Governance News

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

8 December 2021

Contents

Boards and Directors

How non-executive directors view climate risk governance

New report provides insights into how Australia's directors view climate risk, the steps their organisations are taking (or not taking) to respond, and the barriers and drivers of these actions.

Key Takeouts

- The report highlights that though the vast majority of Australian directors are aware of both the risks and opportunities of climate change, there remains a gap in translating this awareness/concern into action in some cases.
- Generally, directors of listed companies are more confident of their boards' climate competence and listed organisations have generally been more active in responding to climate risks and opportunities.
- The report identifies that directors perceive regulatory/political uncertainty on climate as a key barrier to action. The complexity of the issue and not knowing where to start is also flagged as an issue, especially for some director groups (eg NFP directors).
- Appetite for boards to 'do more' on climate governance is also more marked among some director groups than others. Interestingly, directors of listed companies are more likely than any other director group to consider that their board is already doing enough on the issue.

The Australian chapter of the Climate Governance Initiative, in collaboration with the Australian Institute of Company Directors (AICD) has released a report providing insights into non-executive director attitudes and current approaches to climate-risk governance.

The report is based on an AICD member survey as well as interviews with a number of non-executive directors.

Some Key Insights

Most directors are concerned about climate risk

- 77% of survey respondents and all interviewees indicated they are concerned about climate change risk to their organisation.
- The report highlights that the level of concern varies across industry sectors: 70% of directors from government public sector boards indicated there were 'extremely' or 'somewhat' concerned vs 52% of directors of unlisted companies, 48% of directors of listed companies and 47% for directors of not for profits (NFPs).
- Looking at the results across the industries recognised by the TCFD as at 'high risk' of material climate related risk the report found that directors of some high risk industries are more concerned about climate risk to their organisation, and more active in taking steps to manage it than others. For example:
  - 73% of directors from energy and 72% from agriculture, forestry and fishing (AFF) are concerned about climate risk to their organisation. In contrast, only 45% of directors from mining and 49% of directors from insurance and finance.
  - Likewise, directors from the mining sector are less likely than those in other high-risk industries to have taken active steps to respond to climate risks/opportunities. For example mining industry directors were the least likely to indicate that their board had undertaken director training on climate issues, recruited management/other employees with climate expertise, or considered climate governance in the context of board skills gap analysis.

Key climate concerns for directors

- Overall, the greatest concerns for directors in terms of specific climate risks were identified by survey respondents as: regulatory/political uncertainty and the operational effects of climate change (eg workforce disruption).
- Drilling down, there was some variation across sectors in the priority accorded to/the level of concern around specific risks. For example:
  - while directors of listed, unlisted and overseas companies all ranked regulatory/political uncertainty as their top concern, directors on government and NFP boards ranked the operational effects of climate change as their top concern (followed by regulatory uncertainty).

- the 'cost of climate change impacting profitability' was second on the list of concerns for directors of overseas companies, third in the list of concerns for listed and unlisted directors, fourth on the list for directors on government boards and fifth on the list for directors on NFP boards.

Directors are alive to the opportunities

- 51% of survey respondents overall saw either 'significant' or 'some' opportunity in climate change. A further 25% considered there was 'limited opportunity'. 19% saw zero opportunity and 5% were 'unsure'.
- Drilling down, there was again variation in perceptions across sectors.
  - NFP directors were less likely than directors in other sectors to consider there is 'significant' or 'some' opportunity in climate change, with only 37% of NFP directors considering this was the case
  - Directors of overseas companies were more likely than any other group to see the opportunities in climate change (59%), followed by directors on government boards (58%)
- Interviewees emphasised the importance of having both 'a risk and opportunity mindset' on the issue and suggested that there needed to be a shift in thinking on climate change from 'resistant to accepting to leading'.

Perceived benefits of climate action

- Overall, survey respondents ranked the top benefits of climate action from an organisational perspective as: 1) the measurable impact on the environment (43% of respondents); 2) new products and/or services and separately, brand recognition and reputation (ranked equal second, 42% of respondents respectively); and 3) customer satisfaction/meeting client expectations (41% of respondents).
- Encouraging resilience/longevity of business operations ranked fourth overall (32% of respondents).
- Interestingly, investor/shareholder satisfactions and/or lower capital cost was seen as less important (17% of respondents)
- Again, the survey found that director perceptions on this issue varied across sectors.
  - Directors of government public/sector bodies were the only group to rank the measurable impact on the environment as their top opportunity.
  - Unlisted, listed and overseas directors ranked new products and/or services as their top opportunity
  - NFP directors ranked brand recognition/reputation as their top opportunity.
- Commenting on the survey findings, interviewees provided further feedback on the opportunities in the space. For example, interviews with directors from financial services and superannuation funds flagged opportunities to invest in 'opportunities around climate change'.

Views on whether boards need to 'do more' on climate governance are divided

- 46% of survey respondents overall consider that their board should increase the attention given to climate risk governance. 29% consider their board is already doing enough. While a quarter of respondents (25%) were neutral on the question.
- The report highlights that directors who consider their board should do more are also more likely to be concerned about climate risk.
- Looking at it by sector:
  - Directors from the government and NFP sectors are more likely than directors from other sectors to agree that their board should do more on the issue (53% of government and 47% of NFP directors)
  - In contrast, directors of listed companies are the least likely group to consider that their board needs to do more on the issue (41% respondents from this group disagree that their board should do more). 33% of directors from unlisted companies shared this view.
- The report found that:
  - female directors are more likely than their male colleagues to want a greater focus on climate governance on their boards.
  - younger directors are more likely than older directors (65 or older) to want a greater focus on climate governance on their boards.

Perceptions of boards' climate competence

- Overall, the survey found that:

  - 46% of survey respondents agreed that their board had the knowledge and experience to adequately address the climate governance issues facing their organisation.
  - 26% were neutral on the issue.
  - 28% of respondents disagreed.

- Listed company directors were the most confident in their boards' ability while NFP directors were the least confident.

- Women and younger directors were less confident than their male counterparts of their boards' ability to manage climate risk.
  - 36% of female survey respondents indicating they disagree that their board has the necessary climate knowledge/experience vs 24% of male respondents.
  - 59% of directors in the 65 or over age group consider that their board has the necessary climate knowledge/experience vs 45% of directors in the in the 45-64 age group.

Key drivers of action on the issue

- Overall, survey respondents identified customers/clients/service users/members as the top source of pressure to act on climate (54%), followed by employees (50%) and civil society (49%).

- Interestingly, the survey found that pressure from regulators is not a key driver with regulatory pressure ranking last in the list of possible options overall.

- For listed companies investors/shareholders were identified the top source of pressure (54%).

- The report flags that interviewees consider that interest on ESG issues from investors has now 'taken over from remuneration as the number one topic of conversation' with questions at AGMs tending to be focused on ESG issues.

Steps being implemented

Despite the overall high level of concern among directors about climate risk, the survey found that:

- Only 35% of respondents had embedded climate change risk into risk management frameworks and only 33% received a board report on sustainability metrics.

- An even smaller proportion of respondents (26%) indicated that they are measuring climate governance through metrics. The report considers this an indication that climate governance metrics are as yet 'immature and require development', despite the materiality of the risk to many organisations.

In terms of the steps being taken to plan for/ensure boards are climate competent the survey found that:

- The proportion of boards considering climate governance in the context of director recruitment is very low (10%).

- Likewise the proportion of boards that have used climate competence as part of a board skills gap analysis is also low (14%).

- Only 18% of survey respondents indicated that their board had undertaken director training on climate governance issues.

These findings are interesting given the level of confidence in boards' climate competence (46% of survey respondents consider their board to have the knowledge/experience to address the governance issues facing their organisation).

The survey also indicates that most boards are also not yet tying climate related metrics to remuneration: only 4% of survey respondents indicated that they had amended remuneration/incentive arrangements. The report comments that in 2020 only eight ASX 100 companies included climate metrics in short term bonus calculations.

Sustainability reporting

- 21% of survey respondents indicated that they had released a climate change or sustainability report.

- Again, there was variation across sectors with directors at NFPs and unlisted companies much less likely to have released such a report (9% and 15% respectively), and listed companies the most likely group to have done so (38%).

- Interestingly, 43% of survey respondents indicated that their board had undertaken scenario analysis. The report comments that this 'most likely refers not to the TCFD process but to simpler scenario approaches including less detailed business continuity planning for climate risk impacts'.

- Audit and assurance: Most interviewees indicated that their sustainability reports are 'partially assured by the company's external auditor'. The report comments that audit and assurance on climate reporting and disclosure is an emerging area and a 'looming challenge for boards'.

Key barriers to action?

- Uncertainty over Australian government policy was the most cited issue with 46% of directors indicating that this is a barrier to action.
- The difficulty in knowing where to start emerged as a key obstacle (45% of responses).
- 38% of respondents indicated that resourcing constraints were an issue.

Appetite to 'do more on climate governance'?

Page 46 of the report is a table summarising the views of directors in the NFP, government, listed and unlisted sectors.

- Listed companies: The report suggests that the high level of concern among listed company directors, coupled with the high level of confidence 'may suggest an adequate management of the issue or potentially lack of focus'.
- Unlisted companies: The report suggests that the high level of concern in this group, coupled with the 'moderate' levels of confidence in their boards' climate competence, and the 'moderate' level of action being taken may indicate that directors of unlisted entities need to 'elevate' their focus on climate risk.
- Not for profits (NFPs): The report suggests that this group of directors is the most in need of guidance/support given the appetite for boards to do more on the issue, the high level of concern and the limited level of confidence in boards' climate competence.
- Government: Directors in the government sector view climate risk as a major concern and there is appetite to 'do more' on the issue. However, the level of confidence in directors' knowledge/experience of climate related issues is only moderate. The report suggests that this indicates that directors in this sector would like 'to be much more active on the topic'.

