Governance News

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

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Remuneration

Investment Association cautions UK companies over pay decisions

The UK Investment Association has released its Principles of remuneration for 2022. In a letter to FTSE 350 companies the IA highlighted its key areas of focus heading into the 2022 AGM season, as well as key changes to the Principles.

Key areas of focus

- **Expectation that companies continue to show 'restraint' in the context of pay decisions:** Given the ongoing impact of the pandemic, the IA expects remuneration committees to continue to demonstrate 'restraint' when determining executive remuneration outcomes. Where companies have taken but not repaid COVID-19 government support, the IA expects that annual bonuses will not be paid. Generally, the IA expects all remuneration committees to factor in the 'wider stakeholder experience' into remuneration decisions and to clearly communicate the approach the company has taken.
- ESG Metrics in Executive Remuneration:
  - Where companies have integrated ESG risks/opportunities into their long-term strategy, the IA ultimately expects companies to hold executives to account for managing them appropriately through the integration of appropriate ESG metrics into their variable remuneration. These metrics are expected to be: 'quantifiable and clearly linked to company strategy'. The rationale for the selected ESG metrics and targets is also expected to be disclosed.
  - For companies have yet to tie execution of long-term ESG strategy to remuneration outcomes, the IA expects companies to disclose plans for how they intend to do so and the approach they will take in future years.

Principles of Remuneration 2022: Key Changes

The Principles of Remuneration 2022 have been updated to 'reflect developments in market practice and investor expectations'. Key changes highlighted by the IA include the following.

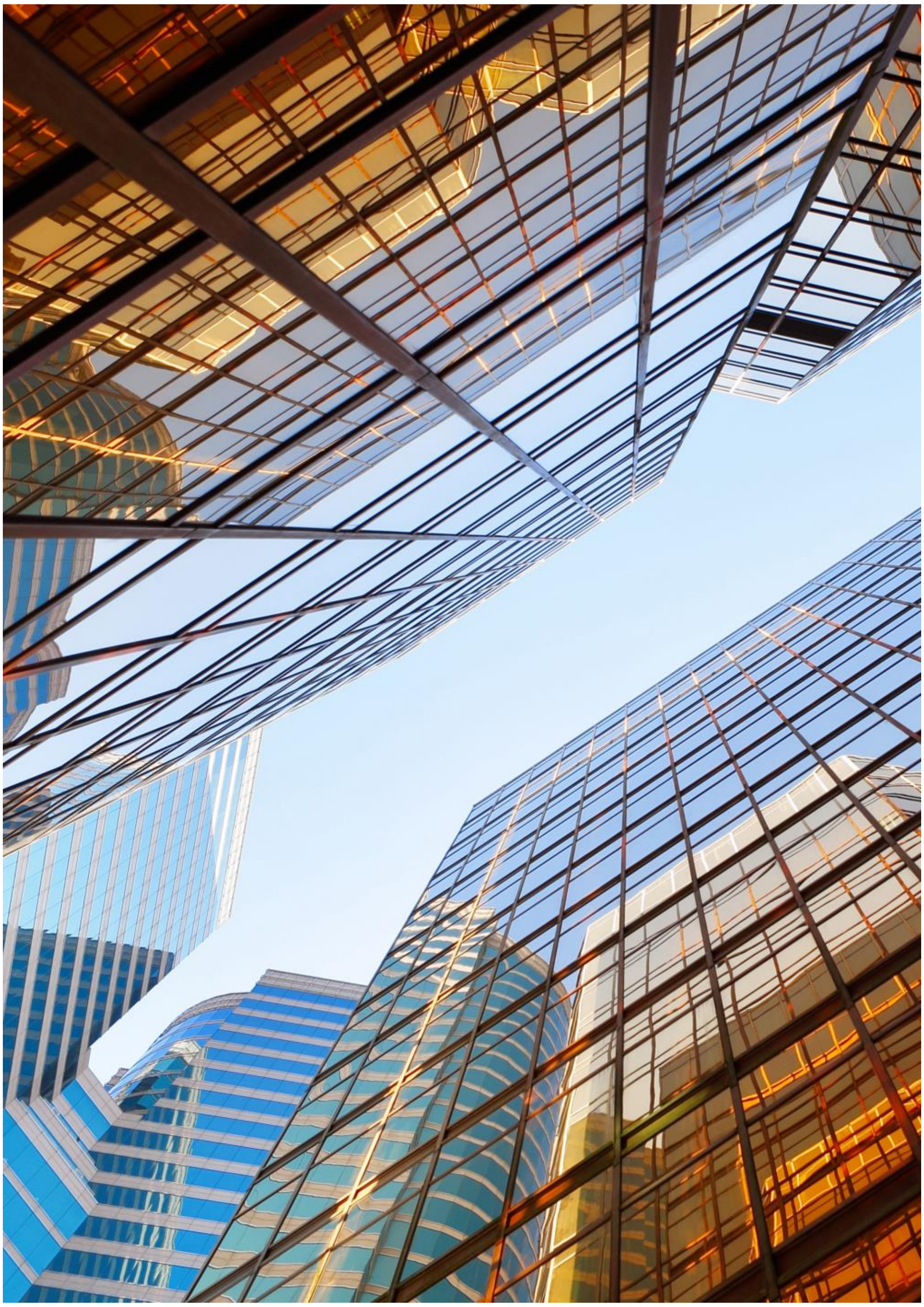
CHANGE	DETAILS
Levels of Remuneration	▪ The Principles of have been updated to make clear that Remuneration Committees are expected to provide a clear rationale for any increase to total remuneration/any element of remuneration
Value Creation Plans (VCPs)	▪ The Principles have been updated to include a new section on investor expectations of VCPs in light of their increased adoption over the 2021 AGM season. ▪ The Principles state that VCPs will be assessed/considered on a case-by-case basis and flag that investors 'are generally sceptical of their introduction'.
Grant Size	▪ The Principles make clear that where share prices have fallen, the IA's preferred approach is for companies to reduce awards at grant stage (rather than 'relying on discretion when awards vest').
Approach to Pensions	▪ In line with the IA's goal for all executive pension contributions to be aligned to the majority of the workforce rate by the end of 2022, them IA's Institutional Voting Information Service (IVIS) will: – 'Red Top' (ie flag as an area of serious concern) any new remuneration policy that 'does not explicitly state that any appointed executive director will have their pension contribution set in line with the majority of the workforce'. – Red Top 'any remuneration report where executive pension contributions are not aligned to the majority of the workforce rate or there is not a credible action plan to align pension contributions for incumbent directors by the end of 2022'.

[Sources: UK Investment Association media release 19/11/2021; Letter to FTSE 350 companies; 2022 Principles of Remuneration]

PwC finds FTSE100 CEO pay dropped in 2021

- According to PwC's analysis of the director remuneration reports at 97 FTSE100 companies that were voted on in the 2021 AGM season, FTSE companies showed restraint on CEO pay decisions. For example:

- FTSE100 CEO median total pay fell by 9% from £3,247,000 in 2020 to £2,940,000 in 2021
  - Fewer CEOs received a bonus this year: 28% of CEOs received zero bonus (as a result of not meeting targets, or the bonus being cancelled or waived) vs 14% in 2020.
  - Fewer CEOs' salaries were frozen: 45% of CEOs have had their salaries frozen for 2021 down from 52% in 2020.
- PwC also found that the trend towards the inclusion of ESG metrics as part of variable incentive arrangements continued to gain momentum in 2021. For example:
  - 58% of the FTSE 100 companies tie ESG measures to executive pay (up from 45% in 2020)
  - 28% of FTSE 100 companies have a measure linked to decarbonisation and net zero
  - 46% of companies included an ESG measure in their annual bonus for 2020. The average weighting given to such measures was 16%
  - 32% incorporated an ESG measure into their 2021 long-term incentive plans (LTIP). The average weighting given was 20%.

  On this issue, PwC UK Reward and Employment Leader Phillippa O'Connor commented that:

  > 'Executive pay and reward offer an important lever to align senior leaders with ESG challenges and is increasingly seen as a key tool to achieving change, with two thirds of investors believing that ESG performance measures and targets should be included in executive pay'.

- Increased willingness to vote 'against' pay: PwC also found that shareholder approval of remuneration packages was lower with the proportion of companies receiving less than 80% support increasing and the proportion of companies receiving over 90% support decreasing.
- PwC UK's expectation is that these trends will continue looking ahead to the 2022 AGM season.

  [Source: PwC UK media release 22/11/2021]

Diversity

Gender equality: 48% of men in 'white collar' roles are 'fatigued' by the discussion

A study into the attitudes of 1000 Australian men working in 'white collar' roles looked at respondents' attitudes to gender equality generally and in the workplace, as well as attitudes to diversity, equity and inclusion (DE&I) initiatives. The study aimed not only to gauge current attitudes, but to identify key barriers to the success of DE&I initiatives and identify key motivators that could drive engagement/participation.

Some interesting findings

Attitudes to gender equality

The study found that though most respondents (65%) agree that 'gender equality affects all of us' and that 'something needs to be done',30% of respondents consider that 'it's not my place to say anything, as it's not really my responsibility'.

The study also identified an apparent lack of acceptance among some men that gender discrimination is an issue. For example:

- 25% of respondents agree that 'men and women aren't supposed to be equal. I believe gender initiatives actually do more harm than good'.
- 45% of respondents consider that if women 'fall behind in society or the workplace men aren't to blame – sometimes women are less driven or motivated'
- 44% consider that men and women are already treated equally

The study found that nearly half of respondents are 'tired of hearing about it': 48% of respondents overall are 'fatigued' by gender equality.

Concerningly, 52% of respondents consider that 'reverse discrimination' is occurring to the point where they are missing out on work opportunities (eg promotions).

Having said this, 51% of respondents consider that their opportunities for advancement have not changed over the past two years.

Perceptions of personal influence/impact

- The respondents in the most senior roles within organisations ('top management') were considerably more likely than those in more junior roles to acknowledge the critical impact that men have on achieving gender equality:
  - 63% of respondents in 'top management' roles agree that men have a critical role to play
  - Interestingly, the proportion of worker/employee respondents who shared this view was slightly higher at 55% than men in the senior/middle management (54%) or front line management (53%) categories.

- From an age perspective, men in the 18-24 age bracket, are more likely than any other age group to recognise that men have a critical impact and the least likely to consider men have zero impact.
- Men in 'family life stages' are also more likely to consider they have an impact, than men who are not.

