tenure:

- Most Chairs (42.6%) have held their role for between 5-9 years and 29.9% of Chairs have held their role for four years or less.
- The proportion of Chairs who maintain their position past the 9 year point is significantly lower. Based on current trends, the report predicts that directors who have been on the boards for more than 15 years will soon become 'an endangered species'.
  - 16.3% of Chairs have held their role for 10-14 years.
  - 11.2% have held their role for 14 or more years (4.6% of Chairs have held their role for 14-19 years, 6.6% of Chairs have held their role for 20 or more years).

To put these figures into context, the report comments that overall, 65.2% of directors and 72.5% of chairs have tenures of less than 10 years, the point at which the ASX Corporate Governance Council considers that it is 'healthy to ask questions about the value of directors'. As such, the report opines that 'these seem reasonably healthy numbers on the face of it'.

[Sources: Governance Institute of Australia media release 03/08/2021; Full report: 2021 Board Diversity Index]

UK to introduce new minimum (non-mandatory) diversity 'benchmarks'? The FCA is seeking feedback on proposed changes to the Listing Rules

Key Takeouts

- The UK Financial Conduct Authority (FCA) is consulting on proposed changes to the Listing Rules, which if implemented in their current form, will mean in scope companies will need to disclose whether they have met minimum diversity benchmarks (on a comply or explain basis).
- The FCA emphasises that the proposed diversity targets 'are not mandatory for companies to meet, so the FCA is not setting "quotas", but providing a positive benchmark for issuers to report against'.
- Proposed diversity benchmarks include:
  - achieving 40% (or more) female board representation (including those self-identifying as women)
  - including at least one board member from a non-white ethnic minority background as designated by the office of national statistics
- The FCA proposes that the new requirements would apply to accounting periods starting on or after 1 January 2022.
- The changes proposed are similar to those put forward by the Nasdaq in the US context. The US Securities and Exchange Commission (SEC) is currently considering a proposal by the Nasdaq to adopt new Listing Rules which would (if implemented) introduce new diversity targets/disclosure requirements (SEC is due to make a decision on 8 August 2021).

Building on existing diversity initiatives, the Financial Conduct Authority (FCA) is consulting on proposed changes to its Listing Rules to enhance transparency for investors on the diversity of company boards and executive management and incentivise companies to prioritise the issue.

If implemented in their current form, the changes will mean that in scope companies will need to disclose annually (on a 'comply or explain' basis): a) whether they have met minimum diversity requirements; and b) standardised data on the composition of their board and most senior level of executive management by gender and ethnic background.

Which companies would be in scope?

- It's proposed that these changes will apply to UK and overseas companies with equity shares, or equity shares represented by certificates (including global depositary receipts), admitted to either the premium or standard listing segments of the FCA's Official List in the UK or considering admission to such listings.
- It's proposed that: open-ended investment companies and 'shell companies' as defined in LR5.6.5AR; issuers of debt securities, securitised derivatives or miscellaneous securities will be excluded from the new requirements.

Proposed timeline?

- The due date for submissions to the consultation is 20 October 2021.
- The FCA plans to make the relevant rules by 'late 2021'.
- It's proposed that the new Listing Rule requirements will apply to accounting periods starting on or after 1 January 2022.

Details

New minimum (non-mandatory) diversity targets

- Under the proposed changes, companies would need to publish an annual 'comply or explain statement' in their annual financial reports. This statement would confirm whether they have achieved the following minimum diversity targets for gender and ethnic minority representation on their board as at a specific date within the accounting period selected by the listed company (the 'reference date').
  - 40% (or more) female board representation (including those self-identifying as women)
  - One (or more) senior board positions (Chair, CEO, CFO or Senior Independent Director (SID)) held by a woman (including individuals who self-identify as a woman)
  - One (or more board) members from a non-white ethnic minority background as designated by the office of national statistics

- In cases where in scope companies have not met 100% of these minimum targets, it's proposed that they would disclose which targets have not been met and why they have not been met.
- In addition, it's proposed that the 'comply or explain' statement would detail any changes to the board that have occurred between the reference date and the date on which the annual financial report is approved, that materially affected the company's ability to meet one or more of the targets.
- The FCA makes clear that 'the Listing Rule diversity targets are not mandatory for companies to meet, so the FCA is not setting 'quotas', but rather 'providing a positive benchmark for issuers to report against'.

Standardised data on the gender/ethnic diversity of leadership within the company

The FCA is also proposing that the 'comply and explain' statement would include certain standardised numerical information on the gender/ethnic diversity of the company's board, senior board positions (Chair, CEO, Senior Independent Director (SID) and CFO) and most senior level of executive management in a table. The specifics of this are included in Annex 2 at p29 of the consultation paper.

FCA guidance

The FCA also proposes to issue guidance to the effect that in-scope companies may, in addition to the new disclosure requirements outlined above, opt to consider including the following additional information in their financial reports to provide further context.

- A brief summary of any key policies, procedures and processes, and any wider context, that the company considers contributes to improving the diversity of its board and executive management.
- Any mitigating factors or circumstances which make achieving diversity on its board more challenging (for example, the size of the board or the country where its main operations are located).
- Any risks it foresees in being able to meet or continue to meet the board diversity targets in the next accounting period, or any plans to improve the diversity of its board.

[Sources: FCA media release 28/07/2021; Consultation; Full text consultation paper: CP21/24: Diversity and inclusion on company boards and executive committees]

Successful corporate-led change? A new study from the University of QLD examines why Australia is one of only three countries that has been successful in reaching 30% female board representation without the use of legislated quotas

Key Takeouts

- Despite the relative success of the approach towards increasing board diversity to date, the report includes seven recommendations to sustain and build on the gains achieved.
- Recommended changes include the adoption of a 40% female board representation target and a rethink/refocusing of board skills matrices

- Research from the University of Queensland has examined the drivers behind Australia's success in achieving 30% female board representation (in aggregate) across ASX 200 boards after a long period of no progress prior to 2009 and in the absence of either an overarching or coordinating body driving progress and or legislated board quotas.
- The report identifies a range of direct and indirect influencers that enabled the 30% milestone to be met
  - Direct influencers include: The ASX Corporate Governance Recommendations; the Australian Institute of Company Directors (AICD) (in particular, the AICD Chair mentoring program); the work of the 30% Club Australia; and Investor groups.
  - Indirect influencers include: advocacy bodies; the media; academic and professional reports/data; and government departments .
- How was change achieved? Broadly, the report identifies four strategies that the interviews for the report identified as key to enabling the change. These are as follows:

- an informal 'mosaic' of individuals/groups/organisations each working towards achieving gender equality were able to leverage each other's work to drive progress (often without formal consultation with each other, except in later years)
- 'significant figures' (eg ASX 50 Chairs and government figures) and organisations used their influence to champion change/drive progress
- individuals also acted to support/sponsor 'high-potential women'
- companies that failed to progress on gender equality received a negative reaction from stakeholders (including investors)

- A key message in the report is that barriers to progress persist and continued efforts are needed to sustain and build on the progress that has been achieved to date.