  [Sources: AICD media release 06/12/2021 ; Full text report: Climate Governance Study Risk and opportunity insights from Australian directors]

Webinar discussing the report findings

The AICD is hosting a free webinar discussion on the report findings on 9 December 2021 from 12-1pm. A recording will also be made available.

You can register for the event (and/or to receive a recording of the discussion) here.

Remuneration

SEC issues guidance on 'spring-loaded' awards

The Securities and Exchange Commission has released guidance - Staff Accounting Bulletin No. 120 - for companies on the appropriate disclosure and recognition of so called 'spring loaded' awards. The SEC describes these awards as:

> 'share-based compensation arrangements where a company grants stock options or other awards shortly before it announces market-moving information such as an earnings release with better-than-expected results or the disclosure of a significant transaction'.

The key message is that SEC considers

> 'non-routine spring-loaded grants merit particular scrutiny by those responsible for compensation and financial reporting governance at public companies'.

In practical terms, this means that SEC expects companies to consider the impact of 'the material nonpublic information' ie the 'market moving information' referred to above, in the context of recognising the cost of these awards.

> [Source: SEC Media release 29/11/2021; Staff Accounting Bulletin No. 120]

Pay for performance? UK High Pay Centre report finds payment of incentives is almost always guaranteed

Research from the UK High Pay Centre found that bonus payments and Long Term Incentive Plans are almost always paid out to FTSE 100 executives and CEOs. For example, in the case of annual bonuses:

- 94% of bonus plans paid out at least some proportion of the potential maximum over the period, with half paying out at least three quarters of the potential maximum.

In the case of Long Term Incentive Plans (LTIPs):

- Payments under LTIPs were made in 85% of cases
- Half of LTIPs paid out at least two thirds of the potential maximum and 21% paid out their maximum potential value.

Interestingly, the report found that 36% of pay-outs were either at 0% or 100% which the High Pay Centre interprets as an indication that performance was 'outside the range set' by the remuneration. On this point, the report comments that:

> 'the frequency with which performance outcomes deviate from the range of possibilities set out in LTIPs highlights the limitations of boards' and CEOs' abilities to forecast and determine business performance. This challenges the notion of the superstar CEO and the imperative to pay vast sums of money to attract or retain executives, creating huge divides within the workforce. It is something that remuneration committees should consider when contemplating the pay demands of their executives, and the pay gaps between high, middle and low earners throughout their organisation'.

Overall, the report questions the value of incentives in driving performance.

> 'The High Pay Centre has historically argued that the frequency of bonus and LTIP payments is suggestive of their limited value as drivers of better business performance. When payments are made more commonly than not, it is hard to believe they could be considered by recipients as rewards or incentives that would encourage greater effort as opposed to a guaranteed component of their pay package. When these payments are consistently awarded to a majority of CEOs every year, is seems unlikely that they reflect outperformance by the recipient'.

> [Sources: High Pay Centre media release 07/11/2021; Full text report: High Pay Centre discussion paper: Are bonus payments and Long Term Incentive Plans fair and proportionate rewards and incentives for business leaders?]

Meetings and Proxy Advisers

ISS Announces 2022 Benchmark Policy Updates

Following consultation, Institutional Shareholder Services (ISS) has released details of updates to its 2022 ISS benchmark proxy voting policies. The changes include changes to ISS' policies on board diversity, executive remuneration, board accountability for unequal voting rights and climate issues.

Key changes to climate-related policies include the following.

- **Board Accountability on Climate change and climate-related risks:** ISS will introduce a new board accountability policy setting 'minimum criteria' for companies considered to be strongly contributing to climate change ie companies currently identified as Climate Action 100+ Focus companies. Under the new policy, ISS will recommend 'Against' votes for 'responsible incumbent directors' where ISS considers that the company is not: providing adequate disclosure such as disclosure aligned with the TCFD framework and/or does not have 'quantitative GHG emission reduction targets covering at least a significant portion of the company's direct emissions'.
- Say on Climate:
  - Management proposals: ISS will go ahead with its plan to 'codify' its approach for analysing 'say on climate' proposals put forward by management. The policy will include a non-exhaustive list of criteria that ISS will consider in making its voting recommendation.
  - Shareholder proposals: ISS will also publish the 'framework' for its a case by case approach to the assessment of 'say on climate' proposals put forward by shareholders.

Updates to Australia-specific policies

ISS made three updates to ISS Australia policy guidelines.

- Virtual meetings: ISS has updated its policy to confirm that it will 'generally recommend against proposals that would permit the company to convene virtual-only shareholder meetings absent exceptional circumstances'.
- Minimum board gender diversity requirements: ISS has introduced a board gender diversity policy requiring at least 30% female representation on S&P/ASX 300 index companies and at least one woman on the board of all other Australian companies. The policy sets out where ISS considers 'exceptional circumstances may be relevant'.
- Board independence: ISS updated the wording on 'board independence' to 'clarify the standard approach to director election recommendations when boards are not majority independent' and the mitigating factors that ISS will take into account when determining the vote recommendation.

More information to come

- ISS plans to released updated policy documents for 2022 'in the coming weeks'.
- ISS plans to release more information about policy application relating to the new climate-related policies as well as other policy changes in an update of ISS' Frequently Asked Questions documents. These updated will be published before the new policies take effect.

[Sources: ISS media release 07/12/2021; ISS 2022 policy updates]

Shareholder Activism

'Say on Climate' continues to gain traction

- As You Sow has welcomed shareholders' endorsement of a 'say on climate' resolution at Sysco Corporations.
- According to As You Sow, 92.1% of Sysco Corporation shareholders voted in support of the shareholder-proposed resolution (filed by As You Sow).
- The resolution called on the company to set Paris aligned, net-zero targets, disclose a climate transition plan, and report annually on progress against the plan.
- As You Sow considers the result to be further evidence of the 'increasing sense of urgency from shareholders that the world is not on track to meet the Paris Agreement's goal of limiting global warming to 1.5 degrees'.
- As You Sow comments that the majority vote at Sysco follows other resolutions during the 2021 season calling for net-zero action from companies, including a 98% vote of support at General Electric and a 56.4% vote at Booking Holdings.

Australia?

- In Australia, the Australasian Centre for Corporate Responsibility (ACCR) is also pushing for companies to adopt a 'Say on climate'.
- The ACCR has filed a number of resolutions calling on companies to give shareholders an advisory vote on their TCFD aligned climate transition plans.
- In response, a number of companies have agreed to voluntarily adopt 'Say on Climate'. These companies include: Santos, Woodside, Oil Search, AGL, Origin Energy and South32.
- Separately, a recent Climate Governance Australia Report produced by the Australian Institute of Company Directors flagged that investor interest in/concern about ESG issues has 'taken over' from remuneration as the key concern. The report comments that 'the "Say on Climate" movement has also begun to feature in the most recent AGM season and is expected to only grow in prominence given global momentum and COP 26'.

[Sources: As You Sow media release 29/11/2021; ACCR website]