Willingness and ability to influence change

- Men in the 18-24 age group have the highest level of 'willingness' to drive change.
- The level of engagement among other age groups is very considerably lower. The survey identifies that over 40% of respondents ranging in age from 25-75 will be 'difficult to engage in the GE movement'.

Key motivators?

- The report suggests that for men with a high ability to influence/drive change, but low willingness to do so, 'altruistic' goals (eg benefits for the company eg improved business performance, team or family) may be the most effective motivators. For example:
  - The survey found that 'altruistic' goals are overall, the top two motivators in terms of participating in training. These are: a) a personal belief that gender equality is 'the right thing to do' (51% of respondents); and b) that it is a way of supporting female colleagues (48%). 45% of respondents also consider that training could be good for team development.
  - In contrast, 'self-oriented' goals were overall less motivating. For example, the survey found that only 31% of men would be motivated by benefits to their own career opportunities.
- The survey also found that respondents are most likely to be motivated and engaged by 'real voices' (personal experiences of real people)
- Most respondents would prefer an interactive, workshop format that 'values the input of men', backed up with the 'research-supported' context and theory behind the training (as opposed to a passive, one-way discussion)
- 63% of respondents overall would prefer 'mixed gender' training (as opposed to training occurring in an all male setting).

Barriers?

- Of the eight possible barriers to participation in training put forward in the report, time required for training (58%), concern that it could lead to 'reduced opportunities for me' (49%) and 'doesn't match my workplace culture' (47%) were the top three concerns.
- 48% of respondents indicated that any of the eight barriers put forward would deter them (at least slightly) from participating in training on the issue:

Who was surveyed

- 83% of respondents worked in 'white collar/office/professional' roles. 17% worked in retail/hospitality/service roles.
- Respondents were drawn from a range of sectors including
- In terms of career stage: 40% of respondents were 'employees', 26% were middle or senior management, 24% were first line management, and only 9% were 'top management' (C-suite, Chair, VP or directors).
- 48% of respondents work in small to medium businesses (6-199 employees), and 45% work in larger enterprises (200 or more employees).
- 30% of respondents fell into the 24-40 age category, 29% fell into the 41-56 age category, 25% fell into the 57-75 age category, and 15% fell into the 15-24 age category. The remainder fell into the 76+ age category.

[Source: Full text report: The Dream Collective: Allyship and Gender Equality Research]

Disclosure and Reporting

ASIC to extend deadlines for 31 December 2021 unlisted entity financial reports

- In response to the ongoing disruption caused by the COVID-19 pandemic, the Australian Securities and Investments Commission (ASIC) plans to extend the deadline for unlisted entities to lodge financial reports by one month for balance dates from 24 December 2021 to 7 January 2022 (inclusive).
- ASIC states that an instrument to amend ASIC Corporations (Extended Reporting and Lodgement Deadlines – Unlisted Entities) Instrument 2020/395 to extend the deadlines is 'expected to be registered on the Federal Register of Legislation by the end of next week'.

Details of extended deadlines

- The deadline for lodgement of full year financial reports, directors' reports and auditor's reports for unlisted disclosing entities and for unlisted registered schemes, is extended from 3 to 4 months. The deadline for all other unlisted entities is extended from 4 to 5 months.
- The deadline for lodgement of half-year financial reports, directors' reports and audit/review reports for unlisted disclosing entities (including unlisted registered schemes that are disclosing entities) is extended from 75 days to 75 days plus 1 month.
- The deadline for lodgement of profit and loss and balance sheets (and other associated information) for:
  - unlisted Australian financial services (AFS) licensees that are bodies corporate and also disclosing entities or registered schemes is extended from 3 months to 4 months.
  - unlisted AFS licensees that are body corporates and are not disclosing entities or registered schemes is extended from 4 months to 5 months.
  - AFS licensees that are not bodies corporate is extended from 2 months to 3 months.
- The relief will not apply to registered foreign companies.
- ASIC will consider relief for other entities and balance dates on a case-by-case basis, where appropriate.

Consequential relief

- For entities that make use of the extended deadlines, ASIC states that the following relief will also be available (where applicable):
  - Similar extended deadlines will be available for sending reports to members
  - Unlisted public companies will be given up to 6 months after year end to hold their AGMs
  - The deadlines for compliance plan audits for registered schemes will be extended by one month
- The reporting deadlines in ASIC Corporations (Wholly-owned Companies) Instrument 2016/785 will be extended by one month for balance dates from 24 December 2021 to 7 January 2022.

Reporting periods ending after 7 January 2022

ASIC states that 'at present' there is no indication that further extensions of time will be necessary for reporting periods ending after 7 January 2022, but it will continue to monitor market conditions and COVID-19 related developments on this front.

[Source: ASIC media release 30/11/2021]

Meetings and Proxy Advisers

Progress update: Meetings and Documents Bill amended in the House

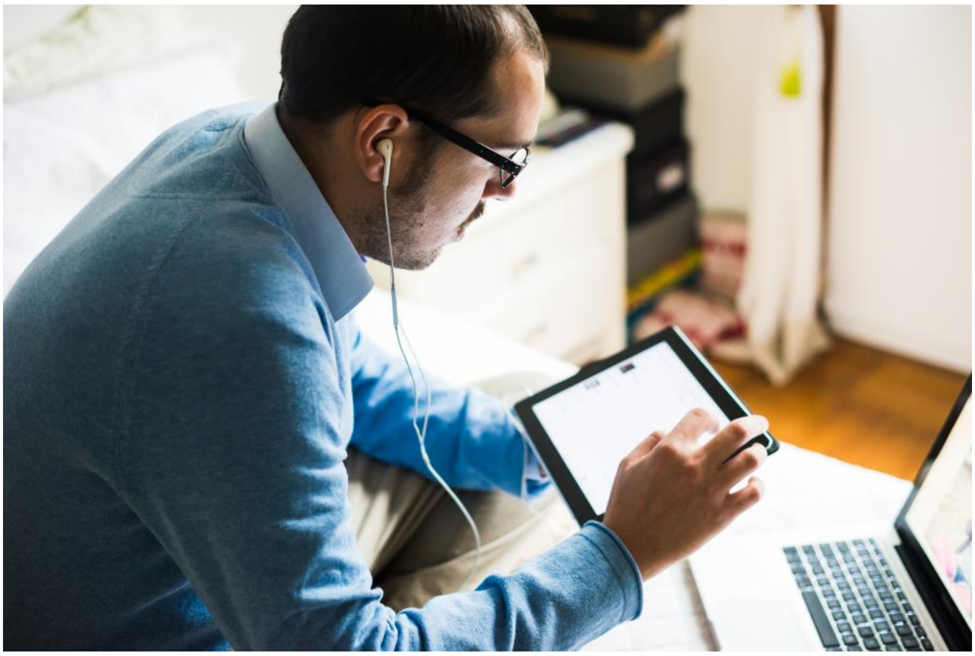
The Bill has been amended so that, if legislated, proposed permanent reforms enabling companies to hold virtual meetings would sunset unless a report into their operation is tabled within a set timeframe.

Context

- Temporary relief (details here) enabling companies to use technology to meet regulatory requirements under the Corporations Act 2001 (Cth) around convening meetings, distributing meeting related materials and signing/executing documents is now in place until 31 March 2022.
- A Bill proposing to introduce permanent reform - Corporations Amendment (Meetings and Documents) Bill 2021 (Bill) – is now before parliament. Importantly, the proposed changes are not identical to the temporary measures now in place. It's planned that the permanent changes introduced by the Bill will take effect immediately after temporary relief measures expire. You can find an overview of the proposed measures in the Bill, and discussion of how they differ from those currently in place, here.

Virtual Meetings: The Bill has been amended in the House

The House of Representatives has voted to approve government amendments to the Bill. Broadly, the changes mean that:



- The provisions in the Bill enabling wholly virtual meetings (sections 249R(c) and 252P(c) of the Corporations Act 2001 (Cth)) would 'cease to have effect' if a report (or reports) into the operation the provisions is not tabled in parliament before the end of two and half years (30 months) of the commencement of Schedule 1 of the Bill. If the provisions ceased to have effect, it's proposed that any meetings held prior to the end of that period would still be valid, but wholly virtual meetings could not continue to be held.
- The review would need to be conducted by an independent panel with at least one member with experience in corporate governance and the role of company directors, experience advocating for corporate social responsibility and experience representing the interests of shareholders.
- If a report into the virtual meeting provisions were to include recommendation, the government would be required to prepare and table within a set timeframe.

While the Senate Report into the Bill ultimately recommended that it be passed, Labor members Committee that recommended that 'an independent review of the Bill be conducted within two years of its implementation date, with particular attention paid to the ability of shareholders to participate in meetings and hold directors to account'.

The Bill has progressed to third reading stage in the House and is yet to be introduced into the Senate.

[Source: Corporations Amendment (Meetings and Documents) Bill 2021]

Institutional Investors and Stewardship

Global report finds companies are facing an uphill battle to convince investors to trust their ESG commitments

The Edelman Trust Barometer Special Report: Institutional Investors US Report provides insights into investor views on a range of issues including: ESG, climate change, shareholder activism and employee activism. The report is based on a survey of 700 institutional investors in seven markets (the US, Canada, the UK, Germany, the Netherlands, the Middle East and Japan) undertaken between 11 August 2021 and 3 September 2021.

Some Key Takeaways

Net zero plans are a baseline expectation

- 91% of investors across all markets expect the companies in which they invest to set and communicate a plan for achieving net zero emissions. The proportion is higher among US investors at 94%
- 88% of investors across all markets, and 93% of US investors, consider that companies that have articulated a net-zero plan deserve a premium

ESG subjected to the same scrutiny as other issues

- The report found that overall 88% of investors across all seven markets subject ESG to the same scrutiny as operational/financial considerations. This proportion is even higher among US investors at 90%.
- Across all markets, most (84%) investors agreed that they 'specifically look for instances when companies do not deliver on their ESG disclosures and promises'. Again, the proportion was higher among US investors at 91%.

Investors don't trust the accuracy of ESG disclosure and many are concerned that companies will not deliver on their stated commitments

- The report found that there is a high level of scepticism among investors across all markets about the ESG disclosures/commitments made by companies. Overall 82% of investors are concerned about this issue.
- The report found that the level of concern is highest among US investors:
  - 86% of US investors consider companies 'frequently overstate or exaggerate their ESG progress when disclosing results'

- In contrast, the level of concern is lowest among Japanese and Canadian investors (75% and 77% respectively).