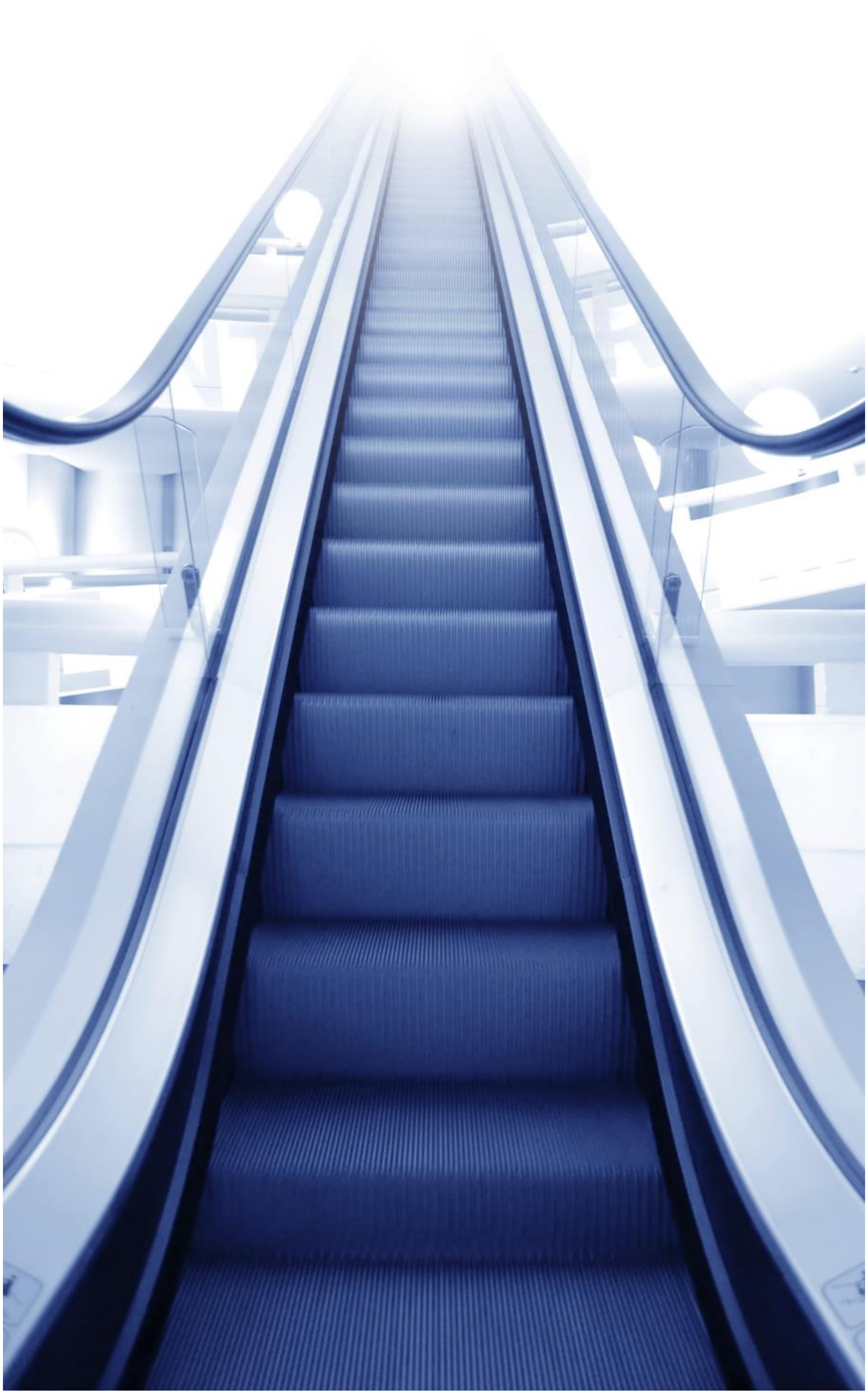
Seven recommendations to build on the successes to date

The report makes seven recommendations to sustain and build on the success achieved. These are as follows.

- Formalise the informal alliance or 'mosaic' of influencers: Recommendation 1 of the report is that the institutions identified as direct and indirect influencers of the change, formalise their alliance. It's envisaged that this alliance would then focus on increasing the pipeline of women in line for executive and board roles by identifying and addressing the systemic barriers to their progression. The report further recommends that the alliance should work collaboratively to implement and support the remaining recommendations in the report.

- 40% female board representation target: Recommendation 2 of the report recommends that the formal alliance of influencers adopt 40:40:20 target (ie 40% men, 40% women and 20% open) for board gender parity and that the ASX Corporate Governance Council should consider this in any future revisions of the ASX Corporate Governance Recommendations and Principles.

- Media strategy to support continued focus/progress: Recommendation 3 of the report recommends that the formal alliance agree upon a media strategy to promote board gender parity. It's envisaged that this strategy would specifically focus on 'calling out' individual



reporters/media outlets who 'use gender stereotypes or matters unrelated to professional standards in reporting upon women in executive or board roles'. The report also recommends that a database of female experts should be established for the media to draw upon for comment.

- Mentoring/board readiness programs: Recommendation 4 recommends that existing mentoring and 'board readiness' programs for women should be prioritised as a key mechanism for increasing the proportion of female ASX 300 directors 'and beyond'. The report makes clear that ASX200 chairs 'should play a more prominent role in this mentoring program'.
- Data driven approach: Recommendation 5 recommends that 'existing series and statistical data should be maintained and refined to identify progress towards 40/40/20 and other areas for attention and change. Likewise, organisations that have failed to move towards market expectations should continue to be targeted through media releases and investor action'.
- Rethink board skills matrices: Recommendation 6 recommends that 'the current conceptualisations of the board skills matrices be reviewed in conjunction with ASX200 board chairs, ASIC and the ASX to identify whether they are aligned to the governance requirements of the present and near future economy and market expectations'. The report suggests that a 'mini summit' could be an effective way of bringing these groups together.
- Refocus and refine recruitment: Recommendation 7 recommends that 'representatives of all executive recruiting firms in each capital city, promoters/underwriters of IPOs and a body representing ASX300 chairs come together to reach a consensus on strategies for defining board role briefs and the depth and breadth of the pool of women candidates'.

[Sources: AICD media release 30/07/2021; UQ media release 30/07/2021; Full text report: Towards Board Gender Parity, Lessons from the Past – Directions for the Future]

Shareholder Activism

Push for board change at Myer: Premier calls for the AGM to be delayed

Myer's largest shareholder Premier Investments (Premier) has announced that it has requested that Myer delay its 2021 AGM to enable prospective (and unnamed) Premier board candidates to review the company's full year FY21 results (which have historically been released in early September) before confirming their commitment to join the board.

Premier argues that delaying the AGM as requested would avoid the need for an 'unnecessary, distracting and expensive EGM [extraordinary general meeting]'. This follows Premier's previous announcement of plans to call an EGM to elect a 'majority independent Myer Board with the necessary skills and experience.'

Premier states that

> 'If Myer does not agree to this simple proposal, Premier will have no alternative but to requisition an EGM in close proximity to the Company's AGM'.

Chair of Premier Investments Solomon Lew commented,

> 'The Myer Board have stated that they are committed to working constructively with Premier as its largest shareholder, and our proposal is a constructive and pragmatic way of resolving the composition of the new Myer Board which is demonstrably in the best interests of all shareholders. The Myer Board has the capacity to make a common-sense decision which will avoid a costly EGM and ensure a smooth transition'.

On the issue of the release of the Myer's FY21 results, Mr Lew said,

> 'Since Myer's March 2021 release, Australian retailers have had to deal with continuous temporary closures in response to COVID19 outbreaks across all major cities, constant changes in Australian consumer confidence and the continued fluctuation of shopping activity in Australia's CBD stores where Myer has a very significant portion of its major stores. Given the level of uncertainty and the large loss incurred last year by Myer (a Net Loss After Tax of $172 million), Premier is requesting that Myer immediately update the market on its expected FY21 results.'
>
> [Source: Premier Investments media release 03/08/2021]

Disclosure and Reporting

Mandatory climate risk disclosure rule proposal by the end of the year: SEC Chair says improving transparency, quality and comparability of information is key to SEC's mission

Key Takeouts

- Chair of the US Securities and Exchange Commission (SEC) Gary Gensler said SEC staff have been asked to develop a mandatory climate risk disclosure rule proposal by the end of the year
- Mr Gensler considers the introduction of a mandatory rule to be important in ensuring access to consistent and comparable information
- On the possible content of future disclosures, Mr Gensler said that staff have been asked to consider a variety of qualitative and quantitative measures including the possible inclusion of disclosure of scope 3 emissions
- On the issue of greenwashing, Mr Gensler commented that where funds labelled themselves as 'green' investors should be able to 'drill down to see what's under the hood'. Accordingly, SEC staff have been directed to consider recommendations about 'whether fund managers should disclose the criteria and underlying data they use'.

US Securities and Exchange Commission Chair Gary Gensler has given a speech discussing SEC's work on developing a new mandatory climate risk disclosure rule and the regulators' work to address greenwashing.

Mr Gensler made clear that he considered this work to be key to SEC's 'mission'.