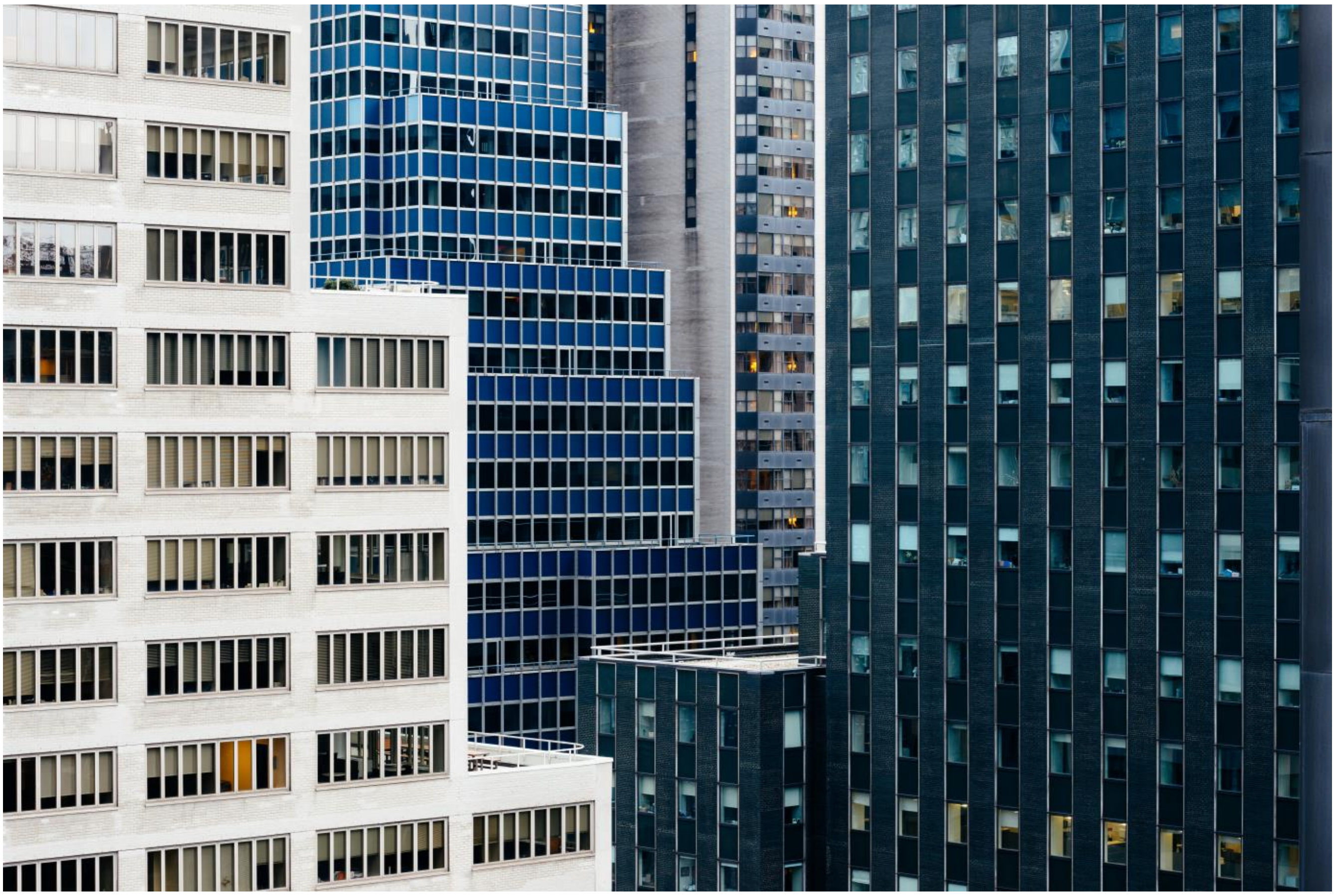
Institutional Investors and Stewardship

In Brief | ACSI has released a report highlighting shortcomings in company engagement with First Nations people and offering guidance to companies on improving engagement practices. ACSI CEO Louise Davidson makes clear that this is an area of concern for investors, given the potential financial and reputational damage that can result from poor engagement. 'Ultimately, substandard engagement can undermine a company's long-term success and ability to operate effectively' Ms Davidson states

[Source: ACSI media release 08/12/2021; Full text report: Company engagement with first nations people]

In Brief | The fourth edition of RIAA's Responsible Investment Super Study 2021 has found that super funds demonstrating leading practice responsible investment are taking a bigger share of the market and financially outperforming their peers

[Source: RIAA media release 02/12/2021]



Markets and Exchanges

UK Listing Rules changes confirmed

Following consultation, the UK Financial Conduct Authority (FCA) has confirmed a suite of changes to the Listing Rules primarily aimed at removing possible barriers to listing/making the UK a more attractive place for companies to list as well as encouraging companies to list at an earlier stage. This is considered necessary in light of the falling number of companies opting to list in the UK.

Key changes include:

- Allowing a 'targeted form of dual class share structures' within the premium listing segment, as per the consultation The FCA observes that this proposal received 'broad majority support'.
- Reducing the amount of shares an issuer is required to have in public hands (ie free float) from 25% to 10% (again consistent with the consultation proposal)
- Increasing the minimum market capitalisation threshold for both the premium and standard listing segments for shares in ordinary commercial companies from £700,000 to £30 million (down from the £50 million put forward in the consultation in response to stakeholder concerns).

The new rules come into force on 3 December 2021.

Other minor changes to 'modernise and streamline' primary markets rule books come into force on 10 January 2022.

The FCA states that the changes address and build on a number of the recommendations made in the UK Listing Review and the Kalifa Review of UK FinTech.

FCA Director of Market Oversight Clare Cole said that the changes

> 'ensure the UK's markets maintain their reputation for dynamism, helping support the new types of companies seeking the investment that drives economic growth and by giving investors more choice with appropriate protection. Over the last few months, we have moved quickly to address areas where our rules could be improved to encourage innovation in primary markets. By taking this agile approach, we are pleased that new IPOs in 2022 will be able to benefit from the revised rules.'

Possible further reform?

The FCA has flagged that it is considering stakeholder feedback on the need for 'wider reforms' to improve the effectiveness of the overall structure of the UK listing regime.

The regulator has said that it plans to provide further feedback on this question in H1 2022, including proposed next steps.

[Sources: FCA media release 02/12/2021; PS21/22: Primary Market Effectiveness Review: Feedback and final changes to the Listing Rules]

Regulators

ASIC reveals the five issues it considers should be on CFO's agendas heading into 2022: Climate Risk Disclosure and Cyber Resilience top the list

In her address to the AFR CFO Live Summit, ASIC Commissioner Cathie Armour briefly reflected on the changing environment for listed companies, how these changes are relevant for CFOs and ASIC's response.

Ms Chester also flagged five issues she believes 'should be on every CFO's agenda for 2022'. These are: 1) climate change disclosure; 2) cyber resilience; 3) continuity of trading and operations in markets; 4) digital financial reports; and 5) a smooth LIBOR transition.

In the course of her address, Ms Armour outlined ASIC's work in each of these areas.

Our key takeaways from Ms Armour's address are below.

Five suggested issues ASIC considers should be on all CFO agendas for 2022

FIVE SUGGESTED KEY AREAS OF FOCUS FOR CFOS	ASIC AREAS OF FOCUS
Climate Change Disclosure	▪ Greenwashing: Ms Armour said that ensuring that climate-related disclosures by listed companies are legally compliant remains a focus for ASIC. In particular, ASIC is focussed on whether: 'public statements about a company's approach to climate-related risks match what they are doing in practice?' ▪ Ms Armour said that where ASIC identifies misleading and/or deceptive conduct, ASIC 'will be guided by the seriousness, pattern and nature of misconduct'. ASIC may take action, including enforcement action. ▪ TCFD-aligned disclosure: Ms Armour said that monitoring the 'continued evolution' of reporting in line with the TCFD framework has been a focus for the regulator since 2018. ASIC encourages listed companies to: – 'assess climate risks to their business – maintain strong and effective corporate governance in this area – ensure that legal obligations are complied with, such as directors' duties and annual reporting requirements – provide meaningful and useful voluntary disclosures to the market'. Ms Armour observed that the TCFD framework may be 'useful' in this context. ▪ Monitoring international developments: Ms Armour said that ASIC will continue to – contribute to the IOSCO Sustainable Finance Taskforce, which is actively engaging with the newly established International Sustainability Standards Board on the development of global standards – monitoring the implementation of mandatory climate change disclosure in other jurisdictions/approach taken by other regulators (eg UK and NZ regulators)
Cyber Resilience	▪ Referencing Report 716 Cyber resilience of firms in Australia's financial markets: 2020–21 (REP 716) into the cyber resilience of financial firms, Ms Armour said that though there has been a 'small but steady improvement' in cybersecurity practices, this falls far short of the level of improvement 'targeted'. ▪ Though the impact of the pandemic was one contributing factor to the slower than targeted improvement, ASIC considers that other factors such as 'the unrelenting escalation in the cyber-threat environment' and the 'overly ambitious targets' set by firms, 'also contributed to the difference between actual and targeted cyber resilience'. ▪ Ms Armour flagged the lack of real improvement in the level of resilience for supply chain risks as an area of concern, commenting:

<table>
<tr><th>FIVE SUGGESTED KEY AREAS OF FOCUS FOR CFOS</th><th>ASIC AREAS OF FOCUS</th></tr>
<tr><td></td><td>'While all firms – large and small – have identified supply-chain risk management as their top priority for the future, going forward, we encourage you to consider applying the good practices identified in the report to the management of these risks'.
▪ Ms Armour underlined ASIC's expectation that notwithstanding the ongoing disruption caused by the pandemic,
'ASIC expects to see a substantial improvement in the management of cyber security risk across Australia's financial market firms when we begin to undertake our next cyber resilience review, most likely in late 2022'.</td></tr>
<tr><td>Continuity of Trading and Operations in Markets</td><td>▪ Ms Armour noted the release of ASIC's report into the 2020 ASX trading outage and the imposition of additional licence conditions on the ASX.
▪ Ms Armour called on market operators and participants to review the expectations of industry outlined in the report around ensuring continuity of operations and trading.
▪ Ms Armour said that ASIC's expectation is that operator and participants:
'implement the measures set out in the report to maintain compliance with their obligations under the law. Critically, these expectations require market participants to have the certainty and ability to trade on alternative venues in the event of a future market outage'.
▪ Ms Armour said that AISC will be monitoring the implementation of actions taken in response to the report to ensure appropriate steps are being taken.</td></tr>
<tr><td>Digital Financial Reports</td><td>▪ Ms Armour encouraged CFOs to 'consider the opportunities to better communicate financial report information to investors using digital financial reports'
▪ Ms Armour observed that though digital financial reporting is voluntary, it has a number of benefits including: 'the potential to reduce the cost of capital, make it easier for investors to navigate reports, and provide investors with timely, high quality and consistent financial data in a structured electronic form for analysis'. She also observed that it is also required in other jurisdictions.</td></tr>
<tr><td>LIBOR Transition</td><td>▪ Ms Armour said that ensuring readiness for the end of the LIBOR benchmark should be a focus for all CFOs whose businesses participate in the international capital markets, 'whether through debt raising and related interest rate swaps, foreign currency hedging or otherwise'.
▪ Ms Armour said that 'ASIC expects firms to completely cease offering new LIBOR products after the end of 2021'.
▪ Ms Armour said that firms are also expected to:
– 'educate staff to ensure new LIBOR contracts are not offered to them, and if you are in financial services, to clients
– have processes and controls to ensure new contracts referencing LIBOR are picked up and escalated before they are finalised
– ask why these contracts are still being written'.
▪ Ms Armour flagged that ASIC is consulting on changes to its mandatory clearing rules to ensure continuity of the current mandatory clearing policy settings with the LIBOR transition.</td></tr>
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Changing environment for listed companies

- Ms Armour identified the influx of retail investors into financial markets since the onset of COVID-19 as a catalyst for change in Australian markets and more broadly. For example, Ms Armour observed that new products, services and 'innovations' are emerging to support this growing retail investor base. Likewise Ms Armour pointed to shifts in the way in which retail investors access information, highlighting the rise of 'finfluencers' as a key change.