The report also found that there is a high level of concern among investors that companies will not deliver on their stated ESG commitments with 72% of investors globally indicating that this is a concern. Drilling down, 92% of US investors are concerned that companies are not effectively executing on their net-zero plans (vs 79% of investors across all seven markets).

Most investors support mandatory ESG disclosure and more regulation

- 85% of investors globally, and 91% of US investors, support the introduction of mandatory ESG disclosure requirements.
- 84% of investors globally, and 87% of US investors, consider that their governments should 'apply more pressure to enforce ESG compliance'
- Most investors globally (81%) consider that companies are not currently disclosing enough ESG information. The proportion is even higher in the US at 84%.

Most investors anticipate an uptick in climate-related litigation as a result of failure by companies to live up to their stated commitments

- The report found 87% of investors across all markets anticipate an increase in the volume of litigation as a result of companies not delivering on ESG promises. Again, the level of certainty on this issue was highest among US investors at 94%.

Approach to investing

- The report found that the vast majority of US investors (95%) are 'interested' in adopting an activist approach to investing.
- Interestingly, 94% of US investors indicated that they 'proactively approach' activists with ideas for change. For context, 88% of investors across all seven markets indicated that they do this.
- According to the report, environment and board structure are the top activist issues for US investors.
  - 81% of US investors indicated that they are likely to engage in shareholder activism on board structure.
  - Over 75% indicate they are likely to engage in shareholder activism on climate issues – eg eco efficiency of a company's operations, environmental impact of supply chain, and greenhouse emissions.

Workforce activism is not a negative?

On the issue of workforce activism, the report found signs that investors tend to view it as a sign of a healthy corporate culture. For example 74% of global investors believe employee activism is indicative of a healthy workplace culture.

The report points out that 2019 Investor Trust Data found that 74% of global investors agreed that companies with activist employees are less attractive investments

[Sources: Edelman media release 17/11/2021; US Institutional Investor Trust Report]

In Brief | The FRC's latest review of reporting against the UK Corporate Governance Code concludes that reporting has improved slightly, but that there is 'still room for further improvement' in a number of areas including disclosure around how companies are applying the Code's principles and explanations for non-compliance as well as disclosure on board appointment, succession planning and diversity

[Source: FRC media release 25/11/2021; Review of Corporate Governance Reporting]

Regulators

Top Story | The Financial Regulator Assessment Authority has launched its first review of ASIC's capability and effectiveness

The scope, approach and timing of the inaugural review of ASIC by the new regulator oversight body, the Financial Regulator Assessment Authority (FRAA), has been confirmed.

Key Takeouts

- The new Financial Regulator Assessment Authority has commenced its inaugural review of the Australian Securities and Investments Commission (ASIC).
- Rather than being a broad-based assessment of ASIC's overall capability and effectiveness, the review will be a targeted assessment of ASIC's strategic prioritisation, planning and decision-making, as well as its surveillance and licensing functions with a strong focus on the regulator's technological capability/use of technology/data.
- This targeted approach will be replicated in future reviews of both ASIC and the Australian Prudential Regulation Authority (APRA).
- The FRAA is due to deliver its report on ASIC to the Minister in Q3 2022.
- The FRAA's first assessment of APRA will commence in 2022, with a report due to be provided to the Minister 'in 2023'.

The Financial Regulator Assessment Authority (FRAA) was established on 29 June 2021 by the Financial Regulator Assessment Authority Act 2021 in response to Hayne recommendations 6.13 and 6.14.

Broadly, the FRAA is tasked with assessing and reporting on the effectiveness and capability of the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA).

On 29 November 2021, the Treasurer announced the launch of FRAA's inaugural review of ASIC. As part of the review process, a consultation paper has been released outlining the FRAA's planned approach to the ASIC Review and to future reviews. The paper also includes 19 specific questions for feedback.

A high level overview is below.

General approach: The FRAA's approach to conducting reviews of the regulators

It's envisaged that:

- The FRAA will conduct targeted biennial reviews of the capability and effectiveness of the regulators. Rather than assessing the overall capability and effectiveness of the regulators as previous capability reviews have done, each review will focus on a defined set of specific issues. These targeted reviews will replace the ad-hoc reviews that have been conducted to date.
- The rationale given for this is as follows.

  > 'Given the breadth of ASIC and APRA's operations, this approach will enable the FRAA to undertake meaningful assessments of each regulatory function and provide sufficient opportunities for the regulators to take action to address findings from the FRAA reviews'.

- The FRAA will undertake its reviews in consultation with the regulators to ensure its assessments 'address the challenges faced by the regulators at the time they are conducted'.
- The reviews will also be informed by stakeholder consultation.
- Importantly, the reviews are expected to be:

  > 'guided by the statutory objectives and responsibilities of the regulators, the government's Statement of Expectations, and the regulators' Statement of Intent'.

Announcing the inaugural ASIC Review, Treasurer Josh Frydenberg emphasised this point stating that:

> 'The FRAA's review will be conducted against the backdrop of the Government's Statement of Expectations and the need for ASIC to continue supporting Australia's economic recovery from the COVID-19 pandemic'.

Inaugural review of ASIC: Scope of the Review

ASIC's approach to 'strategic prioritisation, planning and decision making'

- The consultation paper states that this aspect of the review will include assessment of the regulator's: a) 'regulatory decisions'; b) strategic decisions; and c) decisions relating to the implementation of strategic priorities and allocation of resources. The review will also consider the 'consistency of decision-making within ASIC, its alignment with articulated priorities, as well as whether the strategic prioritisation process is sufficiently responsive to risks identified by ASIC'.
- The consultation paper makes clear that the FRAA will not assess decisions on particular cases or regulatory matters, rather the review will 'assess decision-making in ASIC in terms of overall ASIC governance and process'.
- The assessment of ASIC's strategic prioritisation, planning and decision making is expected to both 'inform other components of the first assessment of ASIC, and subsequent assessments focussing on other areas of ASIC's work'.

The consultation paper includes five questions on this aspect of the review for stakeholder feedback. These are as follows.

- 'Does ASIC have a clear and effective framework for setting strategic priorities and making decisions consistent with those strategic priorities?'
- 'How effective is ASIC's process for identifying risks, and addressing these risks through its strategic prioritisation and decision-making? How effectively is data and technology utilised to inform these processes?'
- 'How effective is ASIC in implementing its strategic priorities and decisions, and allocating resources to give effect to them?'
- 'Are there processes and systems in place to effectively monitor and oversee ASIC's decision-making to ensure decisions give effect to the direction and strategic priorities set by ASIC? Do these processes and systems result in appropriate consistency of decision-making across all levels of ASIC decision makers?'
- 'Is ASIC's strategic prioritisation and decision-making framework clearly communicated to and understood by ASIC staff and external stakeholders?'

ASIC's surveillance work

The review will consider ASIC's surveillance work which is described in the consultation paper as:

> 'the monitoring of markets and regulated entities, ASIC's targeted surveillances of individual firms, and ASIC's targeted surveillances of larger groups of entities or products (sometimes described as thematic assessments)'.

The consultation paper includes five questions on this aspect of the review for stakeholder feedback. These are as follows.

- 'How does ASIC make decisions about the prioritisation and resourcing of surveillance activities?'
- 'To what extent are ASIC's surveillances targeted, efficient, and proportionate? Are those surveillances effective?'
- 'To what extent does ASIC have the appropriate data, technology, and systems to allow it to detect risk, harm and misconduct, prioritise issues, and conduct surveillances?'
- 'How effectively does ASIC use data and technology to reduce the regulatory impost of its surveillance activities?'
- 'Has ASIC appropriately prioritised investment and focus on enhancing its data and technology capabilities in its surveillance activities?'

Licensing

- The review will also assess ASIC's approach to licencing ie it's approach to 'receipt, processing, and granting of licenses and registrations for regulated entities and individuals' as well as ASIC's communication with/interaction with applicants.
- The consultation paper emphasises that the review will not consider enforcement actions related to licences and registrations eg variations/cancellation of licences and registrations. These issues are planned to be included in a future review of ASIC's approach to enforcement.

The consultation paper includes four questions on this aspect of the review for stakeholder feedback. These are as follows.

- 'How does ASIC's licensing function support its regulatory mandate i.e. ASIC's statutory objectives, legislative requirements, risk appetite and strategic priorities?'
- 'Are licensing and registry application decisions timely and consistent? Does ASIC ensure that clear guidance for applicants is made available and that stakeholders are engaged appropriately?'
- 'Does ASIC have the appropriate data, technology, and systems to efficiently manage licensing and registrations?'
- 'How effectively does ASIC use data and technology to reduce the regulatory impost of its licensing activities?'

Next steps

ASIC Review:

- The due date for submissions is 28 January 2022. It's requested that submissions be a maximum of 20 pages in length and supported by 'evidence such as data or case studies' where possible.
- FRAA is due to deliver its report to the Minister in Q3 2022.

Planned APRA Review: The FRAA assessment of APRA will commence in 2022 and be a report will be provided to the Minister in 2023.

[Source: FRAA Consultation: Scope of assessment of the Australian Securities and Investments Commission]

APRA Deputy Chair confirms that GCRA continues to be a key area of focus for APRA

Key Takeouts

- Governance, Culture, Remuneration and Accountability (GCRA) continues to be a key area of focus for the Australian Prudential Regulation Authority
- Looking ahead to 2022, APRA intends to focus on: a) stepping up oversight of the concrete steps being taken by entities to 'embed sound GCRA practices'; b) preparation for new requirements in CPS511 remuneration; c) the roll out of the employee Risk Culture Survey; and d) undertaking 'risk culture deep dive reviews' and 'assessments of risk transformation programs' at a number of entities.

Australian Prudential Regulation Authority (APRA) Deputy Chair Helen Rowell has given a speech affirming the regulator's continuing focus on lifting standards of Governance, Culture, Remuneration and Accountability (GCRA) across regulated entities, outlining APRA's work in this area and flagging priority areas looking ahead to 2022.

A key message in the speech is that the desired GCRA 'transformation' is reliant on leaders driving progress across all 'mutually reinforcing' aspects of GCRA within their organisations.

> 'Ultimately, boards and management are responsible for how they assess and improve GCRA in their entities. On this front, there is more to do. The financial industry has come some way on GCRA since the damaging headlines of the Royal Commission. However, industry's own analysis, through the risk governance self-assessments undertaken since that time, has identified a number of key areas where improvements still need to be made'.