> 'I think updates to public company disclosures and to fund disclosures could bring needed transparency to our capital markets. This gets to the heart of the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. When it comes to disclosure, investors have told us what they want. It's now time for the Commission to take the baton'.

Details

- **High demand for climate disclosure:** Mr Gensler said that it is clear that demand for increased transparency around how companies are identifying and managing climate risk is extremely high and that he considers 'companies and investors alike would benefit from clear rules of the road'. Accordingly he has directed SEC staff to develop a mandatory climate risk disclosure rule for the Commission's consideration by the end of the year.
- **What might such disclosures look like?** Mr Gensler spoke briefly about the considerations being taken into account by SEC staff in the context of developing the proposed new rule. He said that improving the consistency and comparability of information and ensuring the information provided is 'decision useful' for investors (ie that information is sufficiently detailed to be helpful in making investment decisions, as opposed to generic information) would be key considerations. To this end, he said that SEC staff have been asked to consider a variety of qualitative and quantitative information about climate risk that investors 'either currently rely on, or believe would help them make investment decisions going forward'. This information includes:
  - qualitative disclosures around how the company's leadership manages climate-related risks and opportunities and how these factors feed into the company's strategy.
  - quantitative disclosures such as disclosure of Scope 1 and 2 (and possibly) Scope 3 emissions;
  - specific metrics for specific industries, such as banking, insurance, or transportation; and
  - scenario analyses on how a business might adapt to the physical risks associated with climate change and transition risks associated with companies' stated commitments (eg net zero commitments).
- **TCFD framework?** Commenting briefly on the TCFD framework and the role that it might/might not play in this context, Mr Gensler said that he has asked SEC staff to 'learn from and be inspired by' the TCFD framework and other external standard setters'. He made clear however that he considers that the SEC 'should move forward to write rules and establish the appropriate climate risk disclosure regime for our markets, as we have in prior generations for other disclosure regimes'.
- **Location of reporting:** SEC staff have been asked to consider whether these disclosures should be filed in the Form 10-K, living alongside other information that investors use to make investment decisions.

Greenwashing: 'the basic idea is truth in advertising'

- Mr Gensler said that SEC has observed that a 'growing number' of funds market themselves as 'green' with little information to back the claim and/or little transparency around the rationale behind it. In his view, 'investors should be able to drill down to see what's under the hood of these funds'.
- Accordingly, he said that SEC staff have been asked to 'consider recommendations about whether fund managers should disclose the criteria underlying the data they use' and to 'consider whether we might take a holistic look at the Names Rule'.

  [Source: SEC Chair Gary Gensler, Prepared Remarks Before the Principles for Responsible Investment, Climate and Global Financial Markets' Webinar 28/07/2021]

Analysis of ESG reporting in ASX 200 companies finds there is significant room for improvement

Ethical Partners Funds Management has released a report analysing trends in ESG disclosure in a sample of 216 ASX 200 companies. The headline finding is that despite the fact that there has been an increase in reporting, the quality of reporting is lacking. This is flagged in the report as an area on which Ethical Partners will continue to engage on with companies.

Key Takeaways

Emissions disclosure

- Less than half (48%) of companies in the sample have set emissions targets (up from 12% in 2019).
- 29% of the 216 ASX companies analysed have made a commitment of Net Zero by 2050.
- Though most (63%) of companies clearly disclosed emissions data, 37% of companies sampled do not do so.

Biodiversity

- 50% of the 216 ASX companies analysed do not address their impact on biodiversity.
- Of the 50% that do acknowledge biodiversity as a risk, only 14% were assessed as doing so beyond 'a basic acknowledgment of the issue'.

TCFD-aligned disclosure

- 55% of companies in the sample have not yet reported against the TCFD.
- A further 13% were assessed as being 'on their way to full TCFD reporting' or reporting 'somewhat in line with the TCFD criteria'.
- 32% of the companies in the sample were assessed as reporting fully against the TCFD framework

Almost a quarter of companies sampled provided zero sustainability disclosure

- 21% of the companies analysed provided no disclosure on their ESG impact, ESG risks or opportunities. For context, this was an improvement on 2019 when this figure was 40%.
- Of the 79% of companies that did provide some level of disclosure, the report found that the quality was often lacking. In particular, the report highlights the need for companies to move 'beyond quantity of reporting to quality of reporting, from policies and program to evidence of practice and from greenwashing to meaningful action against global challenges'.

Sustainability Development Goals (SDGs)

- 49% of companies of the companies in the sample referred to the SDGs in their reporting (up from 21% in 2019)
- Importantly, 44% of companies were assessed as taking a superficial or 'tick box approach' that did not clearly link their operational goals, strategy and targets with the SDGs. Only 5% of companies were assessed as having fully integrated the SDGs into their strategy and reporting.

Use of E and S metrics in remuneration plans

- Interestingly, the report found that integration of 'meaningful' environmental and social metrics into executive pay is still not widespread (only 18% of companies in the sample were assessed as including meaningful environmental and social metrics in their executive remuneration plans).

Diversity metrics

- 93% of the companies analysed disclosed gender metrics and/or disclosed gender targets
- Less than half (45%) of the companies analysed provided any disclosure on racial diversity – either metrics or policies.
- Only 9% of companies disclosed implementing disability inclusion practices or policies.

[Sources: Ethical Partners media release 29/07/2021; Full text report: 2021 Ethical Standards Report, Transparency and Disclosure in the Australian Company Landscape]

In Brief | Tougher targets needed: In response to the increasing urgency for climate action, the Science Based Targets Initiative has launched a new strategy to aimed at pushing companies to urgently scale-up their emissions reduction targets from aiming for 'well below 2°C' to '1.5°C' above pre-industrial levels

[Source: UN Global compact media release 15/06/2021]

Institutional Shareholders and Stewardship

Integrating ESG considerations into investment processes does not impair returns or add to costs? Report confirms PRI signatories outperform non-signatories

CEM Benchmarking has released a report analysing the cost and performance differences between funds that are signatories to the Principles of Responsible Investment (PRI) and those that are not. The report is based on analysis of publicly available information over the five year period to 2018.

Key Takeaways

The headline finding in the report is that rather than impairing performance or increasing costs, funds that are PRI signatories outperformed other funds (on average) over the period.

Looking more closely:

- The report found no evidence that being a PRI signatory (and therefore integrating ESG factors into the investment process) impaired performance across global investors in any year.
  - PRI signatories had a higher five year average net return in the USA, the UK and Canada than non-signatories.
  - The exception was the Netherlands, where PRI signatories delivered lower returns. However, the report attributes this to the fact that in the Netherlands, non-PRI signatories 'had larger fixed income allocations focused on immunising their liabilities'.
- PRI signatories had higher average total fund net value added than non-signatories: 0.53% for PRI signatories versus 0.01% for non-signatories (net value added is the component of total return from active management (net return minus policy return)).
- PRI signatories were lower cost than non-PRI signatories.

[Source: CEM Benchmarking report: Responsible Investing: The Cost and Performance Differences Between PRI Signatories and Non-PRI Signatories]

Say on climate developments: A global coalition of investors has demanded that companies institute stronger corporate governance mechanisms to ensure accountability for meeting their net zero commitments ahead of the 2022 AGM season

Through the Institutional Investors Group on Climate Change (IIGCC), 53 global investors managing more than $14 trillion in assets, have called on companies to institute new accountability mechanisms, including an annual 'say on climate vote', to ensure they can be held to account for meeting their 'net zero' commitments.

Specifically investors are calling on companies to:

- **Disclose a net zero transition plan:** this is expected to be provided 'within overarching Taskforce on Climate Related Financial Disclosures (TCFD) climate reporting and use the recent Climate Action 100+ Net-Zero Company Benchmark indicators as core metrics to demonstrate progress towards net zero alignment'.
- **Identify the director responsible for the plan:** This measure is intended to enable investors to identify which directors (in addition to the Chair should be engaged with and 'potentially (and as a last resort) voted against where a plan is not provided/implementation is insufficient.
- **Institute an annual (advisory) 'say on climate' vote.**

The statement acknowledges the 'critical role that proxy advisors and data providers will play in assessing the quality of net zero transition plans and the progress of their implementation to-date' and states that signatories will work with data providers/proxy advisers to ensure that 'effective systems are in place and that such assessments can inform voting for the most critical companies in the investment universe'.