- Ms Armour said that these changes have relevance for CFOs:

  'With a growing cohort of retail investors on your share registers and interested in investing in financial products you issue, how best can you communicate with these investors?'

- Ms Armour also cautioned against listed companies rushing into collaborations with 'finfluencers' without taking steps to first ensure that they do not contribute to 'regulatory risk'.

- Ms Armour said that ASIC has also observed a concerning uptick in social media being used in 'blatant attempts to manipulate the market, including to promote pump-and-dump activity'.

- In light of these issues, Ms Armour said that looking ahead to 2022, ASIC will continue to focus on the following:
  - 'monitoring retail investment trends and marketing of products
  - enhancing our surveillance capability of social media to quickly identify pump-and-dump activity and unlicensed advice
  - engaging with peer international regulators – many of whom are observing similar issues
  - engaging with social media platforms and moderators, and reviewing our guidance on discussion forums
  - reviewing the settings for new products and activity, like payment for order flow'.

  [Source: Speech by Commissioner Cathie Armour at the Financial Review CFO Live summit, The CFO agenda – a regulator's perspective, 06/12/2021]

Financial Services

Top Story | Independent Review of the Banking Code calls for banks to maintain Hayne Commission momentum

Our key takeaways from the first independent review of the Banking Code of Conduct since the Hayne Commission.

Key Takeouts

- The independent Review of the Banking Code of Conduct makes 116 recommendations which are broadly aimed at maintaining the momentum from the Hayne Commission by: improving compliance with Code commitments, strengthening and clarifying consumer protections, clarifying the enforceability of Code provisions generally and updating the Code to reflect developments since the last review.
- On the question of how enforceable Code provisions should be designated, the Report takes as its starting point the position that the Code should remain 'self-regulation'. Accordingly, the Report advocates minimising the number of designated enforceable provisions while also making explicit how all provisions in the Code can be enforced. Having said this, the Report identifies a number of Code provisions as potential 'candidates' for designation as enforceable Code provisions. These are flagged below.
- On the question of whether/how the government's proposed changes to responsible lending obligations should/should not be reflected in the Code, the Report makes clear that responsible lending commitments should be retained (and clarified) whether or not the government's planned changes are enacted.
- The Report rejects calls for the Code to include an express commitment for banks not to rely on the point of sale exemption (consistent with Hayne Recommendation 1.7) on the basis that the commitment is essentially unnecessary.
- Next steps: The ABA will consult with members and respond to the Report outlining proposed changes to the Code. This processes expected to be concluded by March 2022. The final changes to the Code (including the Pottinger Review changes) are planned to take effect (subject to ASIC approval) on the later of 1 January 2023, and six months after ASIC notifies its approval of the Code revisions.

On 6 July 2021, the Australian Banking Association (ABA) announced it had commissioned the first independent review of the Banking Code of Practice (the Code) since the Hayne Commission. The review was led by Mike Callaghan. The terms of reference for the review are here.

On 3 December 2021, the ABA released the Final Report of the review. Broadly, the Report concludes that the Code is

> 'an improvement on the previous version and banks are more focused on complying with the Code than they were in the past. The objective of the triennial review should be to maintain this progress. The Banking Code of Practice does not need a complete overhaul or rewrite, but it can be improved in important areas and compliance significantly strengthened.'

This conclusion is more or less encapsulated in Recommendation 1 of the Report, which emphasises the need for the industry to 'maintain' the momentum from the Hayne Commission. Recommendation 1 states:

> 'The ABA should use this triennial review to maintain the momentum coming from the Royal Commission in terms of improving Code awareness and compliance. The Code does not need a complete overhaul, but to maintain momentum there should be no preconceived view to keep change to a minimum. The objective of the Code and enforceability of commitments needs to be clear. Consumer benefits and protections need to be strengthened and clarified, and the commitment to compliance made more tangible'.

Key Recommendations

The Report makes 116 recommendations aimed at:

- clarifying the objective, audience and structure of the Code, adjusting the wording of commitments to make it more definite/forceful and confirming that industry guidelines should not be considered voluntary
- clarifying and strengthening consumer protections in the Code

- fostering compliance with the Code
- updating the Code to reflect the raft of regulatory changes that have been implemented since it was last reviewed in 2017.

Below is an overview of some of the key recommendations and the rationale behind them. A full list of recommendations is included at p9 of the Report.

Fostering a compliance culture

Despite progress, compliance with the Code and consistency in applying the provisions is identified as a key challenge. The Report identifies the fact that the importance of the Code is not necessarily acknowledged by all banks - some banks consider the Code a to be a 'regulatory burden' – as one factor contributing to this issue.

Recommendation 2 therefore calls on banks to reassess their attitude to the Code. It states:

> 'Banks should view the Code as important in outlining the customer focus that is central to the overall long-term success of their organisation, rather than a regulatory burden. Senior leadership in the banks should send a clear message to staff as to the importance of the Code for the bank'.

Clarifying the intended audience for the Code

The Report also flags the way in which the Code is drafted as a problem. The report comments that 'at present, the one document is seeking to meet the needs of too many audiences'. The result is that there is perhaps too much detail included for consumers, and not enough included for bank signatories and bank staff.

To address this, Recommendation 3 recommends that:

> 'While the Code should be accessible to as broad an audience as possible, the primary audience should be the banks and bank staff. It is the rule book for the banks. It should be drafted with sufficient detail, either in the Code or related industry guidelines, to facilitate the implementation of the commitments by bank staff and allow consumer representatives help customers pursue their rights'.

Recommendation 4 recommends that there should be a separate, standard documents for consumers that banks would commit to providing to them, when they make a complaint. This documents would explain that:

> 'consumers have rights in their dealings with banks, along with indicating that the detail of their rights is in the Code as well as advising who can assist them in a dispute with their banks'.

A consumer centric, principles-based approach: clarifying the structure, objectives and status of industry guidelines

A number of recommendations are focused on clarifying the structure and objectives of the Code, again with a view to strengthening compliance.

Recommendations 9-12 recommend changes to the structure of the Code to bring it more into line with the structure (and principles-based approach) outlined in the 2017 Review, clarify the relationship between Code Commitments and those included elsewhere and emphasise the consumer-centric approach underpinning each Code commitment.

Recommendation 9 recommends that the Code should:

> 'begin with a clear statement of the Code's overall objective. Then each part of the Code should start with the outcome sought for customers from that part, and the provisions flow from and are consistent with achieving that outcome'.

Importantly, Recommendation 10 recommends that industry guidelines should 'be considered as Code related documents and not outside the Code and voluntary'. The recommendation states that

> 'Banks should take into account industry guidelines in assessing whether they are complying with Code commitments. If they are not following the best practice outlined in the guidelines, banks will have to demonstrate they are following comparable processes in meeting the commitments. There should be greater transparency in the Code over the role of industry guidelines. They should be specifically referenced in the Code'.

Recommendation 11 recommends that references in the Code to 'legislation' or complying with the law should be clarified to specify 'what they mean for consumers in their relationship with their bank'.

Enforceable Code Provisions and the enforceability of the Code generally

The Review was not tasked with identifying which provisions in the Code should be designated as enforceable Code Provisions, but rather with identifying the appropriate approach to designating such provisions.

The Review proceeded on the basis the 'Code should remain self-regulation'. In light of this, the report suggests that designating too many provisions as enforceable is to be avoided as it

> 'will result in the Code increasingly becoming the main body responsible for monitoring compliance. It would also reduce the incentive for banks to set standards that go above the law'.

Likewise the Report emphasises the need to avoid 'perceptions that there are enforceable and non-enforceable provisions'. Accordingly, the report advocates amending the Code to explain that there are 'layers of enforceability of all provisions'.

- Recommendation 5 recommends that the following factors be considered in the process of identifying enforceable Code Provisions: a) 'the extent to which a provision can be legally enforceable'; b) 'the extent to which a breach is likely to result in significant detriment to a consumer'; and c) 'existing enforceability of provisions under contract law and legislation'; and d) 'the extent to which designating the provision as enforceable will support the role, operation, and enforceability of the Code as self-regulation'. Generally, where provisions are already legally enforceable, the Report makes clear that they should not be designated under the enforceable code provisions regime.
- Recommendation 6 recommends that in the interests of avoiding confusion over which provisions are enforceable and those which are not, the Code should:

  > 'specifically refer to how all the provisions can be enforced. The "layers" of enforceability include contract law, Code obligations being considered by the Australian Financial Complaints Authority (AFCA) in resolving customer disputes, and the breaches of some provision resulting in a penalty under legislation'.