Another key theme running through the address is the role that internal audit can and should play in enabling this to occur. Ms Rowell states:

> 'it is important that organisations understand whether the various streams of GCRA are aligned and working together. As internal auditors, with the ability to see all aspects of an organisation's activities, you can play a key role in helping boards and management do just that'.

APRA's approach to supervision

- Ms Rowell briefly outlined the evolution of the regulator's approach to risk over the period since 2014 and the expansion of the regulator's focus to encompass, and embed into the prudential framework, all aspects of its expectations for the management of GCRA risk over that time.

- Ms Rowell observed that since 2020, there has been a requirement in place for all APRA supervisors to 'explicitly assess GCRA-related risks when they determine the level of supervisory intensity APRA will apply to each regulated entity'.
- Ms Rowell highlighted both the roll out of the employee risk culture survey and the review and response to risk-governance self-assessments as providing useful additional information/insight in this context.
- More particularly, Ms Rowell said that:
  - the employee risk culture surveys are expected to provide 'a much better picture of how GCRA practices are, or are not, working in practice at an entity'.
  - APRA's initial review of the self-assessments completed by 36 APRA-regulated entities following the release of the report into the CBA Prudential Inquiry demonstrated that 'industry is grappling to manage non-financial risks, such as culture and accountability'. Ms Rowell said that recent follow up inquiries with the same 36 entities found some progress has been made to address the four key areas of weaknesses identified by APRA in its review of the initial self-assessments (refer to the table below) though more improvement is necessary/expected.
  - APRA considers the risk governance self-assessment process a success in that the exercise has 'helped entities to better consider and work on more effective responses to issues and non-financial risks'.
  - Ms Rowell said that APRA will be 'following up in 2022 to ensure that this is the case'.

IMPROVEMENT AREA IDENTIFIED BY APRA IN ITS REVIEW OF INITIAL SELF-ASSESSMENTS	PROGRESS MADE
Need for firms to improve their management of non-financial risk	▪ APRA found that entities 'raised the profile of non-financial risk management practices' with many either establishing dedicated non-financial risk committees at the executive level or including non-financial risk as a standing agenda item for their Board Risk Committee meetings. ▪ Entities have also revised their risk appetite statements to incorporate non-financial metrics as material on their risk registers. ▪ A number of boards also consider customer complaints to better understand the underlying causes.
Lack of clear accountabilities	▪ APRA has observed 'increased clarity of ownership and accountability for both risk and compliance' with more progress in the banking industry (probably as a result of the Banking Executive Accountability Regime or BEAR) than in other sectors. ▪ Ms Rowell cautioned against complacence stating 'there is still a long way to go to ensure clear end-to-end accountability for risk is embedded in all APRA-regulated entities'.
Lack of understanding of risk culture and in consequence, boards and senior management finding it challenging to reinforce desired behaviours	▪ APRA has observed 'increased awareness and focus' on risk culture since 2019 ▪ APRA's reviews of entities' risk culture approaches have found ta general improvement, however Ms Rowell cautioned that: 'the approach of many entities towards risk culture would still benefit from further maturity through the use of more consistent methodologies, frameworks and a range of different data sources. In some cases, there also remains a lack of expertise in terms of how to meaningfully assess risk culture, therefore impeding the organisation's ability to move towards its desired risk culture state'.
Efforts to address long-standing and well-known weaknesses were not effective	▪ APRA found that the risk governance self-assessments have encouraged entities to look beyond the 'what' of compliance and issue remediation and ask 'why' risk management frameworks and practices had not been working as intended.

Looking ahead to 2022

Focus on the concrete steps being taken by entities to 'embed sound GCRA practices'

- Ms Rowell said that looking ahead to 2022 'APRA's focus will increasingly shift from working on policy and our own tools to how entities are responding to our enhanced focus on GCRA and whether they are taking steps to embed sound GCRA practices'.
- In particular, APRA will be looking for

> 'evidence that work on risk management and compliance controls has shifted beyond design effectiveness to also ensure operating effectiveness and that boards and senior management are being vigilant to ensure the mistakes of the past are not repeated'.

Remuneration

- Ms Rowell said that over the next 18 months, APRA will have a strong supervisory focus on industry's implementation of the new CPS 511 requirements.
- For a subset of entities, APRA will undertake a more detailed review of implementation progress, including benchmarking against peers. APRA will publish 'thematic findings' from the review to support all entities in their implementation of the new requirements.
- In early 2022, APRA will also release new reporting and disclosure requirements on remuneration for consultation. Ms Rowell commented:

> 'Ultimately, we want to see risk outcomes having a meaningful impact on remuneration outcomes. In the event of adverse risk outcomes, we expect to see those responsible being held to account and their remuneration adjusted downwards. APRA will intensify its supervision of remuneration to confirm that this is happening'.

Employee Risk Culture Survey

- APRA expects entities to use insights from survey results to supplement their own internal indicators eg employee survey results and internal culture reviews, and other data 'to build a more comprehensive picture of their risk culture'.
- Ms Rowell suggested that entities may also want to 'draw on the specific areas highlighted in the report they receive from APRA to develop a deeper understanding of the underlying causes of employee perceptions and mindsets, for example through discussions and focus groups with staff'.
- Ms Rowell said that APRA will use the risk culture survey results to inform 'further discussions with participating entities' both in terms of the strengths and areas of improvement identified.
- APRA's longer term aim is to 'provide evidence of the extent to which positive changes impacting risk culture are – or are not – occurring'.

Other activities

Ms Rowell said that APRA will also be 'driving improvements' by 'continuing to undertake risk culture deep dive reviews, and assessments of risk transformation programs, at a number of entities'.

The 'crucial role' of internal audit in enabling 'sound GCRA Practices'

Ms Rowell said:

> 'internal audit teams have a crucial role to play in helping to enable sound GCRA practices across an organisation. With their independent reporting line to the board, internal audit is ideally placed to highlight issues of concern, including the behavioural and mindset issues, that underlie the more visible symptoms of GCRA weaknesses. Examples of these signs of a poor risk culture include inadequate risk management reporting, long-outstanding risk or compliance issues and poor oversight of, or response to, incidents…
>
> the real skill – and value add that auditors can provide – is to look behind the metrics of poor responses to control weaknesses to understand what the fundamental drivers of such behaviours are, and to call those out'.

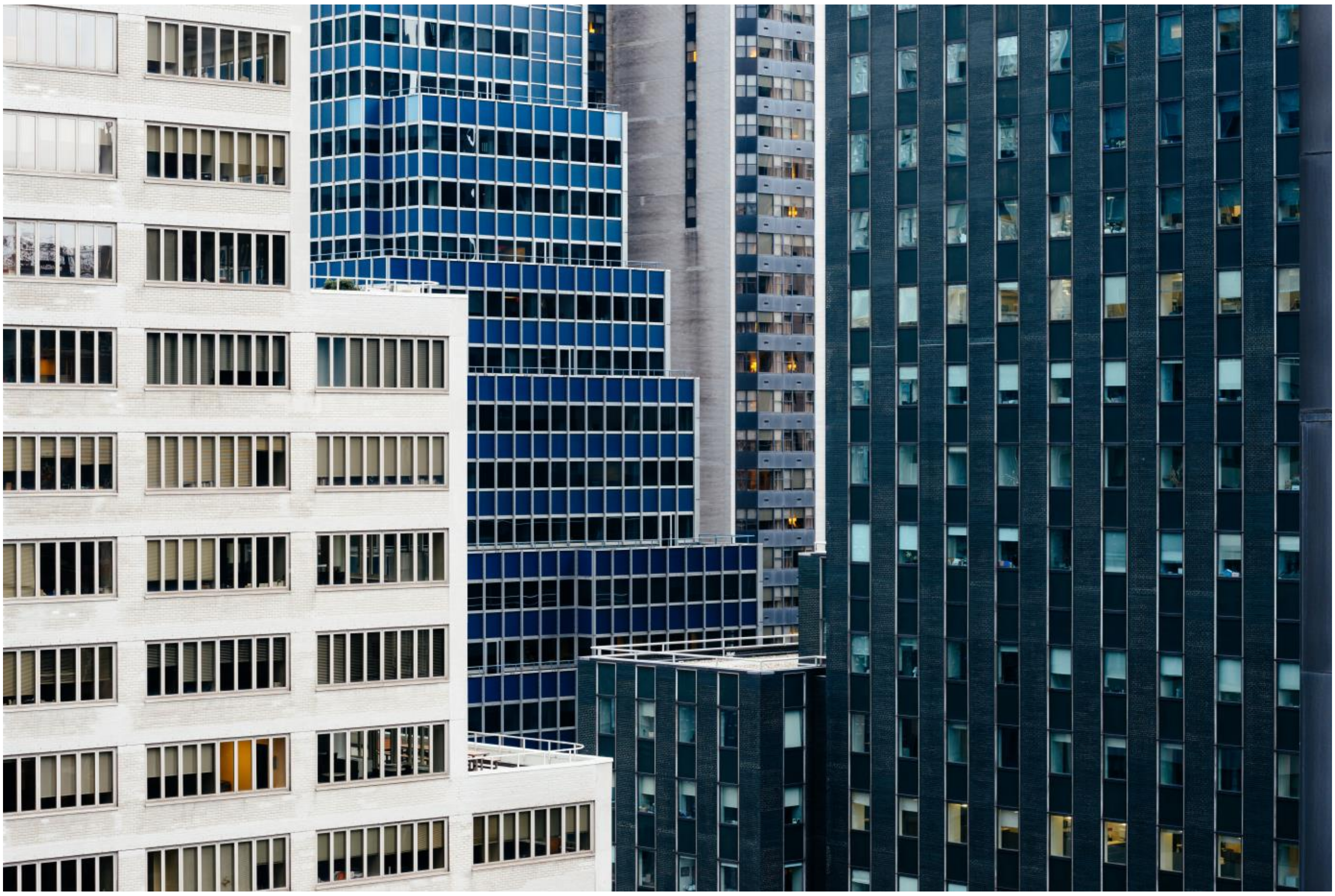
Ms Rowell said that while 'traditionally' internal auditors have looked at issues from a 'controls perspective' APRA now asks that they look at issues from a 'people or behavioural perspective' ie to 'ask why things might be happening from a behavioural perspective' In the context of financial institutions, Ms Rowell said that APRA would like internal auditors to be asking:

'how can I get the true picture of the risk culture of my organisation? How do I identify GCRA issues in my organisation before they manifest in a real problem? How do I ensure I'm looking at the right things, that I'm capturing the relevant issues and concerns and – perhaps most importantly – providing real insight back to the board'?