Companies are expected to act ahead of the 2022 AGM season

- Investors involved in European investor engagement through Climate Action 100+ will be 'putting the expectations into practice through related company engagements'. Ahead of the 2022 AGM season, companies will be asked to demonstrate their alignment with the corporate governance expectations above.
- The measures outlined above have already been implemented by a number of companies: The IIGCC observes that as a result of investor engagement by IIGCC members, a number of companies including (among others) Shell, Unilever, Nestle, Glencore, Iberdrola and TotalEnergies have already implemented these measures which are intended to 'secure a step change in corporate governance on climate risk' and to complement/strengthen the existing 'say on climate initiative'.

[Source: IIGCC media release 30/07/2021]

Fidelity signals its intention to take a firmer line on diversity and climate risk

Global asset manager Fidelity International has launched new Sustainable Voting Principles and Guidelines which include new policies on climate change and gender diversity.

Details

Climate risk: Fidelity expects all companies to meet certain minimum expectations around the management of climate risk. From 2022, Fidelity will vote against the management of companies that fail to:

- Take 'action to manage' climate change impacts and reduce their greenhouse gas (GHG) emissions in line with limiting global warming to no more than 1.5 degrees. This includes having a strategy to reduce scope 3 emissions and using scenario planning (including multiple scenarios).
- Make 'specific and appropriate disclosures around emissions, targets, risk management and oversight'. This includes setting and reporting on 'ambitious targets aligned to the UN's Paris Agreement on Climate Change including an approach to net zero'.

Board gender diversity: Fidelity has also signalled that board gender diversity will be a particular area of focus in engagement discussions with companies.

- Fidelity states that in developed markets (including the UK, European Union, USA and Australia) it will 'consider voting against' company management where the board does not have 30% or more female directors.
- In markets were 'standards on diversity are still developing' it expects boards to have 15% female board representation.

Fidelity will consider voting against boards where minimum diversity, environmental and/or social expectations are not met.

[Source: Fidelity International media release 26/07/2021]

Regulators

ASIC enforcement: ASIC Chair Joe Longo says the regulator is not under any pressure to take a more 'business friendly' line

Australian Securities and Investments Commission (ASIC) Chair Joe Longo has given his first interview as the new head of the regulator.

Questions to Mr Longo covered a range of topics including among other things, ASIC's stance on enforcement and whether the regulator is under pressure to be more 'business friendly' in its approach. Mr Longo strongly denied that there was any such pressure on the regulator and emphasised that he intends that ASIC will continue to be an 'active, credible law enforcement agency'.

Commenting on ASIC's overall approach to enforcement, Mr Longo rejected any characterisation of the regulator as a soft touch. He stated:

> 'It's true that, coming out of the Royal Commission, enforceable undertakings got a bad rap. But the fact of the matter is you can't litigate everything. ASIC has always been an active litigator…I'm absolutely committed to ASIC remaining an active, credible law enforcement agency. No one should be under any doubt that we will not continue to litigate'.

Asked to comment on the regulator's immediate priorities, Mr Longo said that AISC is primarily focused on supporting business and consumers through the pandemic while at the same time, addressing urgent issues eg scams impacting vulnerable consumers.

Asked to comment on whether ASIC expects an uptick in insolvencies in light of the Sydney lockdown and other recent lockdowns, Mr Longo said that as yet no significant increase has materialised, though this could change.

> 'As things stand, we're now 18 months into this pandemic and we have not seen a material uptick in insolvencies even now – they're at historic lows…The Australian economy has been remarkably resilient. Whether that will continue in the coming months, obviously lockdown in NSW is of great concern to everyone, but as things stand, we're not seeing a dramatic increase in insolvencies; we'll have to see whether that continues.'
>
> [Source: ABC RN Breakfast 29/07/2021]

Increased regulatory oversight of ESG rating and data providers? IOSCO seeks feedback on proposals in light of the potential risks

As part of its broader sustainability focussed work program, the Board of the International Organization of Securities Commissions (IOSCO) has issued a consultation paper seeking feedback on proposals aimed at mitigating the risks stemming from the activities/products offered by ESG rating and data providers.

IOSCO comments that:

> 'Given that the activities of ESG ratings and data products providers are not generally subject to regulatory oversight at the moment, increasing reliance on these services raises concerns about the potential risks they pose to investor protection, the transparency and efficiency of markets, risk pricing, and capital allocation. In addition, the lack of standards in this area may present the risk of greenwashing or misallocation of assets and could lead to a lack of trust in ESG ratings or in the data products' robustness or relevance'.

Based on an initial 'fact finding' exercise, IOSCO proposes and seeks further feedback on several recommendations intended to mitigate key risks. These include the following.

- **Increased regulatory oversight:** IOSCO suggests that regulators may wish to consider increasing their oversight of ESG ratings and data providers (eg by increasing their oversight of providers corporate governance organisational and operational structures from a conflicts management perspective) (recommendation 1).
- **Increased transparency around the methodology used/information on which ratings are based:**
  - IOSCO suggests that ESG ratings and data products providers 'could consider issuing high quality ESG ratings and data products based on publicly disclosed data sources where possible and other information sources where necessary, using transparent and defined methodologies' (recommendation 2).

  - Recommendation 5 suggests that ESG ratings and data products providers could 'consider making high levels of public disclosure and transparency an objective in their ESG ratings and data products, including their methodologies and processes'.

- Independence/avoiding conflicts of interest:
  - Recommendation 3 suggests that ESG ratings and data products providers could consider taking steps to ensure that their decisions are 'independent and free from political or economic pressures and from conflicts of interest'.
  - Recommendation 4 suggests that ESG ratings and data products providers could consider taking steps (on a best efforts basis) to avoid activities/procedures/relationships that 'may compromise or appear to compromise the independence and objectivity of the ESG rating and ESG data products provider's operations or identifying, managing and mitigating the activities that may lead to those compromises'.

- Addressing 'shortcomings in market conduct':
  - Recommendation 6 suggests that ESG ratings and data products providers 'could consider maintaining in confidence all non-public information communicated to them by any company, or its agents, related to their ESG ratings and data products, in a manner appropriate in the circumstances'.
  - Recommendation 8 suggests that ESG ratings and data products providers could consider 'improving information gathering processes with entities covered by their products in a manner that is efficient and leads to more effective outcomes for both the providers and these entities'.
  - Recommendation 9 suggests that ESG ratings and data products providers could 'consider responding to and addressing issues flagged by entities covered by their ESG ratings and data products while maintaining the objectivity of these products'.

- Making it easier for data product providers/ESG ratings providers to find relevant information and have queries answered:
  - IOSCO further suggests (recommendation 10) that entities that are subject to assessment by ESG ratings and data products providers may wish to consider 'streamlining their disclosure processes for sustainability related information to the extent possible, bearing in mind regulatory and other legal requirements in their jurisdictions'. IOSCO suggests that this could include creating a 'dedicated section' on their website with links to all sustainability related publications published by the entity; the dates of the relevant publications and timelines for when they are planned to be updated/reviews. It's also suggested that entities could designate an internal point of contact to address any requests from ESG ratings/data product providers.

    [Source: IOSCO media release 26/07/2021]

In Brief | ASIC has released its latest quarterly update covering the period 1 April to 30 June 2021. The update highlights among other things, ASIC's focus on monitoring/adjusting regulatory actions to support business 'withstand and recover' from the impacts of COVID-19. The update reiterates that ASIC intends to continue to monitor 'how market conditions and COVID-19–related developments affect financial reporting, audit and AGM obligations'

[Source: ASIC media release 03/08/2021; ASIC report 697 ASIC quarterly update: April to June 2021]

Financial Services

Lifting data capability is key: ASIC's has released its follow up review of industry's actions to address consumer harm in the context of TPD insurance

Overview | ASIC report 696: TPD Insurance: Progress made but gaps remain

Key Takeouts

- The need for insurers to lift their data capability – the way in which they collect, utilise and store their data - is overall, the key area for improvement identified in the report and the 'key message' from the regulator in terms of the steps it expects insurers (and trustees) to take to lift standards.
- Trustees are also expected to enhance their data capability for insurance in superannuation and to work with insurers
- The report flags that some insurers have identified 'challenges' in collecting relevant data in the context of group policies. The report calls on all insurers and trustees to work together to address this issue in light of the fact that 'it is clear that data gaps that relate to group data held by trustees and intermediaries cannot be addressed without cooperation'.
- Claims handling is flagged as a focus for the regulator going forward.