- Recommendation 7 recommends that the wording of existing Clause 10 in the Code (which commits bank staff to acting in a 'fair, reasonable and ethical manner') should be aligned with the wording in s912A of the Corporations Act 2001 (Cth) (the Act) and explain that the provision is enforceable under the Act. However, the Report observes that 'Clause 10 would be suitable for designation as an enforceable code provision' if the wording is not aligned with s912A. Recommendations 28 outlined below builds on this recommendation.
- Recommendation 8 recommends the inclusion of a new commitment for banks to 'have in place the appropriate systems, processes, and programs to support an integrated approach to compliance. Banks should commit to a program of periodically reviewing the effectiveness of their compliance framework through their internal and external audit arrangements and to reporting the detail of the outcomes of these audits to the BCCC. A summary of the audits should be included in each banks published annual reports. This commitment would be suitable for designation as enforceable under the enforceable code provision regime'. Recommendations 29-30 outlined below build on this recommendation.

The Code Commitment to act in a 'fair, reasonable and ethical manner'

Recommendations 28-30 are focussed on strengthening the commitment in existing Clause 10 of the Code which states that bank staff with deal with consumers in a 'fair ethical and reasonable manner'.

Recommendation 28 recommends that:

> 'The commitment for banks to engage with customers in a fair, reasonable and ethical manner (or if aligned with the Corporations Act – efficiently, honestly and fairly) underpins all Code commitments and should be prominently positioned in the Code. The Code should state the commitment is enforceable under the law (the Corporations Act if aligned, if not, Clause 10 is a suitable candidate to be designated under the enforceable code regime)'.

Recommendation 29 and 30 are focused on strengthening compliance with this commitment.

- Recommendation 29 recommends that banks commit to having in place 'appropriate frameworks and systems to support compliance with the Code' and to conducting a 'rolling audit program using internal and external audit arrangements' to ensure effectiveness. The report observes that this recommendation is 'an appropriate candidate to be designated under the enforceable code regime'.
- Recommendation 30 recommends that the commitment to have trained and competent staff that understand the Code and how to comply should cover staff at all levels including management. Recommendation 30 further recommends that banks should 'develop industry wide standards for competency and conduct for bank staff and

that the Code should explicitly 'state that staff will be supported by appropriate systems and technology to support compliance with the Code.'

The role and powers of the Banking Code Compliance Committee (BCCC)

The Review considered whether there is a need to adjust the duties/powers of the Banking Code Compliance Committee (BCCC), including whether the sanctions available to the BCCC remain appropriate.

- Sanctions: On the question of sanctions, the report notes that various submissions called for the BCCC's existing sanctions powers to be strengthened in various ways. However, the report recommends against giving the BCCC powers to impose financial penalties for non-compliance on the basis that doing so would potentially blur the distinction between the BCCC and ASIC (recommendation 109). The report does however recommend that the BCCC be given power to require a bank to publish a notification on its website that is has breached the Code and state what correction action the bank has taken (Recommendation 110).
- Reporting to the BCCC: A number of submissions raised concerns about the significant burden on Code members occasioned by having to provide compliance reports to the BCCC. Recommendation 106 recommends the introduction of a 'materiality threshold for banks' breach reporting to the BCCC' and for the BCCC to review its information requests in light of ASIC's new breach reporting arrangements (Recommendation 105). However, requests to otherwise limit reporting to the BCCC were rejected.
- The BCCC's ongoing role: Recommendation 104 the report states that:

  > 'The BCCC should maintain its role overseeing compliance with a Code based on self-regulation and promoting best practice in helping banks achieve good outcomes for their customers. The BCCC is not a regulator enforcing compliance with the law'.

Responsible lending commitments should be retained

The review considered the consequences for the Code from the government's proposal to remove the responsible lending obligations from the National Consumer Credit Protection Act 2009. The review concludes that whether or not the proposed changes are enacted, existing references in the Code to responsible lending obligations should be retained. However, the report also makes clear that these obligations are in need of clarification.

Key issues raised in the consultation concerned the following issues: responsible lending obligations generally, lending to co-borrowers, consumer credit insurance and lenders mortgage insurance and the recommendations reflect this.

- Recommendation 59 recommends that: 'Irrespective of whether announced changes to the National Consumer Credit Protection Act 2009 eventuate, the principles of responsible lending (the 'care and skill of a diligent and prudent banker'), should be set out in the Code. This should incorporate, consistent with the law, that the commitment for responsible lending for individuals is that banks will undertake reasonable inquiries to assess a borrower's capacity to repay the loan without substantial financial hardship and in doing so to consider the borrowers income, debt and expenses and the purpose for which the borrower is seeking the loan'
- Recommendation 60 recommends that: 'Banks should commit to assess all the information they have as to whether a co-borrower is receiving a substantial benefit under the loan'
- Recommendation 61 recommends that: 'The protections in the Code in Clauses 64 to 66 with respect to consumer credit insurance should be applied to all sales of credit insurance and not just limited to those sold via digital channels'.
- Recommendation 62 recommends that: 'Banks should commit not to sell consumer credit insurance with low claim to premium ratios'.
- Recommendation 63 recommends that: The ABA's Lender Mortgage Insurance – Guiding Principles should be referenced in the Code.

Lending to small businesses

Recommendations 64-72 relate specifically to lending to small businesses. Among other things, recommendation 65 recommends that

> 'While it will take time to incorporate the Pottinger Review recommended changes to the definition of small business in a revised Code following the triennial review, ABA banks should commit to introduce the changes as soon as possible'.

[Note: Hayne Recommendation 1.10 recommended that the ABA should amend the definition of small business in the Code so that the Code applies to any business or group employing fewer than 100 full time equivalent employees, where the loan applied for is for less than $5 million. The ABA has committed to implementing the recommendations of the 2020 Independent Review of the definition of small business in the Banking Code of Practice (Pottinger Review). Recommendation 5 of the Pottinger Review recommended that:

- The definition of 'small business' in the Banking Code (other than for the purposes of financial products or services regulated by the Corporations Act 2001) should be amended to mean a business that employs fewer than 100 full time equivalent employees or, in the case of a business that is part of a group of companies, the group employs fewer than 100 full time equivalent employees;

- The provisions of the banking Code that relate to credit should apply to a small business credit facility only if it is below A$5 million]

Point of Sale exemption

Hayne Recommendation 1.7 recommended the removal of the point of sale exemption in light of the harm caused to consumers. Noting that the government has yet to implement the recommendation, consumer groups called for the Code to be amended to include an express commitment for banks not to rely on it.

The Report rejects this argument for change on the basis that it is unnecessary. The Report states:

> 'It appears that subscriber banks do not rely on the point-of-sale exemption, hence a commitment that they will not rely on the exemption would be largely symbolic. New protections should be targeted to areas where there is evidence of current problems'.

Ensuring access to 'inclusive and accessible' banking especially for vulnerable consumers

The extent to which the Code contributes to/supports the provision of inclusive, affordable and accessible banking services to customers, and in particular, to vulnerable consumers and those in remote and regional areas was also a focus of the Review.

The Report concludes that though progress has been made on these issues by a number of banks, consistency in approach across all member ABA banks remains an issue.

The Review identified scope to broaden the definition of 'vulnerability' within the Code (recommendation 35) and to clarify and strengthen existing Code commitments. Recommendations 35-58 are focused on driving progress on this issue. Among other things, the Review recommends that certain provisions in the Code be amended to make clear that the onus should not be on consumers to self-identify to the bank as vulnerable as in need of assistance before they can access that help. For example, 39 recommends that:

> 'The wording in Clause 38 that the bank "may only become aware of your circumstances if you tell us" should be removed and replaced with wording along the lines of Clause 93 in the 2020 General Insurance Code. Similarly, the wording in Clause 43 that the bank "may become aware if you are a low- income earner only if you tell us about it" should be amended. While customers should be encouraged to tell their bank if they are a low-income earner, banks should commit to proactively identify if customers may be eligible for basic accounts'.

Similarly, Recommendation 51 recommends that Aboriginal and Torres Strait Islander people should not have to self-identify as Aboriginal or Torres Strait Islander in order to access the 'tailored assistance available'. The report recommends that these options should be advertised and that 'preferable, bank staff should ask customers whether they have Aboriginal and Torres Strait Islander heritage'.

Parts 9 and 10 of the Code: Responding to and resolving complaints

Recommendations 83-95 recommend changes to Part 9 of the Code which is entitled 'when things go wrong'.

Among other changes, the recommendations include suggested amendments aimed at improving access to financial hardship assistance. Recommendation 84 recommends improvements to the way in which banks contract with debt buyers for the sale of unsecured debts and the treatment of vulnerable customers in this context.

Recommendations 96-103 recommend improvements to the way in which banks resolve complaints. Among other things, the report recommends greater alignment with ASIC requirements, including that the definition of complaint in the Code should be aligned with the definition in ASIC Regulatory Guide 271 (Recommendation 99).

Recent developments/emerging issues

Open Banking

Consumer groups called for the Code to be amended to include additional consumer protections in light of the roll out of the Consumer Data Right/Open Banking.

Ultimately, though the review does not accept all proposals put forward, it does acknowledge concerns about how the rules will apply to vulnerable customers and more particularly joint accounts in situations of family violence/financial abuse.

Recommendation 15 recommends that 'Chapter 35 of the Code should reference that a customer has the right to remove a joint account from the Consumer Data Right and banks will be proactive in identifying vulnerable customers and alerting them to this right'.

Design and Distribution Obligations (DDOs)

Recommendation 16 recommends that the Code should be amended to clarify that if a customer suffers loss or damage because a bank contravened the Design and Distribution Obligations, the customer may recover the loss or damage from the bank.