Ms Rowell pointed to the IIA Practical Guide to Auditing Risk Culture as a 'useful reference' to assist in this.

[Source: APRA Deputy Chair Helen Rowell, Speech to the Financial Services Assurance Forum, Seeing the full the picture on GCRA 26/11/2021]

ASIC Chair Joe Longo updates the PJC on the regulator's recent work program



In his opening statement to the Parliamentary Joint Committee on Corporations and Financial Services, Australian Securities and Investments Commission (ASIC) Commissioner Joe Longo recapped some of ASIC's activities over the past six months.

Mr Longo highlighted the following activity/developments:

- Imposition of licence conditions on the ASX and 'accountability mechanisms' on its board and senior management in response to the November 2020 ASX outage.
- Contributing to the Treasury-led Council of Financial Regulators (CFR) working group on crypto-assets and issuing guidance for exchange traded products with crypto as underlying assets.
- The commencement of the Director ID regime
- Supporting industry as it 'adapts' to a 'raft of significant' Hayne reforms which came into effect in October eg design and distribution obligations (DDOs), updates to breach reporting and anti-hawking laws. Mr Longo reiterated that ASIC will take a 'reasonable approach to transition in the early stages' of the reforms. Mr Longo also said that ASIC has undertaken an 'enormous amount of work' in preparation for the changes eg developing the necessary guidance to support implementation. Mr Longo also said that AISC is engaging closely with industry to support implementation.

- With respect to enforcement, Mr Longo said that ASIC is close to completing all Hayne Commission-related enforcement actions, with the last remaining investigation almost completed'. Mr Longo also listed a number of examples of recent 'significant enforcement outcomes' secured by the regulator.

Looking ahead to 2022, Mr Longo said that:

- ASIC has established a new 'Regulatory Efficiency Unit' which is tasked with monitoring how the regulator administers the law and regulates industry with a view to identifying any 'unnecessary frictions', minimising costs of regulatory requirements and 'ultimately driv[ing] better compliance'.
- ASIC welcomes the opportunity to engage with the Financial Regulator Assessment Authority (FRAA) as it conducts its assessment of ASIC's effectiveness/capability.
- ASIC will continue its 'work on digital transformation', through the ASIC Data Strategy being implemented by the Chief Data and Analytics Office. ASIC has already started using its 'certified "data lake"' to provide a platform from which all data activity on the financial services industry can be 'brought together, shared, reused and collaborated on through cutting edge data and analytic tools'
- ASIC appeared before the Senate inquiry into the collapse of the Sterling Income Trust and answered questions in relation to our oversight of the matter. ASIC provided a supplementary submission to the Committee on Wednesday.

ASIC's approach to enforcement

Mr Longo concluded his statement by reiterating that 'ASIC will continue to be a strong and targeted law enforcement agency. We will use the full suite of tools and powers to address wrongdoing. But as always, our enforcement approach will be responsive to changes in our regulatory environment'.

[Source: Parliamentary Joint Committee on Corporations and Financial Services, Opening statement by ASIC Chair Joe Longo, 26/11/2021]

In Brief | The government has appointed Ms Liza Carver as a full-time member of the ACCC for a five-year period starting 1 March 2022

[Source: Treasurer Josh Frydenberg media release 29/11/2021]

Financial Services

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 1 December 2021 to reflect developments relating the following recommendations.

- Recommendation 6.13 (Regular capability reviews of ASIC and APRA)
- Recommendation 6.14 (A new oversight body to oversee ASIC and APRA)
- Recommendation 7.3 (Elimination of the exceptions and qualifications to generally applicable norms of conduct)
- Recommendation 7.4 (Legislation should identify the fundamental norms of behaviour being pursued)

You can find the full text of the table here.

Hayne implementation: The ALRC has released its first interim report as part of its Review of the Legislative Framework for Corporations and Financial Services Regulation

- In response to Hayne Recommendations 7.3 and 7.4, the government has tasked the Australian Law Reform Commission with conducting a Review of the Legislative Framework for Corporations and Financial Services Regulation. You can find the terms of reference for the review here. You can find a short article providing an overview of the background and scope of the review here.
- On 30 November 2021, the Australian Law Reform Commission (ALRC) released the first of three planned interim reports, Interim Report A. The report considers the use of definitions in corporations and financial services legislation.
- A theme running through the report is that currently the legislation is unnecessarily complex, intricate, voluminous and difficult to navigate. More particularly, the report highlights six 'problems' with the current drafting/design of the legislation. These are as follows:
  - 'Problem One: Incomplete understandings of legislative complexity
  - 'Problem Two: Complex use of definitions.
  - Problem Three: Difficulties navigating definitions.
  - Problem Four: Overly prescriptive legislation.
  - Problem Five: Obscured policy goals and norms of conduct.
  - Problem Six: Difficulties administering complex legislation'
- The report includes 13 recommendations which the ALRC considers 'relate to matters of consensus…and are accordingly in a form that may be implemented prior to the conclusion of this Inquiry, if accepted by the Australian Government'. These include:
  - specific recommendations to address inconsistency in the use of definitions in the Corporations Act 2001 (Cth) (Corporations Act) and the Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act) (Recommendations 3-6)
  - specific recommendations to simplify/improve the design of definitions in both the Corporations Act and the ASIC Act (Recommendations 7-12)
- The ALRC also seeks feedback on 16 proposals and 8 questions around specific definitions, concepts, and standards in corporations and financial services legislation as well as the evidential basis for reforms.
- The report is accompanied by 'prototype legislation' which illustrates how some of the proposed reforms flagged in the report might be implemented. The due date for submissions on Interim Report A is 25 February 2022

[Source: ALRC Review: ALRC Interim Report A and related materials]

Performing well, but scope to improve: Treasury's independent review of AFCA makes 14 recommendations to support improvement in AFCA's processes/approach, the government has endorsed the recommendations

- On 24 November 2021, the government released the final report on the review of the Australian Financial Complaints Authority (AFCA), together with its response to the review.
- Overall, the review concludes that:

  'AFCA is performing well in a difficult operating environment and a changing regulatory landscape…to produce an effective dispute resolution service for consumers and small businesses. While this is an endorsement of its performance in its establishment phase, AFCA will need to continue to develop and improve its processes as it consolidates its place in the financial system'.
- The review includes 14 recommendations to support this aim – 13 directed at improving AFCA processes and 1 directed at government. The majority of recommendations are focused on enhancements to AFCA's transparency/communications and improvements to decision making processes.
- Recommendation 14 recommends that: 'The National Consumer Credit Protection Act 2009 should be amended to no longer require authorised credit representatives to be members of AFCA'. The government has said it agrees with this recommendation noting that:

  'the requirement for authorised credit representatives to be members of AFCA does not enhance consumer protection or access to redress as the obligation to pay compensation awarded by AFCA remains the responsibility of credit licensees'.
- The government has said it supports the implementation of all other recommendations by AFCA.

AFCA has welcomed the report findings

In a statement, AFCA Chief Ombudsman and CEO David Locke welcomed the overall findings of the review.

> 'We welcome the report's endorsement that we are delivering a fair, independent, efficient and effective complaints resolution service. The comments on our performance, including from the former Federal Court judge brought in as an independent expert, are highly encouraging. We were also pleased to read the government's response to the findings of the Review, which supports the recommendations and notes that AFCA is performing well and providing an effective dispute resolution service for consumers and small businesses.'

Mr Locke said that AFCA is committed to continuous improvement and has a number of projects already underway. The insights and analysis from Treasury's review will be used to 'further inform this work'.

SAFAA has welcomed the recommendation that complaints from sophisticated clients should be excluded

The Stockbrokers and Financial Advisers Association (SAFAA) has welcomed the recommendation that complaints from sophisticated clients should be excluded (Recommendation 6).

SAFAA CEO Judith Fox comments:

> 'SAFAA has long expressed concerns about the extent to which AFCA accepts complaints from sophisticated and high-net-worth investors. Our view is that the exercise of jurisdiction to hear complaints from wholesale clients is not the basis upon which the external dispute resolution scheme was legislated by Parliament and is an issue of fundamental unfairness to retail clients, for whom AFCA was set up to assist, as well as member firms. We are pleased to see that consideration has been given to the problem of wholesale investors, with significant investment sophistication and the resources to seek redress, taking advantage of AFCA, which was set up to provide a free complaints service for retail investors who cannot pursue redress through the courts'.

[Source: Review of the Australian Financial Complaints Authority - Final Report; Minister for Financial Services, Superannuation and the Digital Economy Jane Hume media release 24/11/2021]

APRA has finalised the new bank capital framework

New bank capital framework finalised

- Following four years of consultation, the Australian Prudential Regulation Authority (APRA) has finalised its capital adequacy and credit risk capital requirements for authorised deposit-taking institutions, contained in Prudential Standard APS 110 Capital Adequacy (APS 110), Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk (APS 112) and Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk (APS 113).
- APRA has released a response paper summarising some of the key issues raised in consultation and its response to those issues.

Why the changes are being made

- An information paper summarising the changes and the rationale behind them states that the primary driver behind the reforms is ensuring that 'banking industry maintains an unquestionably strong level of capital in normal times and has the in-built flexibility to weather adverse conditions, as well as to update Australian standards to align with the internationally agreed Basel framework'.
- In addition, the reforms are expected to:
  - enhance flexibility through higher capital buffers
  - improve risk sensitivity, through increasing capital requirements for higher risk lending and decreasing it for lower risks
  - support competition by limiting differences in capital requirements between smaller and larger banks
  - improve the comparability of bank capital ratios, both domestically and with global peers
  - improve 'proportionality' by reducing operational burden for smaller banks.

On this last point, APRA flags that the reforms introduce new 'simplified capital requirements' for smaller, less complex banks (those with under $20 billion in assets and simple business models which APRA says constitute 'about three quarters of domestic banks').

APRA Chair Wayne Byres comments that this simplified approach for smaller banks 'avoids unnecessary regulatory burden, without jeopardising prudential safety'.

- Page 7 of the information paper provides a one-page comparison of the reforms against existing requirements.