The Australian Securities and Investments Commission's (ASIC's) 2019 review of total and permanent disability (TPD) insurance (REP 633) (summarised here) identified 'significant' industry-wide problems with the design of total and permanent disability (TPD) insurance and the claims handling process, and called on insurers and superannuation trustees to take 'urgent' action to lift standards.

Ahead of the commencement of new design and distribution obligations on 5 October 2021, ASIC has released a follow up report - Report 696 TPD Insurance: Progress made but gaps remain - analysing the progress that nine life insurers (including the seven reviewed in REP 633) have made and/or are planning to make, towards addressing the issues identified in the 2019 report.

Importantly, the focus of the follow up report is on insurers rather than on trustees, though the report does flag that ASIC intends to continue to engage with trustees on their progress towards better monitoring of member outcomes in insurance in superannuation

ASIC's headline message and the key theme running through the report is the need for insurers to lift their data capabilities which the regulator sees as key to enabling them to take a proactive approach to identifying trends and managing consumer harm, and to designing, marketing and distributing sustainable products.

A high level overview of the key findings in the report and ASIC's expectations going forward is below.

Progress since the 2019 report (but there is room for further improvement)

The report welcomes the progress that has been made by insurers on a number of key issues identified in the 2019 report (REP 633) but also identifies a number of areas where it considers that improvement is needed.

Pages 5-6 of the report provide a snapshot of the key report findings. Pages 7-8 of the report provide a summary of ASIC's expectations of both insurers and trustees.

Most insurers have completed internal reviews

The report found that eight of nine insurers reviewed have already completed their own reviews of the issues identified in REP 633, with the final insurer in the 'final stages' of doing so. A number of insurers have also committed to implementing future reviews on specific issues.

Progress has been made to address the harms caused by use of restrictive definitions

Starting to remove or revise restrictive definitions

- ASIC found that 100% of insurers have 'started discussions' with trustees about the use of restrictive definitions, with eight insurers having put forward options to change the Activities of Daily Living (ADL) definition in group policies.

- The report observes and welcomes the general shift towards the widening of eligibility criteria (and the shift away from using the ADL definition) which ASIC considers will result in fairer outcomes for consumers. The report also welcomes the move by some insurers towards including mental health criteria in TPD definitions, again on the basis that ASIC considers it will result in better consumer outcomes.
- In terms of concrete actions, the report gives a number of examples of changes to policies that have been implemented by trustees and insurers. These include (among other changes): removing the ADL definition and/or the minimum average hour requirement and amending the 'everyday work activities' (EWA) definition to increase the consecutive period of unemployment before the EWZ definition applies from six months to 16 months. On this point, ASIC encourages insurers and trustees to 'start improving TPD definitions as early as possible before renewing insurance arrangements, and consider mid-term amendments where possible'.

Monitoring/assessing the impact of the TPD definition

- ASIC comments that REP 633 called for insures to develop and collect sufficiently detailed data to enable assessment of the impact of 'each limb' of the TPD definition (eg the ADL definition) from a consumer value perspective. That is, to enable assessment of the value of products for consumers/cohorts of consumers.
- The report found that in response to this, six insurers have developed and implemented a range of measures to enable them to assess product value, the most commonly used measures being: customer experience, complaints, claims outcomes, claims loss ratios and lapse rates.
- However, the report flags that 'data gaps' (ie lack of sufficiently granular information) are currently limiting the effectiveness of these measures, an issue which ASIC notes 'most insurers' have committed to addressing.

Cooperation between trustees and insurers is needed to overcome challenges in data collection

- The report flags that some insurers have identified 'challenges' in collecting relevant data in the context of group policies. In particular, the report flags that most insurers have limited visibility of group claims before claims are lodged because the insurer does not receive claims information directly, but relies on trustees/fund members to pass on the information.

  Commenting briefly on its expectations of trustees in this context, the report observes that trustees are 'often better placed than insurers to collect member data, such as demographic and work characteristics, which are needed to evaluate the effects of eligibility criteria and the effect of restrictive definitions on different member cohorts'.

  The report calls on all insurers and trustees to work together to address this issue in light of the fact that 'it is clear that data gaps that relate to group data held by trustees and intermediaries cannot be addressed without cooperation'.
- Broadly ASIC's message to insurers is that they should 'consider removing' restrictive definitions from TPD policies or 'appropriately redesigning the product' to ensure compliance with new design and distribution obligations ie that products meet consumer needs and that they 'monitor the effects of any product changes on consumer outcomes and value to consumers'. ASIC also expects trustees to focus on lifting their data capabilities. ASIC has flagged that it will continue to work closely with APRA on the issue.

Some improvement in 'onerous' claims handling practices

- ASIC found that most insurers have 'enhanced their written and verbal communication practices with consumers', created new/improved staff guidelines to improve claims handover between claim managers; implemented and/or enhanced controls for requesting medical information/investigating suspected non-disclosure, and implemented changes to enable consumers to lodge claims in at least two ways of making a claim eg online, over the phone or by submitting paper documents.
- The report also welcomes the general shift away from the use of physical surveillance and the implementation of guidelines/protocols to ensure that where surveillance is used, it is used appropriately. On this point, ASIC flags that it is reviewing the use of physical surveillance and non-disclosure investigations in income protection claims, and states that it 'will act if we find evidence of practices in breach of the law including the duty of utmost good faith'.

The report flags that claims handling will be an area of focus for ASIC going forward

- The report states that ASIC will continue to analyse claims data to 'identify outliers or trends which indicate potential consumer harm, and will act if we see problems in claims data such as lengthy claims handling timeframes or high rates of claim-related disputes'. ASIC's expectation is that going forward, insurers will continue to 'identify and remove frictions in the claims handling process' and comply with new claims handling obligations that will come into effect from 1 January 2022.

- Commenting briefly on its expectations of trustees in this context, ASIC observes that trustees have an obligation to act efficiently, honestly and fairly when handling and settling insurance claims and 'need to do everything that is reasonable to pursue a member's insurance claim if the claim has a reasonable prospect of success'. ASIC comments that 'in light of these obligations, trustees should proactively address hurdles that members face when making a claim – trustees are better placed than insurers to see the members' entire journey from obtaining cover to claim decision'. ASIC flags that it intends 'use its enhanced regulatory oversight of consumer protection in superannuation to ensure trustees are meeting their obligations when handling members' insurance claims'.

Overall key improvement area – data capability

The need for insurers to lift their data capability – the way in which they collect, utilise and store their data - is overall, the key area for improvement identified in the report and the 'key message' from the regulator in terms of the steps it expects insurers (and trustees) to take to lift standards.

The report states:

> 'Insurers need to act on gaps identified by the findings of their reviews and continue to implement changes to drive better outcomes for consumers. Insurers need to uplift their data capability because poor data capability creates key conduct, compliance and governance risks, which can lead to financial risk.
>
> Trustees also need to enhance their data capability for insurance in superannuation. As noted in REP 675, trustees need to consider how they can collect and analyse data to monitor and review member outcomes across all forms of insurance they offer to their members. Trustees also need to consider trade-offs between the different value measures when designing insurance for their members. Trustees will need to work collaboratively with insurers to lift industry standards'.

Expectations of insurers

ASIC expects insurers to:

- continue to 'invest in systems to capture, store and retrieve data, especially in relation to key claim events (eg independent medical examinations (IMEs)) and policy-level data'. The report found that most data gaps identified by insurers relate to key claim events, and that 'this deficiency means insurers lack insight into key frictions within the claims handling process'.
- view data collection as a continuous improvement exercise and have in place a plan and timetable to strengthen their data capability. Insurers are expected to 'maintain searchable and reportable data to proactively identify trends and manage consumer harm'.
- 'use data to drive a consumer-centric approach to designing, marketing and distributing sustainable products. This aligns with APRA's expectations'.