Buy Now Pay Later (BNPL)

The Review considered whether the changing consumer payment landscape, and more specifically whether the growing popularity of buy now pay later (BNPL) products/services, and the increasing involvement of ABA banks (ie either offering BNPL services or partnering with BNPL providers), warrants revisions to the Code.

Ultimately, the Report concludes that as things stand currently, some of the broader emerging issues raised by these changes may be more appropriately covered in ASIC's ePayments Code or the Australian Payments Network Industry Standards.

Having said this, the Report makes clear that

> 'it would be appropriate for ABA banks to signal in the Code that their involvement in the BNPL sector will be consistent with the principles that underpin the Code, such as responsible lending and dispute resolution'.

The Report points to the approach that the Commonwealth Bank has taken to setting eligibility requirements for the StepPay product as good practice in terms of banks helping to ensure the suitability of BNPL products for customers.

The Report recommends that the Code should both:

- include a commitment that BNPL products issued by banks will be subject to credit checks and eligibility requirements to ensure the products are suitable for consumers (Recommendation 17)
- include a commitment that banks commit only to partner with BNPL providers that are members of ACFA and agree to meet ASIC guidance on dispute resolution (Recommendation 18)

Epayments Code

The voluntary ePayments Code applies to consumer electronic payment transactions. According to the report, currently, most banks, credit unions and building societies subscribe to it.

Consumer advocates advocated for the inclusion of a commitment in the Code for subscriber banks to also subscribe to the ePayments Code. This was accepted in the final report. Recommendation 23 recommends that:

> 'ABA banks should commit to subscribing to the ePayments Code and complying with the consumer protections in the ePayments Code'.

A technology-neutral approach

The Review identified some instances where the wording of the Code needs to be updated to reflect recent developments, including changes in technology.

Recommendation 22 recommends that the language in the Code should be technology neutral 'where possible' to help ensure it remains as current as possible.

Scams

The Review included consideration of whether the Code should address the issue of scams (an issue which is not directly addressed in the current Code). Though the report makes clear that protecting consumers from scams should be priority for banks and for regulators, it does not endorse calls from consumer groups for the Code to include commitments from banks to be responsible for proactively identifying, preventing and compensating consumers in the event that they suffer loss as the result of scam activity.

The report does however recommend that the Code should include commitments by banks to provide appropriate training for staff on the issue (Recommendation 113) and to informing customers about their options if they have been scammed (Recommendation 114). On this last point, Recommendation 114 specifies that this information should be available in languages other than English and that banks should provide a 'dedicated scam/fraud telephone line'.

Triennial Reviews of the Code remain appropriate

- The report concludes that the existing requirement for the Code to be independently reviewed every three years 'remains appropriate' and recommends that this continue (Recommendation 115).
- However, noting feedback from consumer groups, the Report also acknowledges that there 'would be merit in a more structured approach for stakeholder input on the need for changes between reviews'. The Report recommends (Recommendation 116) that the ABA 'Consumer Outcomes Group should be used to provide input to the ABA as to whether amendments to the Code are required between triennial reviews, or whether the issue can wait to be considered at the next review'.

Next steps

- The ABA will consult with members and respond to the final report outlining proposed changes to the Code. This process is expected to be concluded by March 2022.
- The ABA intends to submit an application to ASIC for approval of Code changes by 31 March 2022.
- The changes to the Code (including the Pottinger Review changes) are planned to take effect on the later of 1 January 2023, and six months after ASIC notifies its approval of the Code revisions.

[Sources: ABA media release 03/12/2021; Full text report: Independent Review of the banking code of practice 2021 November 2021]

Top Story | Status update: Tracking progress against each of the Hayne Commission's 76 recommendations

The Financial Services Royal Commission's final report was publicly released on 4 February 2019. In the almost three years since its release a number of actions have been implemented in response – though in many cases, the changes have not yet been fully implemented.

We have prepared a table briefly outlining the actions taken to date and/or the planned actions to be implemented in response to each of the Commission's 76 recommendations. We will be updating the table regularly.

The table was last updated on 8 December 2021 to reflect developments relating the following recommendations.

- Recommendation 1.7 (Removal of the point of sale exemption)
- Recommendation 1.10 (Definition of small business in the Banking Code)
- Recommendation 1.16 (Enforceable Code Provisions)

Financial counsellors want BNPL products to be regulated under the National Credit Code

- Financial counsellors have called on the government to commission an independent review of the regulatory framework governing the buy now pay later (BNPL) sector citing the results of a recent survey in support.
- The Financial Counselling Australia (FCA) survey of financial counsellors found that:
  - the number of clients presenting with BNPL debt has spiked with 84% of respondents indicating that 'half, most or all' clients now present with BNPL (vs only 31% one year ago). This is attributed to the ease with which BNPL products can be accessed (and the absence of an affordability assessment).
  - 61% of financial counsellors consider that most/all of their clients now struggle to pay other essential living expenses (eg groceries, medical expenses) as a result of their BNPL debts.
  - the survey also found that hardship practices are falling short, with BNPL providers self-regulating under the BNPL Code of Practice rating between 4.7 and 5.5 for hardship practices (where 1 in the lowest rating and 10 is the highest)
- 95% of financial counsellors consider that BNPL products should be regulated, as other credit products are regulated, under the National Credit Code, though the 'exact form of that regulation however needs to be determined'.

[Sources: Financial Counselling Australia media release 06/12/2021; Full text report: It's Credit, It's Causing Harm and It Needs Better Safeguards: What Financial Counsellors Say About Buy Now Pay Later]

'Disaster' claims: ASIC calls on general insurers to prioritise compliance with DDOs and claims handling reforms

- The Australian Securities and Investments Commission (ASIC) has released an article summarising comments by ASIC Senior Executive Leader, Insurers, Rhys Bollen to the Insurance Council of Australia's 2021 Industry Forum. Mr Bollen spoke about the implications of recent reforms – new design and distribution obligations (DDO) and claims handling reforms - from an insurance claims handling perspective and ASIC's expectations of insurers.
- Design and Distribution Obligations:
  - Research projects conducted by ASIC last financial year into how disaster claims are being managed identified that some customers were unaware of limitations in their cover. For example, one research project (conducted prior to the commencement of DDO) focusing on Townsville which is designated as flood prone, found that many customers were unaware of key limitations on their policy and were 'at risk of being underinsured for flooding'.
  - On this point, ASIC states that the introduction of DDO require insurers 'to take a customer-centric approach when designing insurance policies, and target their sales and marketing to the customers their products were designed for'. In the context of 'disaster' policies, Mr Bollen said that this means that insurers 'need to consider whether their products are designed to meet the needs of consumers who live in parts of Australia that are prone to disasters.'
- Claims handling reforms:
  - Mr Bollen also noted that from 1 January 2022, all firms that provide claims handling services will be required to be licensed under the Australian financial services (AFS) licence regime and will need to meet the requirements under that regime.
  - Mr Bollen said that this financial year ASIC is reviewing claims handling in handling in life insurance, with a focus on 'historically problematic practices such as the over-use of physical surveillance of claimants'. He suggested that ASIC 'may do something similar next financial year in the general insurance space'.
- Recommendations for insurers:
  - Insurers should centralise oversight of disaster claims by having in place a 'dedicated end-to-end claims manager' to avoid customers having to re-explain/repeat their story to multiple operators. ASIC research conducted last financial year identified this as a 'significant' area of friction for claimants.
  - Insurers should 'proactively and effectively' communicate with claimants about the claims process, how their claim will be assessed, the timeframe for resolving their claim and the progress of their claim. Again, this was an area of 'significant' friction identified in ASIC research.
  - Mr Bollen also called on insurers 'to invest in the systems, processes and internal controls to ensure good consumer outcomes are achieved for your customers.
- Mr Bollen concluded with the statement: 'We will be monitoring and will consider regulatory intervention where necessary.'

[Source: ASIC media release 07/12/2021]

ASIC has released insights into its review of insurance claims handling during the Black Summer bush fires

The Australian Securities and Investments Commission (ASIC) has released insights from its review into the handling of insurance claims for consumers affected by the 2019-20 'Black Summer' bushfires. ASIC states that detailed findings have been shared directly with insurers.

The review involved ASIC collecting and monitoring the claims handling data of 12 insurers (representing over 90% of home insurance market) over a 15 month period.

ASIC found that across the 8801 claims reviewed:

- almost all claims (99%) determined by insurers were approved in-full or in-part
- 88% of claimants accepted the insurer's decision within four months of lodging a claim
- 93% of claims are closed, 5% withdrawn and 2% open, as at September 2021.

'Good practices' identified

The review identified the following 'good practices', which ASIC has called on all insurers to 'adopt more broadly'.

- 'Responding swiftly to the event, tracking bushfires and proactively contacting customers in affected areas, encouraging them to lodge a claim or even evacuate'
- 'Paying the maximum temporary accommodation benefit at the outset of claims assessed as a 'total loss', to provide certainty to those claimants'
- 'Making product design changes to broaden policy coverage for fire damage, and effectively making this change retrospectively'
- 'In advance of the upcoming disaster season, undertaking simulation exercises to stress-test a response to simultaneous disasters, including how insurers will respond in a pandemic to allow for assessment and emergency repairs to property'

Areas for improvement

ASIC also flagged that some insurers needed to make improvements in certain areas. These areas include the following.