Consultation on draft guidance to support implementation

APRA is consulting on draft guidance – Draft Prudential Practice Guide APG 110 Capital Adequacy (draft APG 110); Draft Prudential Practice Guide APG 112 Capital Adequacy: Standardised Approach to Credit Risk (draft APG 112); and Draft Prudential Practice Guide APG 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk (draft APG 113) - to support implementation of the changes:

The due date for submissions is 11 March 2022.

Implementation and next steps:

- The changes to Prudential Standard APS 110 Capital Adequacy (APS 110), Prudential Standard APS 112 Capital Adequacy: Standardised Approach to Credit Risk (APS 112) and Prudential Standard APS 113 Capital Adequacy: Internal Ratings-based Approach to Credit Risk (APS 113) will come into effect from 1 January 2023.
- Following consultation, APRA plans to finalise the guidance 'and progress revisions to associated reporting requirements and other related standards' over the next 12 months.
- APRA's expectation is that

> 'all banks will ensure that they are ready to meet the minimum standards when they commence, and seek to implement better practice in capital management in line with the intent of the reforms. This includes setting prudent capital targets with an adequate management buffer, updating capital projections and internal capital adequacy assessment processes (ICAAPs), and conducting stress testing on the new basis'.
>
> [Source: APRA media release 29/11/2021; APRA consultation: Revisions to the capital framework for authorised deposit-taking institutions]

Bill to establish CCIVs and introduce the Retirement Income Covenant introduced

The Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021 was introduced into the House of Representatives on 25 November 2021.

Among other things, if legislated, the Bill would:

- establish the Corporate Collective Investment Vehicle regime by:
  - amending existing laws to establish a CCIV 'as a new type of a company limited by shares that is used for funds management'. The explanatory memorandum describes as CCIV as 'an umbrella vehicle that is comprised of one or more sub funds and is operated by its single corporate director'
  - establishing the regulatory and tax frameworks corporate collective investment vehicles (CCIVs).
  - amending the taxation law to specify the tax treatment for CCIVs
  - the government intends that the CCIV regime will commence from 1 July 2022.
- insert a new retirement income covenant into the Superannuation Industry (Supervision) Act 1993 (Cth) (SIS Act) requiring trustees of RSEs to develop a retirement income strategy for beneficiaries who are retired or are approaching retirement. These amendments would commence on the day after Assent. The explanatory memorandum states that this will 'allow trustees to take steps to gather information to formulate their retirement income strategy that will be publicly available from 1 July 2022. Trustees will not be required to give effect to all components of their strategy by 1 July 2022 as implementation of the strategy will be an ongoing process'.

The Bill also proposes to extend the government's temporary loss carry-back measure, and an update to the list of deductible gift recipients.

In a statement, Assistant Treasurer Michael Sukkar said that the legislation 'supercharge international investment into Australia's fund management industry' by enabling the use of a structure that is more familiar to overseas investors.

The statement quotes Special Envoy for Global Business and Talent Attraction Peter Verwer AO as stating that the 'initiative will help boost Australia's share of global funds, more closely matching its strengths as a financial services hub'.

> [Sources: Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021; Assistant Treasurer Michael Sukkar media release 25/11/2021]

SAFAA supports proposed changes to the wording of Standard 3 (conflicts) in the Financial Planners and Advisers Code of Ethics

Context: Consultation on proposed changes

On 3 November 2021, the Financial Adviser Standards and Ethics Authority (FASEA) launched a consultation on possible changes to the wording of Standard 3 of the Financial Planners and Advisers Code of Ethics 2019 (the Code) to ensure alignment with the intent of the standard as explained in FASEA's supporting guidance.

For context, the current wording of Standard 3 is as follows:

> 'You must not advise, refer or act in any other manner where you have a conflict of interest or duty.'

Three proposed options for change

The FASEA put forward three possible options to amend the existing wording of Standard 3. These are as follows.

3 PROPOSED OPTIONS TO AMEND THE EXISTING WORDING	RATIONALE
Option 1: 'You must only advise, refer or act where you do not have a conflict of interest or duty, being that which could reasonably be expected to induce you to act other than in the client's best interest'.	▪ FASEA explains that this wording is intended to integrate FASEA's intent (consistent with the guidance) into the Standard itself.
Option 2: 'You must not receive any benefit (whether monetary or non-monetary), nor enter into any relationship, that could reasonably be	▪ FASEA explains that this option is intended to align with the findings of the Hayne Commission that where possible, conflicts between duty and interest should be removed and

3 PROPOSED OPTIONS TO AMEND THE EXISTING WORDING	RATIONALE
expected to influence the advice you give or the service you provide to your client'.	the finding that conflicts of interest and conflicts between duty and interest should be eliminated rather than 'managed'. ▪ FASEA also considers that the proposed wording in Option 2 'draws on the established principles of conflicts contained in section 963A of the Corporations Act'.
Option 3: Proposes to retain the existing wording of Standard 3 without change.	

SAFAA supports the intent behind Option 1 (but has called for clearer and simpler wording)

The Stockbrokers and Financial Advisers Association's (SAFAA) submission supports Option 1, as 'the best choice of the three [options] presented', but has called on FASEA to simplify the proposed wording to make it simpler, clearer and ultimately easier to understand.

SAFAA's preferred wording is as follows:

> 'Advisers must not advise, refer or act in any other manner where they have a conflict of interest or duty that is contrary to the client's best interests.'

SAFAA CEO Judith Fox commented:

> 'We welcome FASEA putting forward an option that clarifies that a conflict of interest only exists when the adviser acts in a manner contrary to the client's best interests. But we query why the proposed wording needs to be more complex and less accessible than FASEA's intent.
>
> The aim surely is to be as clear and concise as possible to facilitate compliance with the Standard. We urge FASEA to provide less complex wording by using its own language in the intent.'

Timeline

The due date for submissions to the consultation is 1 December 2021.

[Sources: SAFAA media release 29/11/2021; SAFAA submission: Code of ethics – consultation on standard 3, 29/11/2021]

Internal Audit can and should play a key role in the successful implementation of recent reforms says ASIC Commissioner Sean Hughes

In a speech at the Financial Services Assurance Form, Australian Securities and Investments Commission (ASIC) Commissioner Sean Hughes spoke about the important role that internal auditors play in helping to ensure companies deliver the best outcomes for the investors and consumers using their products and services. Mr Hughes emphasised in the current environment, investors and consumers stand to benefit from 'insights on risk and wariness to harm' provided by internal audit teams 'more than ever before'.

In illustration, Mr Hughes pointed to the emerging risks associated with/flowing from the very rapid uptake of digital business models as a result of the pandemic. Mr Hughes observed:

> 'The surface area of risk-exposure is growing exponentially due to conditions created by the pandemic. Consumers and investors are pushing into the digital realm across financial services, wealth management and markets. Everything – from what we invest in, to whose advice we listen to – is rapidly evolving. As such, the work of internal auditors, and risk, compliance and governance professionals, is more significant for risk identification and control efficacy today than perhaps at any other time in modern history. We need to support the economy, promote market integrity and efficient and competitive markets. We need to protect consumers – regardless of whether they are individual consumers, retail investors, wholesale investors or small businesses'.

Focus areas for ASIC in 2022 and the role of auditors

Mr Hughes identified the following as areas of focus for the regulators looking ahead to 2022.

- Reducing the risk of harm caused by scam activity. Mr Hughes said that this is prompted by the 'rapid rise' in investment scams that ASIC has observed since the outset of the pandemic. For example Mr Hughes said that in January and February 2021, reports of misconduct to ASIC were up by over 200% compared to 2020. While in March 2021, reports of misconduct about investment scams were ten times the pre-pandemic average.

- **Supporting industry readiness for the raft of reforms that took effect in October 2021** eg design and distribution obligations, anti-hawking reforms, deferred sales model for add-on insurance products, new reference checking and information sharing requirements for financial advisers/brokers and new breach reporting and internal dispute resolution requirements.

Mr Hughes said that ASIC is both 'looking to financial services organisations to demonstrate strong governance controls that support sound decision making and a culture of achieving fair and efficient outcomes' and for firms to have in place efficient complaints handling and remediation processes. He observed that internal audit has a key role to play in this context. Mr Hughes said:

> 'As an 'independent, objective assurance and consulting activity', internal audit plays a key role in an organisation's risk management, control, and governance processes. An important part of those processes should be ensuring that customers who buy your products and services are not exposed to harmful conduct, but rather, experience fair and positive outcomes. With the right operating framework, resourcing and leadership backing, the internal audit function can provide the company's leadership with a trusted "independent voice" for an objective assessment of the organisation's capabilities'. More importantly, the organisation can improve its culture and conduct off the back of this objective assessment. In fact, I believe the Board should see the internal audit function as its best friend. Internal Audit is the mirror into which the organisation's leadership looks to ask itself – is this how we really appear? Internal auditors can use their truly independent voice to provide the Board with a frank assessment of the organisation's "pain points"'.

Mr Hughes emphasised that managing 'non-financial' risks, including the sorts of risks identified by the Hayne Commission (eg fee for no service issues) makes good business sense for business and that again, the internal audit function has an important role to play. Mr Hughes called on internal audit to 'establish a strong and audible voice' to influence leaders to 'step up and do better'.

Suggested 'practical steps' to ensure good customer outcomes

Mr Hughes identified three suggested 'practical steps to ensure good customer outcomes' in this context. They are:

- Ensuring that the risk of consumer hard is 'at the forefront of audit planning'. Mr Hughes said that 'audit plans, coverage, charters and methodologies should include specific references to identifying consumer harm and improving consumer outcomes. They should also cover specific topics such as vulnerable consumers'.
- Ensuring internal audit staff and the first and second lines of assurance are appropriately trained and have the 'necessary tools and skills to identify consumer risks, and develop adequate action plans to mitigate or escalate those risks'.
- Assessing the effectiveness of the business in managing conduct risk/driving better customer outcomes by developing 'good data points' and assessment techniques. For example, monitoring whether a particular action results in a drop in the volume and the severity of customer complaints about a particular issue.

Mr Hughes also recommended the Internal Audit Better Practice Guide for Financial Services in Australia, which was released in the wake of the Hayne Commission and specifically addresses customer harm.