APRA flags that it will:

> 'follow up' insures that 'failed to provide a level of confidence about their investment in data and systems' and work with APRA to refine its data collection on life insurance. This work will focus in particular on 'targeting standardised, granular information for early identification of trends and emerging risks'.

Expectations of trustees

Commenting on its expectation of trustees, ASIC states that

> 'Trustees also need to enhance their data capability for insurance in superannuation. As noted in REP 675, trustees need to consider how they can collect and analyse data to monitor and review member outcomes across all forms of insurance they offer to their members. Trustees also need to consider trade-offs between the different value measures when designing insurance for their members. Trustees will need to work collaboratively with insurers to lift industry standards'.

In particular, ASIC expects trustees (in line with the findings in REP 675) to:

- collect and analyse data to monitor and review outcomes to better meet their regulatory obligations, including to promote the best interests of their members. This includes analysing outcomes for members on the default insurance settings.

- consider embedding detailed data-sharing arrangements in service level agreements with insurers so they can access the data required to monitor member outcomes, and insurers can access data to manage consumer harm (e.g. pre-lodgement information on claims).

  [Source: ASIC media release 02/08/2021; REP 696 TPD insurance: Progress made but gaps remain]

Hayne reform: Committee paves the way for the passage of the Better Advice Bill

- The Financial Sector Reform (Hayne Royal Commission Response - Better Advice) Bill 2021 was introduced into the House of Representatives on 24 June 2021 and referred to the Senate Committee on Economics for report by 28 July 2021. You can find a brief summary of the Bill in Governance News 30/06/2021 at p15.
- Among other things, the Bill proposes to give effect to the government's response to Hayne recommendation 2.10 by: a) expanding the role of the Financial Services and Credit Panel (FSCP) within the Australian Securities and Investments Commission (ASIC) to operate as the single disciplinary body for financial advisers; b) introducing additional penalties/sanctions for financial advisers who have breached their obligations under the Corporations Act 2001 (Cth); and c) introducing a new two stage registration system for financial advisers.
- If the Bill is passed in its current form, the new disciplinary and registration systems for financial advisers will apply from 1 January 2022.
- Registration requirements:
  - Stage 1 registration would commence from1 January 2022 and require financial services licensees to make a one-off application to ASIC to register their financial advisers.
  - Stage 2 registration for individual advisers (which would require individuals to apply to the registrar to register themselves annually) would commence either on a day set by proclamation, or if no such proclamation is made within a specified period, four years after Assent.

Committee report

- **Recommendation that the Bill be passed:** The Senate economics legislation committee has issued a report recommending that the Bill be passed in its current form. In making the recommendation, the Committed noted the 'overall support' for the passage of the proposed reforms across the submission received, including support for the wind-up of the Financial Adviser Standards and Ethics Authority (FASEA).

  Labor senators also expressed support for the implementation of Hayne recommendation 2.10 (and by extension support for the Bill to be passed).

- **Recommendation that the government undertake a two year review:** The Committee acknowledged the 'substantive issues about potential cost impacts' on advisers that the reforms may have, and the potential impacts of this on access to financial advice.

  In response to these concerns, the Committee states that 'it is the responsibility of the regulator to look to reduce regulatory costs across the Financial Advice industry in this transition'.

  The Committee also recommended that the government 'conduct a review of the Financial Services and Credit Panel (FSCP) and its functions two years after the legislation comes into effect'.

- **Composition of the FSCP:** According to the Committee's report, the composition of the FSCP 'attracted a significant amount of comment, particularly with regard to the potential for conflict of interest and the mechanism employed to manage it'. According to the report, 'it was generally felt that FSCP members excusing themselves without replacement was not ideal, and that self-declaration of such a conflict lacked sufficient robustness'.

  In their comments Labor senators 'encourage[ed] the government to strongly consider the view of consumer advocates, and consider appointing representatives with appropriate consumer experience and sectoral knowledge to the Financial Services and Credit Panel'.

- **Lack of access to the regulations:** The Committee's report acknowledges that in the absence of the regulations 'even the regulators are currently unable to assess the full impact the legislation will have'. However, the Committee's view was that this should not be a barrier to the passage of the Bill given that 'the regulations will in due course be published and consulted on, and subject to parliamentary scrutiny, including disallowance.'

  In a dissenting report, Senator Rex Patrick expressed strong support for the 'goals' of the Bill, but stated that he is unable to support it as currently drafted, without seeing the detail of the Regulations to support its implementation.

He stated: 'This half-baked Bill is not fit to pass—as least not without seeing the proposed regulations that are to accompany it'. He recommended that the Bill not be put to a vote until the regulations have also been 'put before Parliament'.

[Source: Senate Economics Legislation Committee Report: Financial Sector Reform (Hayne Royal Commission Response—Better Advice) Bill 2021 [Provisions]]

Hayne financial advice case study: Federal Court finds that an AFSL holder did not have adequate supervision processes in place to ensure its authorised representative acted in accordance with best interests obligations

The Federal Court handed down its decision in Australian Securities and Investments Commission v RI Advice Group Pty Ltd (No 2) [2021] FCA 877 on 2 August 2021.

The case concerned matters that were the subject of a case study considered by the Hayne Commission (see: Interim Report at p202-205).

ASIC's case

- Broadly, ASIC's case was that RI Advice Group Pty Ltd (RI Advice) (an Australian Financial Services License holder) failed to properly supervise one of its authorised representatives, a (former) financial adviser.
- ASIC alleged that between 2013 and 2016, RI advice contravened s 961L of the Corporations Act 2001 (Cth) (the Act) by failing to take reasonable steps to ensure that its authorised representative (and financial adviser) complied with the Best Interests Obligations (ie ss 961B, 961G, 961H and 961J) under the Act.
- ASIC argued that RI Advice knew, or should have known, that there was substantial risk that the adviser in question was not complying with his Best Interests Obligations and was repeatedly bypassing compliance processes and recommending inappropriate products to retail clients. ASIC further alleged that RI Advice did not take reasonable steps in response to this. For example ASIC alleged that RI Advice did not have appropriate policies/processes in place to ensure that the adviser was competent, to monitor him 'adequately', or to escalate and address any compliance concerns appropriately/in a timely manner.
- ASIC also alleged that during the same period, RI Advice failed to do all things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly as required under s 912A(1)(a) of the Act.

Failure to have in place effective policies/processes to ensure compliance

The Court held that RI Advice failed to do all things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly as required under s 912A(1)(a) of the Act.

Importantly, the Court made clear that the mere fact that it was established that the adviser breached his Best Interests Obligations, was not sufficient in itself to establish that RI Advice failed to take reasonable steps to ensure he complied with these obligations. Rather, the Court held that:

> 'RI's compliance standards and other processes were not effective in relevant respects (for example, in ensuring that Mr Doyle provided all advice documents to pre-vetting while he was subject to the pre-vetting program) and therefore were deficient' [at 366]

Justice Moshinsky later observes that proactive steps to ensure compliance in this context may be required:

> 'The authorities indicate that s 961L may require a licensee to take steps to ensure representatives are competent, to monitor and supervise them (including in relation to advice processes, advice quality and conflicts of interest), to ensure compliance concerns are escalated, and to take action that is commensurate with the risks presented by such concerns' [at 396]

The Court also accepted ASIC's argument that RI Advice contravened s 961L of the Corporations Act, by failing to take reasonable steps to ensure that the adviser complied with the Best Interests Obligations under the Act. By extension, the Court held that RI Advice also contravened s 912A(1)(c) and (ca) of the Act.

The penalty hearing for RI Advice and the adviser has not yet been set. A case management hearing will be listed for a later date.

Commenting on the outcome, ASIC Deputy Chair Sarah Court emphasised the need for licensees to exercise effective oversight. Ms Court said:

> 'Financial advice licensees need to understand that they can be liable if their advisers do not act in the best interests of their clients and do not prioritise their clients' interests over their own. ASIC commenced this proceeding because of the harm caused to investors when advice is not appropriate. In some cases, Mr Doyle's clients were retired, or approaching retirement. Licensees need to have proper systems and processes in place to monitor the advice given by advisers to make sure consumers are protected.'
>
> [Sources: ASIC media release 02/08/2021; Australian Securities and Investments Commission v RI Advice Group Pty Ltd (No 2) [2021] FCA 877]

Independent review of the Banking Code Compliance Committee announced

The Banking Code Compliance Committee (BCCC) has announced that Phil Khoury has been appointed to lead an independent review of its performance and operations. The review will coincide with the review of the Banking Code of Practice.