- Systems, processes and internal controls: ASIC considers that some insurers need 'to make improvements to the quality, accuracy and reliability of claims information recorded in their systems. Insurers' data had quality issues including some data missing where ASIC would expect it to be reported (for example, 97 claims were reported with a date of decision, but no decision was reported)'.
- Policies need to meet customer needs:
  - ASIC observes that though almost all claimants were given temporary accommodation under their policy, 'almost 5%' of this group had exhausted the benefit by the end of January 2021 which suggests that 'at least for some policyholders, the cover may have been insufficient to meet consumers' needs'.
  - ASIC observes that 21% of policies had debris removal as part of the sum insured rather than as an additional benefit. ASIC states that 'where it is part of the sum insured there are concerns this may contribute to underinsurance'.

ASIC calls on all insurers to be consumer-centric in handling claims

ASIC Deputy Chair Karen Chester commented:

> 'With summer upon us, we want to remind all insurers they now must manage claims efficiently, honestly and fairly. To consumers, the real value of an insurance policy is tested when they need to claim. It is important that claims are resolved quickly, that the process is consumer-centric, that repairs and rebuilds are timely, and that consumers are supported as well as possible after a disaster.'

ASIC will continue to monitor claims handling practices/processes

ASIC observes that the review was also completed ahead of the commencement of insurance claims handling legislative reforms due to come into force from 1 January 2022.

ASIC states that:

> 'From January 2022, ASIC will continue to work with the industry to set clear expectations and will be monitoring insurers to ensure claims are handled in a manner that is timely, accurate and transparent'.
>
> [Source: ASIC media release 01/12/2021]

Consultation launched on draft legislation to establish a reinsurance pool covering property damage caused by cyclones and cyclone related flood damage

Key Takeouts

- The draft legislation proposes to establish a reinsurance pool for cyclones and related flood damage, to commence from 1 July 2022.
- It's proposed that the Australian Reinsurance Pool Corporation (ARPC) would administer both the cyclone pool and the existing terrorism reinsurance scheme.
- The proposed reinsurance scheme would be funded by industry and backed by a $10 billion government guarantee.

- Unlike the voluntary terrorism reinsurance scheme, it's proposed that insurers providing insurance that covers eligible cyclone risk, would be required to obtain reinsurance for eligible cyclone risk with the ARPC.

- On 4 May 2021, the government announced plans to establish a reinsurance pool covering the risk of property damage caused by cyclones and cyclone related flood damage. The aim of the scheme is to improve both the accessibility and affordability of home and business insurance for consumers.
- On 3 December 2021, Treasury released draft legislation – [draft] Treasury Laws Amendment (Measures for a later sitting) Bill 2021: Cyclone reinsurance Bill; [draft] Terrorism Insurance Amendment (Cyclone and Related Flood Damage Reinsurance Pool) Regulations 2022 – together with a 'factsheet' clarifying the proposed changes, for consultation.
- Broadly, if legislated, the changes would extend the operation of the operation of the Terrorism and Cyclone Insurance Act 2003 (Cth) (the Act) to include the proposed cyclone reinsurance scheme (scheme).
- The proposed scheme would:
  - cover damage caused by a cyclone that commences during a declared cyclone event (as declared by the ARPC)
  - generally mean that contracts covering household property policies, residential and mixed-use strata policies, small business property policies, property policies for charities and not-for-profit entities and farm residential policies would be eligible under the scheme
  - be funded by insurance premiums and supported by a $10 billion annually reinstated Commonwealth guarantee.
- Importantly, it's proposed that unlike the voluntary terrorism reinsurance scheme, insurers providing insurance that covers eligible cyclone risk, would be required to obtain reinsurance for eligible cyclone risk with the Australian Reinsurance Pool Corporation (ARPC) which would be responsible for administering the scheme. Announcing the consultation, Assistant Treasurer Michael Sukkar said that mandatory participation by eligible insurers would 'ensure the reinsurance pool provides the greatest possible reduction in premiums'.
- It's proposed that an initial review of the scheme would be conducted three years after commencement, and then every five years thereafter (to align with the regular reviews of the terrorism reinsurance scheme).

Proposed timing and next steps

- The due date for submissions to the consultation is 17 December 2021
- Proposed implementation:
  - If legislated, insurers would be expected to start entering into reinsurance agreements with the ARPC from 1 July 2022.
  - The proposed deadline for large insurers to have joined the scheme (ie to have obtained reinsurance for all eligible cyclone risks with the ARPC) is 31 December 2023.
  - The proposed deadline for small insurers to have jointed the scheme is 31 December 2024.

ACCC to monitor the effectiveness of the scheme

- Assistant Treasurer Michael Sukkar flagged that the Australian Competition and Consumer Commission (ACCC) will be tasked with monitoring the premiums of insurance policies covered by the pool from 2022.
- Mr Sukkar said that the ACCC is expected to 'collect data to evaluate the impact of the reinsurance pool and assess whether the savings from the reinsurance pool are being passed through to policyholders'.
- Mr Sukkar said that the government would provide the regulator with an extra $18.4 million in funding over five years to enable/support this additional work.

[Sources: Treasury Consultation: Exposure draft legislation: cyclone and related flood damage reinsurance pool 03/12/2021 – 17 December 2021; Assistant Treasurer Michael Sukkar media release 03/12/2021]

Strengthening crisis preparedness: APRA consults on new cross-industry prudential standards

The Australian Prudential Regulation Authority (APRA) has released a discussion paper together with two draft cross-industry prudential standards - CPS 190 Financial Contingency Planning (CPS 190) and CPS 900 Resolution Planning (CPS 900) – for a five month consultation. APRA states that:

'The two proposed standards are aimed at ensuring entities are prepared to deal with threats to their viability, thereby reducing the negative consequences resulting from failure'.

Two draft standards

- Draft CPS 190 Financial Contingency Planning (CPS 190) would require all APRA-regulated entities to have in place detailed plans (commensurate with the size and complexity of their business) setting out the actions they would take to 'restore financial resilience or exit the industry safely' if they were under severe financial stress.
- CPS 900 Resolution Planning (CPS 900) would 'require large or complex APRA-regulated entities to take pre-emptive actions so that, in the event of their failure, APRA can resolve them with limited adverse impacts on the community and the financial system'.

Timing

- The due date for submissions on the draft standards is 29 April 2022.
- APRA proposes that CPS 900 would come into force from 1 January 2024
- CPS 190 is proposed to commence on 1 January 2025 for superannuation trustees and 1 January 2024 for all other entities.
- APRA plans to consult on supporting guidance material in 2022.

Four major banks required to maintain additional loss-absorbing capacity

APRA has also written to the four major banks to notify them that by 1 January 2026, they will be required to maintain additional that the final setting for loss-absorbing capacity will be an increase in minimum Total Capital requirements of 4.5 percentage points of risk-weighted assets, to be met from 1 January 2026.

APRA states that the purpose of this is to ensure that 'in the unlikely event of a failure, a major bank could be recapitalised using a large pool of private, rather than taxpayer, funds'.

Deputy Chair John Lonsdale said the disorderly failure of an APRA-regulated entity could have a significant impact on the economy and society.

> 'APRA-regulated entities have made substantial improvements in contingency planning over recent years, however there remain large gaps in capabilities between entities and across industries. By laying out a consistent, transparent and enforceable framework, APRA will be better able to strengthen crisis preparedness and close those gaps' Mr Lonsdale said.
>
> [Sources: APRA media release 02/12/2021]

ASIC releases guidance on limited advice

- In response to stakeholders calls for more practical guidance, the Australian Securities and Investments Commission (ASIC) has released an information sheet – INFO 267: Tips for giving limited advice – together with an example statement of advice (SOA).
- Broadly, INFO 267 outlines some of the steps advisers can take to help ensure they meet their legal obligations (eg the best interests duty) as well as the Financial Adviser Standards and Ethics Authority (FASEA) Financial Planners and Advisers Code of Ethics (Code of Ethics) when giving limited advice. INFO 267 supplements existing guidance in RG 175 Licensing: Financial product advisers-Conduct and disclosure and RG 244: Giving information, general advice and scaled advice.
- The example SOA is annotated to aid understanding of the relevant requirements under the Corporations Act 2001 (Cth).
- ASIC's aim in releasing the INFO Sheet and annotated SOA example, is to provide clarity around the compliance obligations attaching to the provision personal advice to retail clients, and in doing so, support compliance.
- ASIC Commissioner Danielle Press commented:

> 'We expect this guidance will provide regulatory certainty to industry and help reduce compliance costs. It will assist financial advisers in their efforts to make these forms of advice more available to consumers and assist them in delivering quality advice in a timely, affordable, and compliant manner.'
>
> [Sources: ASIC media release 01/12/2021; INFO 267: Tips for giving limited advice; example statement of advice]

In Brief | The Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021 has been referred to the Senate Economics Legislation Committee for report by 3 February 2022

[Source: Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021]

In Brief | Jobkeeper information required to be disclosed by listed entities, including whether the entity or its subsidiaries have made voluntary repayments of Jobkeeper payments, and the total amount of those repayments, is now publicly available on ASIC's website. ASIC plans to update the report monthly. The current report captures Jobkeeper information disclosed up until 30 November 2021

[Sources: ASIC media release 07/12/2021; Consolidated Report]

In Brief | ASIC has launched 'a centralised financial advice webpage' to make ASIC guidance easier to find and access

[Sources: ASIC media release 07/12/2021; ASIC Financial Advice Hub]

Accounting and Audit

ASIC to 'routinely' tell directors about audit quality concerns? ASIC consults on proposed changes to its approach to communicating the findings of audit reviews

The Australian Securities and Investments Commission (ASIC) has released a consultation paper - Consultation Paper 352 Communicating audit findings to directors, audit committees or senior managers (CP 352) together with proposed revisions to Regulatory Guide 260: Communicating findings from audit files to directors, audit committees or senior managers (RG 260) - seeking feedback on its proposal to start communicating audit review findings directly to the directors of entities audited on a routine basis, as opposed to the current 'exception' basis.