Call to action

Mr Hughes said that internal audit needs to play a 'key role' in helping to successfully implement the reforms that came into effect in October 2021, including in particular the DDO, breach reporting and IDR reforms. Mr Hughes suggested that the following five questions could be useful in this context:

- How did your internal audit team assess whether or not the preparation for – and implementation of – these reforms was on the right track? How good were the end-products? What difference or improvements did you observe?
- Now that the DDO, breach reporting and IDR regimes are in place, how effectively are they being applied? How are you measuring and testing this?
- What are the impacts on customers, for example using DDO – have distribution practices changed?
- Are your customers enjoying better outcomes? Have the number of customer complaints changed? What metrics are there to measure these outcomes? How are they being reported to the board? How fresh is the data?
- Are there other things your organisation could be doing to implement the regimes more effectively?
- It is important to remain vigilant and not grow complacent.

Reflecting on the skills that internal audit professional need in order to effectively steer and influence their boards and executives toward successful implementation of the reforms, Mr Hughes suggested that the following four attributes 'are ideal':

- 'A competent understanding of your organisation's business strategies, as well as of external factors such as new law reforms.
- An agile mindset and attitude to adapt to the fast-evolving nature and needs of the business, including digital transformation.
- Confidence to challenge the status quo and provide an objective, independent voice to leadership; especially when that voice might result in uncomfortable discussions.
- A deep-seated conviction that customers who buy your products and services should be better off, and ultimately receive outcomes that are good for them. And a sense of self-recognition and acknowledgment that you played a part in that success, and that your efforts made a difference, for the better'.

[Source: Speech by ASIC Commissioner Sean Hughes at the Financial Services Assurance Forum, hosted by the Institute of Internal Auditors Australia, Pursuing the best outcomes for customers: ASIC's approach and the work of internal auditors 25/11/2021]

ASIC flags its main priorities for superannuation for FY21-22

Australian Securities and Investments Commission (ASIC) Senior Executive Leader, Superannuation Jane Eccleston has written an article recapping the regulator's priorities for the superannuation sector for FY21-22.

Broadly, ASIC's focus in the superannuation sector will be guided by two of the four overarching priorities identified in ASIC's latest corporate plan. Namely:

- reducing the risk of harm to consumers
- driving industry readiness and compliance with standards set by law reform including the Your Future, Your Super (YFYS) reforms, the design and distribution obligations (DDOs), new internal dispute resolution (IDR) standards, anti-hawking measures, changes to breach reporting requirements, and (subject to the passage of legislation) the retirement income covenant.

With respect to the second point, Ms Eccleston reiterated that in light of the volume of change, ASIC intends to take 'a reasonable approach to enforcement, provided trustees are using their best efforts to comply' in the 'early stages'.

This extends to 'technical or inadvertent breaches of the October reforms, where trustees have systems changes underway and they act quickly to address problems that arise'.

Also consistent with ASIC's previous comments, Ms Eccleston said that 'where trustees are found to not be acting in good faith, or we detect conduct causing actual harm to consumers, ASIC will not hesitate to enforce the law'.

Ms Eccleston said that 'good intentions are not enough to meet the standard of conduct required of trustees. ASIC expects trustees to take responsibility for how their decisions can affect consumers in practice. We are undertaking various regulatory initiatives on increased transparency and scrutiny of trustees'.

Three 'priority projects' for FY2021-22

Ms Eccleston identified the following as 'priority projects'.

THREE 'PRIORITY' PROJECTS	DETAILS
Performance Communications Review	▪ ASIC is conducting a surveillance of trustees' communications to members about the results of the recent performance test. More particularly, ASIC is monitoring performance test failure notifications and a sample of member communications made by other funds that passed the recent performance test. ▪ Ms Eccleston said that this project has three objectives. These are to ensure that" a) 'consumers are aware of the performance of their fund; b) 'consumers have accurate information regarding the results of the performance test that is not misleading' and c) 'the policy intention of the reforms is upheld'.

THREE 'PRIORITY' PROJECTS	DETAILS
IDR in super and transition to RG 271	▪ ASIC plans to continue its work to support industry's transition to RG 271 Internal dispute resolution which took effect on 5 October 2021. ▪ Ms Eccleston reiterated calls for trustees to 'assess their approach to IDR as an indicator of their overall fund culture and ensure they are delivering and assessing IDR in a member-centric way'. ▪ Ms Eccleston said that in 2022 ASIC will undertake a surveillance of trustees on their compliance with the enforceable RG 271 requirements and determine if 'further regulatory action is necessary'.
Distribution reform implementation and surveillances	▪ ASIC will continue to monitor the industry's implementation of 'the distribution reforms' ie design and distribution obligations (DDOs), changes to hawking rules and 'stapling' reforms. ▪ Specifically ASIC will: – conduct a review of trustee's use of the 'employer distribution channel' – the distribution of superannuation products through employers. Ms Eccleston said that this will involve reviewing a sample of trustees practices and 'if necessary, action if we identify misconduct resulting in consumer harm' – continue to conduct 'regulator proactive reviews' of trustees' marketing/advertising across all channels and engage with trustees as needed to ensure compliance with disclosure obligations. Ms Eccleston commented that in 2021, ASIC has reviewed over 7000 individual pieces of advertising and this has resulted in changes to websites/advertising of nine trustees. – review marketing of superannuation funds that have 'green' or ESG focused products 'particularly whether there is a risk of "greenwashing" or unreliable and overstated claims about sustainability'

Other focus areas

- Superannuation calculators and retirement estimate projection tools: ASIC has released a consultation paper and draft legislative for consultation seeking feedback on how ASIC 'can update our relief to best facilitate the provision of tools that can help consumers think about how superannuation can be part of their retirement income'. ASIC also seeks to 'give clarity to trustees about how they can use calculators and retirement estimate projection tools as part of their retirement income strategies under the government's proposed retirement income covenant'.
- Insurance in superannuation: ASIC will monitor industry's progress on addressing the issues we have raised in recent years. For example, ASIC will be focusing on: the changes trustees are making in response to new DDOs, claims handling obligations and other recent reforms, as well as 'how trustees are monitoring member outcomes and value for money, and how they are using these insights to refine their insurance arrangements and practices'.
- Whistleblower policies: Ms Eccleston said that ASIC will continue to monitor compliance with the whistleblower policy requirement and entities' handling of whistleblower disclosures.

[Source: ASIC Senior Executive Leader, Superannuation Jane Eccleston, ASIC's focus in superannuation 2021–22 23/11/2021]

APRA flags: performance, governance and member engagement are key focus areas in the superannuation context

In a speech to the Fund Executives Association Limited Members' Discussion Forum, Australian Prudential Regulation Authority (APRA) Member Margaret Cole highlighted three focus areas for the regulator in the superannuation context: addressing under-performance, governance and boards and member engagement.

Performance

Ahead of the release of the third MySuper Product Heatmap and the first Choice Product Heatmap (and accompanying insights papers) and following the first MySuper performance test, Ms Cole emphasised that the regulator wants to 'see persistent underperformance eradicated'. Ms Cole commented:

> 'We have no tolerance for members remaining in underperforming products – particularly products closed to new members as a result of failing the performance test a second time. To trustees: action is required – step up or step out'.

- Ms Cole said that APRA has observed that some trustees are 'responding appropriately by driving forward with mergers and successor fund transfers (SFTs)' which have spiked in the last 12 months - a trend APRA welcomes - and others are 'working to rectify performance issues'. She observed that 'realistically the strongest lever to pull is reducing fees'.
- Ms Cole commented that:

> 'The APRA super team will be very focused on holding trustees to account when it comes to determining outcomes to members. We intend to be bold, pushing into the issues, asking the hard questions and taking action where needed, and showing we will use our full range of tools to get our messages across more widely'.

Governance and the 'quality of boards'

Ms Cole observed that 'many things that need improvement start with the quality of boards and good governance' and that in light of this, board composition and effectiveness is also a focus for APRA. Ms Cole called on industry to consider the following questions:

> 'Does your board have the right mix of skills and capabilities? Is board membership refreshed to ensure a range of diverse perspectives and avoid the danger of group-think? Do you have fit-for-purpose rules to support good governance for today's environment, on tenure, for example, or the process for appointments? Good practice, in my view, would be to mirror ASX principles on tenure. How can your entities be at the forefront of good practice – not waiting to be cajoled by regulators?'

Member Engagement

- On the issue of member engagement, Ms Cole observed that fewer members have 'taken charge of their own super' following the recent MySuper performance test than anticipated. Ms Cole also observed that 'there's quite a lot of brand promotion out there and you must all be thinking carefully about how you will be able to justify this as being in members' best financial interests'.
- Ms Cole said that she would 'like to see more done to make sure that members get the benefit of clear, concise information in plain English' suggesting that industry could for example, consider forming a cross-entity taskforce to consider the issue.
- Ultimately, Ms Cole said that regardless of how disengaged (or engaged) members are, APRA's expectation is that they should not be 'disadvantaged'. Ms Cole called on industry to 'constantly ask yourselves the question who are you here to serve and how are you prioritising the interests of your members'.

[Source: APRA Member Margaret Cole – Remarks to the Fund Executives Association Limited Members' Discussion Forum, 24/11//2021]

Accounting and Audit

Work to do: ASIC reports on audit inspection findings for 12 months to 30 June 2021

The Australian Securities and Investments Commission (ASIC) has released the findings of its latest inspection of 45 audit files for the 12 months to 30 June 2021 - REP 709 Audit inspection report: 1 July 2020 to 30 June 2021. The inspections covered financial reports for years ended from 31 December 2019 to 31 December 2020.

ASIC has also released individual firm reports for the six largest audit firms.

- REP 710 BDO firms in Australia: Audit inspection report—1 July 2020 to 30 June 2021
- REP 711 Deloitte Touche Tohmatsu Australia: Audit inspection report—1 July 2020 to 30 June 2021
- REP 712 Ernst & Young Australia: Audit inspection report—1 July 2020 to 30 June 2021
- REP 713 Grant Thornton Australia Limited: Audit inspection report—1 July 2020 to 30 June 2021
- REP 714 KPMG Australia: Audit inspection report—1 July 2020 to 30 June 2021
- REP 715 PricewaterhouseCoopers Australia: Audit inspection report—1 July 2020 to 30 June 2021

Key Takeaways

REP 709 found an 'overall increase' in the percentage of key audit areas where auditors 'did not obtain reasonable assurance that the financial reports were free from material misstatement'.