> [Note: A review of the Banking Code was launched on 6 July 2021. The planned commencement date for the revised Code (including changes to the definition of small business) is the later of either six months after ASIC notifies its approval or 1 January 2023. The terms of reference for the review are here.]

Among other things, the BCCC review will consider:

- the powers and role of the BCCC and the extent to which it achieves its purpose of monitoring and driving best practice Code compliance
- the performance of the BCCC taking into account good practice standards, including ASIC Regulatory Guide 183: Approval of financial services sector codes of conduct that are relevant to the operation of the BCCC
- whether changes could make the BCCC more effective. For example, the review will consider and make recommendations about: a) whether the existing Charter is an appropriate governing document for the BCCC; b) what other powers and sanctions may be appropriate for the BCCC; and c) what actions the BCCC should take to improve the effectiveness of its monitoring program.

The full terms of reference are here.

Timing and next steps

- The review commenced on 8 July 2021. The due date for the final report is 30 November 2021. The BCCC expects to respond to the review by 31 March 2022.
- Mr Khoury expects to undertake a review of the BCCC processes and some 'targeted stakeholder consultation' before releasing a consultation paper in 'early September 2021'.

> [Source: BCCC media release 02/08/2021]

ASIC launches civil proceedings against two credit providers for failure to cooperate with AFCA

The Australian Securities and Investments Commission (ASIC) has commenced civil penalty proceedings in the Federal Court against two credit providers and Australian Credit Licence (ACL) holders - General Commercial Group Pty Ltd, formerly Urban Commercial Group Pty Ltd (Urban) and Eden Capital (Australia) Pty Ltd (Eden) – and against the two individuals who were the owners and operators of the firms, in connection with their (alleged) failure to cooperate with AFCA.

Broadly, ASIC alleges that during the relevant period, both credit providers repeatedly engaged in 'disruptive, aggressive and uncooperative behaviour toward AFCA, with the intent of disrupting AFCA's complaints handling and investigation processes and undermining the effectiveness, efficiency and fundamental principles of the AFCA Scheme'.

ASIC's case cites a number of examples of this alleged conduct including: threatening AFCA complainants with legal proceedings unless they withdrew their AFCA complaint, commencing proceedings against complainants because they lodged an AFCA complaint; failure to pay an AFCA determination; threatening to bring proceedings against AFCA staff members who were investigating complaints; commencing proceedings against an AFCA staff member; and failing to identify/locate/provide documents and information requested by AFCA for the purpose of resolving complaints.

ASIC alleges that this conduct was in contravention of their obligations to both:

- take reasonable steps to cooperate with Australian Financial Complaints Authority (AFCA) as required under the National Consumer Credit Protection Act 2009 (Cth) (NCCP Act); and
- do all things necessary to ensure that credit activities authorised under their ACLs were engaged in efficiently honestly and fairly as required under the NCCP Act

ASIC is seeking declarations of contraventions of the NCCP Act, pecuniary penalties and other orders to be made by the Federal Court.

[Source: ASIC media release 02/08/2021; Concise statement; Originating application]

The costs of Hayne implementation in the advice sector are too great? Parliamentary Committee hearing hears rising costs are unsustainable

The Standing Committee on Economics Review of Australia's four major banks and other financial institutions held its first public hearing focused on the financial advice and mortgage broking sectors on 29 July 2021.

In his introduction to the hearing, Committee Chair Tim Wilson said that in light of the issues identified by the Hayne Commission, the hearings are an important mechanism to hold industry publicly accountable for ensuring they 'make the crucial improvements needed to restore trust in our financial institutions' including through implementing relevant Hayne recommendations.

However, in practice questions from the Committee to the Association of Financial Advisers (AFA) were not focused primarily on Hayne implementation and the extent to which industry has assessed progress, but on the impact that recent regulatory reform has had on the sector including in particular, the drivers behind the rising costs of providing advice, the exit of advisers from the sector as well as new educational requirements.

An overview of some of the key takeaways from the AFA's appearance at the 29 July hearing is below.

Opening statement to the Committee

- In his opening statement, AFA National President Michael Nowak told the Committee that the 'barrage of reform' over the last decade, has meant that financial advice has become 'excessively complex', 'overregulated' and costly to provide, driving many advisers to exit the sector and putting affordable advice out of reach for many consumers.
- In essence, Mr Nowak said that the 'balance' between regulation and consumer protection had been lost and that this should be 're-established'.
- Mr Nowak also questioned the rationale behind applying certain Hayne reforms to financial advisers, arguing that the focus of the Hayne Commission was on the conduct of financial institutions rather than on small-business financial advisers who make up the majority of the sector and the 'vast majority of whom are doing the right thing'. Mr Nowak cited 2020 AFCA complaints statistics showing that complaints against financial advisers accounted for 1.4% of the total number of complaints received in support of this.
- Mr Nowak also observed that the Hayne Commission had 'never heard from nor commented on the majority of advisers, who are highly professional and ethical, nor their clients'.
- Mr Nowak expressed 'concerns' about the way in which the Hayne reforms 'have been driven through without adequate consideration of the consequences' and 'frequently without the obligatory impact statemen and the costs to industry having been assessed'.
- Summing up the impact of Hayne reforms on the advice sector, Mr Nowak said:

  'On behalf of all the financial advisers in Australia I can tell you that the impact of these reforms has been significant. Cost of service has risen, adviser numbers have dropped and the balance to achieve greater consumer protection has not been sufficiently weighed against the barriers these reforms have placed to people being able to obtain financial advice'.

Role of the AFA in educating/supporting implementation of the Hayne recommendations

Asked to comment on the role the AFA has played in educating/supporting financial advisers around the implementation of the Hayne recommendations, including benchmarking progress, the Committee heard that the AFA provides a weekly email update highlighting the changes to members, supplemented with a number of webinars to help advisers keep abreast of the many regulatory changes coming through. For example, the AFA had provided webinars around the new annual renewal requirement which commenced on 1 July 2021. The Committee heard that the AFA does not have in place benchmarks around implementation.

Affordability pressures – the drivers behind the rising costs of providing advice

A number of questions to the AFA concerned the rising costs for advisers in providing advice, including the ASIC industry levy and the costs flowing from increased regulation of the sector. Though the AFA had not quantified the costs flowing through from the increased regulatory burden (beyond the ASIC levy), it was emphasised that the costs on individual advisers is considerable.

On this point, Committee Chair Tim Wilson opined that:

> 'I think this [the declining affordability of financial advice] is one of the most distressing things that has happened as a consequence—not just the ASIC fee rise, but the front-load cost rise. If the only people who can afford financial advice are those who, frankly, are already established, the well-off and the rich, particularly the more we front-load the costs, then it's more likely that those who desperately need financial advice won't be able to get it, while the rich and the powerful will be able to get it, take advantage of it and further entrench their position'.

The AFA agreed with this sentiment, adding that additional reforms (for example the establishment of a single disciplinary body for advisers) would like add to the costs burden.

Mr Falinski invited the AFA to comment on the drivers behind the increasing cost of the ASIC levy. AFA Acting CEO Philip Anderson opined that the primary driver was the increased cost of Hayne court actions and litigation against large institutions, rather than being generated by any increased supervisory/enforcement costs arising from the activities of financial advisers.

Views on the value of increased automation?

Dr Leigh queried whether increased use of automation by advisers could help bring down the costs of providing advice.

Mr Anderson responded that ultimately automation even if it were used more widely would only solve part of the problem – it would reduce the time needed to generate a statement of advice. However, the key issue is that advisers would still be required to follow a one-size-fits-all onerous process in order to fulfil compliance obligations.

A need to rethink implementation of Hayne recommendations (in the advice sector)?