More particularly, ASIC proposes to start 'routinely' communicating the findings of its review of audit files where it:

- believes that an auditor 'has not obtained reasonable assurance that the entity's financial report is free of material misstatement'
- 'considers that audit work should be improved in future years, even though reasonable assurance was obtained that the financial report for the current year was free of material misstatement'
- 'has concerns that the auditor did not meet the independence requirements of the Corporations Act (including professional requirements), has not addressed the matter, and has not adequately reported the matter in an auditor's independence declaration'
- 'considers any other matter should be drawn to the attention of the directors or audit committee of the audited entity'.

ASIC Commissioner Sean Hughes said that the proposed shift in approach is intended to:

> 'assist audit committees and directors to engage the auditor on the steps they are taking to address any issues and ensure that the audit is adequately resourced. This is important in supporting audit quality and broader market confidence in the quality of financial reports'.

The consultation on the proposed change follows the release of ASIC's latest review - REP 709 Audit inspection report: 1 July 2020 to 30 June 2021 (see: Governance News 1 December 2021 at p28) – in which ASIC made 'negative findings' in 23% of the 115 key audit areas reviewed across 35 audit files of the six largest audit firms.

The due date for submissions to the consultation is 11 February 2022.

> [Sources: ASIC media release 02/12/2021; Consultation Paper 352 Communicating audit findings to directors, audit committees or senior managers (CP 352); Draft: Regulatory Guide 260: Communicating findings from audit files to directors, audit committees or senior managers (RG 260)]

Greenpeace report finds investors are unwilling to vote against auditor appointments (despite climate shortcomings)

A Greenpeace report has highlighted the level of apparent unwillingness on the part of investors to hold auditors to account on climate related risk. The report comments that

> 'Auditor appointments are waved through by the vast majority of shareholders with very few objections of any kind and negligible numbers of climate-related concerns'.

For example, the report found that:

- In 2021, auditors at all in-scope FTSE 100 companies received 90% or more shareholder support, with only one company receiving less than 95% support.
- Interestingly, the report found that this high level of support also applied to 'High Carbon Companies'. According to the report, all auditor appointment votes at these companies also received over 90% shareholder support
- Both BlackRock and Vanguard voted for all auditors in their FTSE 100 and FTSE 250 holdings.

More willing to vote for shareholder resolutions than to vote against appointing auditors?

The report also flags that shareholders appear to be more willing to vote for non-binding shareholder resolutions calling for separate audited reports on the impact of a 1.5°C scenario on key financial assumptions, as compared with voting on auditors or accounts.

Call for the UK government to impose new duties

Citing the report findings Greenpeace has called on the UK government to legislate specific duties for companies, their directors and auditors, to ensure climate risk is appropriately reflected in financial statements.

More particularly, Greenpeace has called for company directors to be required to:

- State in the notes to the financial statements whether and how they have adopted assumptions/estimates in their accounts which are compatible with a Paris-aligned corporate strategy.
- If they have not, to provide supplementary disclosures in the notes to the financial statements detailing how the accounts would be impacted if they had used such assumptions/estimates.

Greenpeace has also called for auditors to be required to 'undertake audits that test accounts against assumptions/estimates aligned with 1.5° Goal and flag to shareholders any concerns about the assumptions and estimates used by the company'.

Calls for shareholders to be more vigilant on climate risk in the audit context

Greenpeace has also called on shareholders not only to support shareholder resolutions calling on companies to publish audited reports on the financial implications of climate risks but to both:

- Include (in addition to other criteria) climate risk integration as an assessment criterion for voting on auditor appointments
- Adopt a stewardship policy to 'vote against the reappointment of audit committee chairs and auditors at companies that do not integrate material climate change-related information into their reports and accounts'.

> [Source: Greenpeace report: Accountable: Shareholder votes on auditor appointments]

Risk Management

ASIC has released an update on financial firms' progress towards improved cyber-resilience, supply chain risk remains an area of concern

The Australian Securities and Investments Commission has released its third update on the cyber resilience of financial firms: Report 716 Cyber resilience of firms in Australia's financial markets: 2020–21 (REP 716). The report is based on a voluntary self-assessment by financial firms against the National Institute of Standards in Technology (NIST) Cybersecurity Framework.

For context, firms were asked to assess their cyber resilience against five functions – identify, protect, detect, respond and recover – using a five stage scale ranging from the lowest level of preparedness, 'partial' to the highest level of preparedness 'adaptive'.

The report provides a progress update on organisations' cyber resilience in the two years since the publication of Report 651 Cyber resilience of firms in Australia's financial markets in November 2018-19 and the 2017 report, Report 555 Cyber resilience of firms in Australia's financial markets (REP 555).

Key Takeaways

Less improvement than anticipated

- The report concludes that there was an overall 1.4% improvement since the last report.
- ASIC observes that this is well below the 15% improvement achieved between the release of the 2017 and 2019 reports, and is also below the 14.9% improvement targeted by financial services firms for the 2020/21 period.
- ASIC attributes this to three causes: 1) 'overly ambitious targets'; 2) 'escalation in the threat environment'; and 3) reprioritisation due to the pandemic'.
- Some good progress:
  - The report identified improvements in the management of digital assets (7.2%), business environment (6.0%), staff awareness and training (4.7%), and protective security controls (4.5%).
  - The report also found that: 90% of firms have strengthened user and privileged access management, 88% of firms are ensuring users are trained and aware of cyber risks and 86% of firms have 'mature cyber incident response plans in place'.
- ASIC also found that the cyber resilience of many SMEs has improved while the confident of larger firms in their cyber resilience has decreased, narrowing the gap between small and larger firms on the issue.

Supply chains

- ASIC flags the level of cyber resilience for supply chain risks as an area of concern given the lack of 'material improvement' in the area since the last report. ASIC comments that supply chain risk was identified as the area with the highest improvement target for the period.
- 'Areas of challenge' highlighted by ASIC include:
  - identifying details of information flows (31.8% of firms rated themselves as 'risk-informed' or 'partial' – the lowest rating of preparedness on the five level scale)
  - incorporating security requirements into supplier contracts (38.4% of firms rated themselves as 'risk-informed' or 'partial')
  - adequate supplier monitoring to maintain visibility of risks (42% of firms rated themselves as 'risk-informed' or 'partial')
- Larger firms were ahead of SMEs in terms of improving practices.
- Firms are targeting a 16.9% improvement over the next 12 to 24 months.
- APRA and has called on all firms to prioritise investment in supply chain risk management. ASIC comments:

  > 'While all organisations identified supply chain risk management as their top priority for the future, we encourage all firms to consider the application of the good practices identified in the report for managing these risks. Failure to invest in supply chain risk management could lead to significant consumer harm that might warrant ASIC investigation and action'.

'Good practices'

The report highlights some examples of what ASIC considers to be 'good practice' and insights into where firms currently stand. The table below provides a snapshot.

GOOD PRACTICE	ASIC'S OBSERVATIONS
Assessing suppliers and monitoring them for risks: ASIC considers that critical suppliers should be subjected to the same level of scrutiny/treated similarly to internal threats. They should be included in risk governance frameworks/standards and monitored based on their risk profile and ability to affect the firm's service delivery.	▪ ASIC observed that 'more mature firms' reported that all critical service providers are subject to an independent annual audit ▪ However, some firms reported having no monitoring processes in place for suppliers, and some 'declared confidence in their suppliers to manage cyber risks' or were reliance on attestations from some of their larger suppliers. ▪ ASIC comments that there is recognition among many firms of the need for structured processes to manage this risk. Many firms are investing in building their capability in this area over the next period, with a number having initiated third party supplier management programs.
Mapping critical information and data flows: ASIC considers that information and data flows for internally and externally managed systems should be documented. ASIC emphasises that the tools used to document these systems should 'enable easy maintenance and regular risk reviews' which in turn should inform the overall risk profile of suppliers.	▪ ASIC found that 'Firms are clearly aware of the need for visibility and effective risk management in this area. They reported initiatives that are underway and further progress planned over the next period'.
Incorporating security requirements into supplier contracts: ASIC considers that a 'minimum set of security requirements' should be incorporated into supplier contracts, including periodic assessments performed by the firm or external assessors.	▪ ASIC states that the more mature firms have a minimum set of security requirements stipulated within contracts with all critical suppliers. ▪ However: – Some firms reported that suppliers were not required to implement any security controls. Others reported that cybersecurity requirements are not 'specifically incorporated into supplier arrangements, but were assessed periodically'. – 'Many' firms reported that only some contracts incorporated security requirements. These firms had plans in place to address this as contracts come up for renewal.

[Sources: ASIC media release 06/12/2021; Report 716 Cyber resilience of firms in Australia's financial markets: 2020–21 (REP 716)]

In Brief | Climate-related issues dominate MSCI's predicted top 10 ESG trends for 2022. MSCI predicts that as the world's largest companies embrace net-zero, pressure on suppliers to decrease their GHG emissions will significantly increase over the next year to the point where it 'may become as familiar to suppliers as downward pressure on pricing'

[Source: MSCI report: 10 ESG Trends to watch in 2022]

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