In light of the increased regulatory pressure and increasing costs of providing advice Mr Falinski opined that:

> 'it is clear that this committee should recommend to the Parliament that many of the remaining Hayne royal commission recommendations will do nothing more than harm and damage to ordinary Australian consumers.'

Committee Chair Tim Wilson agreed that this should be noted as Mr Falinski's position, adding that it 'may be the position of the committee. I somehow suspect there will be a debate about that…'

Continued use of Commissions?

Asked to comment on the appropriateness of the continued use of commissions in life insurance, Mr Anderson responded that the majority of clients prefer commissions, over paying an upfront fee.

> 'If they pay by commissions the cost plays out over a number of years. If they pay a fee they have to pay it all up-front as well as paying the premium. Where advisers run businesses where they give clients the choice - you can pay a fee up-front or you can pay via commissions - and the products allow for the commission to be taken out so it's effectively rebated, universally clients are choosing to pay by commission. The research that has been done quite broadly is saying that the vast majority of life insurance clients are not prepared to pay a fee, or if they are prepared to pay a fee it goes nowhere near the cost of providing advice'…

AFA National Vice President Stephen Perera added that increasingly advisers are giving clients the option to pay a fee, and the option is not being taken up. He expressed the hope that consideration would be given to allowing the commissions to continue, stating:

> 'It is not a perfect system and we are not suggesting that. But as your colleague, the shadow minister Stephen Jones, has pointed out, the mortgage brokers have been able to make a case for commissions and he is open for the life insurance sector to prosecute that case as well, so we are hoping for that opportunity'.

FASEA education requirements for financial advisers

Asked to comment on whether the AFA has a position on FASEA education requirements for advisers Mr Anderson said that while supportive of increased educational requirements, the AFA remains concerned that the current arrangements do not adequately recognise the experience and previous study of existing advisers.

[Source: Transcript: House of Representatives Standing Committee on Economics Inquiry into Australia's Four Major Banks and Other Financial Institutions: Financial Advice public hearing 29/07/2021]

Life Commissions may still have a role to play? Committee hears advice clients prefer commissions to paying upfront fees

The Standing Committee on Economics Review of Australia's four major banks and other financial institutions held its first public hearing focused on the financial advice and mortgage broking sectors on 29 July 2021.

Questions to the Financial Planning Association of Australia (FPAA) picked up on many of the same themes as those put to the AFA discussed separately above) and the responses were also broadly similar.

In particular, the Committee heard that the costs of providing advice, including as a result of increased regulation and the ASIC industry levy, have very substantially increased for advisers and the FPAA expressed the hope that the design of the levy would be reviewed.

FPAA CEO Mr De Gori stated,

> 'It's not only a declining number of advisers in the marketplace; there are activities that we're aware ASIC undertakes that have nothing to do with financial advisers, yet they're placing that cost in the financial adviser levy bucket'.

Use of technology to bring down the costs of advice/streamline processes

A number of questions to the FPAA concerned the complexity meeting compliance requirements from an adviser perspective, including the time required to generate a 'brick of paper' in order to provide a compliant statement of advice to a client.

The Committee heard that the FPAA is working with ASIC 'to create a digital SOA [statement of advice] that would effectively have no paper involved at all, which will much better address the cost and the time to produce the SOA and what the client actually receives and delivers'.

Position on commissions

In his opening statement, FPAA CEO Dante De Gori noted that the FPAA banned commissions from its members in 2009, and was the only professional body or association to call an end to grandfathering commissions during the Commission.

Dr Leigh asked whether the FPAA would also support an 'end to commissions in life insurance on the basis that they're really akin to the other form of conflicted remuneration that the Hayne Royal Commission ruled out?'

Mr De Gori responded that the FPAA is advocating for a review to take place.

> 'We have been very clear in our position here to say that one of the things that we want to ensure is that consumers just have choice about how they want to pay for advice services, and at this point in time we believe that commissions in life insurance still have a place or role to play. We also want to wait and see until the review is conducted over the next 12 or 18 months'.

Simplification of financial products

Dr Leigh asked a number of questions, prompted by discussions with consumer advocates, around the FPAA's view on the value of simplifying financial products with a view to ensuring consumers 'don't fall into traps of investing in overly sophisticated financial deals which see them losing their homes'.

Mr De Gori said that the FPA would support this.

> 'The FPA would very much support moves to try to simplify and make things a lot less complicated. It's not just the Australian public…I think the moves towards streamlining or rationalising products, and also removing these gimmicky types of products in the marketplace that really do nothing but harm both consumers and the public at large, are a welcome announcement. Financial planners aren't scared of not having product. Let me be very clear here: even though the legislation itself is about licence to give financial product advice, that's 20-plus-year-old rhetoric. In today's world, our members want to give financial advice, which may or may not include recommending financial products. Therefore, simplification of products would be a welcome sight with respect to ensuring that there is reduced complexity in the marketplace for the Australian public and for our members'.

Lack of gender diversity in the advice sector

Asked to comment on the reasons behind the lack of diversity within the advice sector and the steps being implemented by the FPAA to address this, Mr De Gori said that currently 27% of FPAA members are female and the FPAA is hoping to increase it to 50%. To drive progress, the FPAA has a number of measures in place including mentorship programs. The FPA has also received a $1.5 million grant to deliver scholarships to women in finance over the next two years which is expected to benefit 'hundreds of women'.

Position on FASEA education requirements

Asked to comment on the FPAA's position on FASEA education requirements, and whether there is a need to review them/and possibly consider introducing grandfathering arrangements, Mr De Gori said that the FPAA had put forward options when the requirements were initially established around how best to give recognition to prior experience, including giving recognition to continual professional development (CPD).

However Mr De Gori stopped short of calling for a reassessment of existing obligations.

> 'Obviously, this has been in place for some time now and we haven't had any opportunity to again engage in this. Advisers have now well and truly started the process, but we would welcome the opportunity, if there were an opportunity, to look at that going forward. But I would say this: I think we have to be very careful to ensure that the integrity of the measures remain. There are a lot of advisers who have done the studies already and who may be eligible for some changes down the track, so I think we just need to be mindful of the fact that there are many advisers who have gone down the path as prescribed at the moment'.

Committee member Ms Hammond concluded her questioning by stating

> 'I actually have a very strong opinion that the educational requirements that have been imposed are inflexible and not fit for purpose. They don't take into account experience and they're not fit for purpose. I think that the educational requirements, now that FASEA is being wound up and is being put into Treasury and ASIC, need to be re-examined'.

> [Source: Transcript: House of Representatives Standing Committee on Economics Inquiry into Australia's Four Major Banks and Other Financial Institutions: Financial Advice public hearing 29/07/2021]

In Brief | ASIC has prosecuted ten companies between 1 January 2021 and 30 June 2021 for failing to comply with their legal obligations under the Corporations Act to lodge financial reports. The regulator has said it intends to continue to prosecute companies that fail to comply with reporting obligations

> [Source: ASIC media release 03/08/2021]

In Brief | Well-positioned: APRA Stress testing of insurers during COVID-19 demonstrated that 'insurers are well-positioned to withstand a very severe economic downturn, while still meeting their commitments to policyholders'

> [Source: APRA media release 03/08/2021l]

Other News

The economic costs of managing COVID-19: New government report released

Treasury has released a report on the relative cost effectiveness of different types of COVID-19 health interventions and potential responses to outbreaks of the virus. Treasury's estimates of the economic costs are based on modelling provided to the National Cabinet by the Doherty Institute on the impact of different levels of community vaccination on the transmission potential of the Delta variant of COVID-19.

Some Key Takeaways

- Overall the report concludes that continuing to minimise the number of COVID-19 cases by taking 'early and strong action' in response to outbreaks of the Delta is more cost effective than other approaches.
- Given that 'moderate' or 'strict lockdowns' are still expected to be necessary until 70% of the population aged 16 years or more are vaccinated, the costs of managing COVID-19 are expected to remain high.
- However, once this 70% threshold is reached, the economic costs of COVID-19 management is expected to be reduced to $200m per week, falling to $140m per week once 80% of people are vaccinated.

[Sources: Economic Impact Analysis: National Plan to Transition to Australia's National COVID 19 Response; Transcript Press Conference 03/08/2021]

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