According to the report:

- ASIC made negative findings in 23% of the 115 key audit areas reviewed at the largest six audit firms. For context, this is similar to the previous report which made negative findings in 24% of the 156 key audit areas reviewed at the largest six firms for the 12 months to 30 June 2020.
- Across the all 16 firms, ASIC made negative findings in 32% of the 149 key audit areas reviewed.
- ASIC comments that the largest number of negative findings continued to relate to the audit of asset values and impairment of non-financial assets and the audit of revenue.
- ASIC's separate risk-based reviews covering financial reports of listed and other public interest entities conducted this year led to material changes to net assets and profits for 3% of financial reports reviewed. This compares to 4–5% for previous years.

ASIC has called on firms to lift standards

The report acknowledges that ASIC's inspections focus on a limited number of 'higher risk key audit areas of audit files' and that the report also does not include assessment of/reports on 'positive audit quality'. As such, the report 'does not represent a balanced scorecard and caution is needed in generalising the results across the entire market'.

Nevertheless, ASIC considers that:

> 'The increased overall level of negative findings is of concern and warrants deliberate and concerted action by all firms to improve audit quality and to reduce the incidence of negative findings'.

ASIC Commissioner Sean Hughes called on audit firms to step up their efforts to lift standards. Mr Hughes said:

> 'Noting the overall increase in findings, ASIC calls on audit firms to continue to evaluate the effectiveness of their current initiatives to improve audit quality and revise them or implement new and improved actions if they are not achieving appropriate outcomes. This includes promoting a strong culture focused on audit quality, attracting the right talent for complex audits, effective supervision and review of audits and accountability of partners, managers and staff for audit quality and effective root cause analysis of negative findings'.

In terms of concrete steps, ASIC expects audit firms to:

- identify the root causes of negative findings;
- develop and implement action plans to address these issues; and

- to monitor the effectiveness of their action plans and adjust them where needed to ensure they are achieving their objectives.

The report points to ASIC's Information Sheet 222 (INFO 222) Improving and maintaining audit quality as a helpful resource in this context.

The report also emphasises the role of leaders - directors, audit committees and management – in supporting and driving improvements in audit quality through the promotion of a 'strong culture', attracting/retaining the 'right talent for complex audits', and avoiding 'fee related conflicts of interest'.

Table 4 at page 19 of the report is a non-exhaustive list of some of the considerations/actions that ASIC considers leaders, partners and staff may take to promote a culture focused on audit quality. Table 5 at page 20 is a non-exhaustive list of the considerations/actions that may assist in ensuring firm have the capability to undertake complex audits.

ASIC flags that it intends to update the INFO 222 to include examples of 'how firm leadership, partners and staff can contribute to a culture focused on audit quality and considerations for audit firms to attract, develop and retain the talent needed for complex audits'.

ASIC's planned regulatory activity

Table 7 at p27 of the report outlines ASIC's planned areas of focus looking ahead to 2022. ASIC Commissioner Sean Hughes flagged that ASIC's future regulatory activity in this area will include:

> 'reviewing our programs for regulating auditors and financial reporting, consulting on routine reporting of audit findings to directors and continuing our focus on enforcement actions for deficient audits'.

[Sources: ASIC media release 30/11/2021; REP Download Report 709 Audit inspection report: 1 July 2020 to 30 June 2021]

Risk Management

APRA has finalised its guidance on managing the financial risks of climate change

APRA has released final Prudential Practice Guide CPG 229 Climate Change Financial Risks (CPG 229)

Key Takeouts

- The guidance is aligned with the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) recommendations and was developed in consultation with both domestic and international peer regulators.
- APRA's expectation is that management of material climate-related risks is integrated into existing risk and governance frameworks to support informed decision making. As such, the draft guidance is intended to be read alongside/supplement APRA's existing guidance in CPS 220, SPS 220, CPS 510 and SPS 510.
- The guidance is targeted at all APRA-regulated entities. APRA has drafted the principles-based guidance with the intention of allowing entities sufficient flexibility to be able to tailor their approach as appropriate to their size, customer base and business strategy.
- In terms of implementation, APRA encourages all APRA-regulated entities 'to begin using the finalised guidance immediately to enhance their management of climate change financial risks in a manner that is appropriate to their business and its particular circumstances'.

Overview

Following consultation, the Australian Prudential Regulation Authority (APRA) has released final guidance that aims to both clarify regulatory expectations around the management of material climate-related risks and opportunities and to assist all APRA-regulated entities to integrate management of these risks into their existing governance and risk frameworks to support informed decision making.

APRA has also released a response paper highlighting some of the key issues raised in the consultation process and the regulator's response.

Announcing the release of the final guidance APRA Chair Wayne Byres emphasised that CPG 229:

> 'does not prescribe any particular way of doing things. Nor does it force companies to making any particular investment, lending or underwriting decision – those are matters for the entities themselves to decide. But we do want to make sure that those decisions are well-informed, and don't undermine the interests of bank depositors, insurance policyholders or superannuation members'.

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

Substantially similar to the consultation draft with some minor changes

The final guidance substantially the same as the draft guidance on which APRA previously consulted with some 'minor amendments' made in response to industry feedback. These changes include: clarifications around the use of climate-related targets, guidance on considering the impacts of the financial risks of climate change on capital adequacy, and guidance on disclosing key design features of scenario analysis. These changes are flagged in the overview of the guidance below. APRA has made a marked-up version of the guidance (showing the differences between the consultation draft and the final guidance available on its website here).

APRA comments that all 48 submissions on the draft guide were broadly supportive, though a key theme to emerge from the consultation was for APRA to provide more detailed and more prescriptive guidance on various issues.

APRA has resisted calls to be more prescriptive in its approach.

A flexible principles-based approach

As flagged, consistent with the approach in the draft guidance, the final CPG 229 maintains a principles-based approach which is intended to enable each institution to 'adopt an approach that is appropriate to its size, customer base and business strategy'.

Importantly, the guidance is intended to assist APRA-regulated entities to comply with existing requirements in: Prudential Standards CPS 220 Risk Management (CPS 220), SPS 220 Risk Management (SPS 220), CPS 510 Governance (CPS 510), SPS 510 Governance (SPS 510).

Overview

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

Consistent with the approach in the draft guidance, CPG 229 makes clear that APRA views 'ultimate responsibility for the sound and prudent management' of an APRA-regulated entity's business operations as resting with the board. Consistent with this, the guidance underlines the importance of board oversight and involvement in the management of climate risk (ie the financial risks arising from climate change, including physical, transition and liability risks).

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

The guidance suggests (at para 16 p11) that a 'prudent' board would be 'likely to undertake' the following.

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

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

The role of senior management

The guidance also identifies (para 17 p12) a number of actions/functions that APRA considers senior management would 'typically' be responsible for. These include:

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

Risk Management

Climate risk management policies and procedures should be documented

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

Identifying risks and recording exposure

- In APRA's view, a 'prudent institution would seek to understand climate risks and how they may affect its business model including being able to identify material climate risks and assess their potential impact on the institution'. CPG229 suggests that scenario analysis, could be useful in this context.
- The guidance suggests that climate risks could be considered within the established risk categories in CPS 220 and SPS 220. APRA's expectation is that entities are able to demonstrate how the materiality of climate risk has been determined within each of these categories.
- The guidance states that a 'prudent institution would likely seek to identify economic sectors with higher or lower exposures to physical and/or transition climate risks'. Paragraph 24 at p13 sets out a list of potential factors that may be relevant in this context. The final guidance lists two additional factors not included in the consultation draft: vulnerability to climate-related supply chain changes or disruption and vulnerability to climate-related disruption of business activities.
- The guidance further suggests that assessment of economic sectors could be used to develop sector-specific policies/procedures for the institution when undertaking business engagements (eg insuring, investing etc). APRA suggests that 'good practice' would see an 'integrated approach to climate risks taken across different business lines (such as underwriting, investment, product development and lending functions)'.

Use of ICAAP

- The draft guidance put forward the Internal Capital Adequacy Assessment Process (ICAAP) as 'an appropriate framework for considering and recording' the material impact of the risks of climate change on capital adequacy.
- In response to concerns raised about this approach, the final CPG 229 retains the ICAAP as an option, but recognises that 'it may be appropriate for institutions to adopt alternative processes as they build capabilities and work towards inclusion of this risk within the ICAAP'.
- The response paper comments that:

  > 'APRA maintains the view that institutions should consider the interactions between climate change financial risks and capital adequacy. This is consistent with their general obligations under the relevant industry-specific capital adequacy standard to maintain adequate capital against the risks associated with its activities. APRA expects institutions to take steps to continue to mature their capabilities in this area'.

Risk monitoring

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

- APRA considers that a 'prudent institution' would ensure that climate risk data and metrics are updated regularly to support decision-making by the institution's board and senior management. The final guidance also includes a new paragraph (30) clarifying that institutions may also wish to set climate-related targets for their activities. The guidance states that:

  > 'Climate-related targets should be linked to an institution's climate-related metrics, and aligned to an institution's overall business strategy and risk management framework. The climate-related targets established by an institution may also reference external benchmarks, such as sector, national and/or international targets. Further guidance on the targets an institution may develop is provided by the Financial Stability Board Task Force on Climate-related Financial Disclosures, Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017).'

- APRA also suggests that 'better practice in risk monitoring extends to monitoring the impacts that climate risks may have on outsourcing arrangements, service providers, supply chains and business continuity planning'. .

Risk controls

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

The guidance states,

> 'In most cases, APRA envisages that an institution would choose to work with customers, counterparties and organisations which face higher climate risks, to improve the risk profile of those entities. Indeed, providing finance to assist customers to adapt to climate change is an important function of the financial system. However, where the institution considers this engagement will not result in the climate risks being adequately addressed, an institution may need to consider standard risk mitigation options such as: a) reflecting the cost of the additional risk through risk-based pricing measures; b) applying limits on its exposure to such an entity or sector; or c) where the risks cannot be adequately addressed through other measures, considering the institution's ability to continue the relationship.'

Internal risk reporting

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

Scenario analysis and stress testing

APRA's expectations around the use, scope and implementation of scenario analysis are set out in detail at p16-18 of the guidance.

- The guidance states that 'APRA considers it prudent for institutions to develop capabilities in climate risk scenario analysis and stress testing, or to have access to external scenario analysis and stress testing capabilities, to inform their risk identification in both the short and long term'.
- The guidance states that in developing their capability, entities should have regard to leading practice. Broadly, APRA considers that this entails:
  - a short term assessment of the institution's current exposures to climate risk in line with current business planning cycles
  - a long term assessment of the institution's future exposures based on a range of difference climate-related scenarios (potentially extending to 2050 'or beyond).
- The guidance suggests that scenarios should:
  - assess both the physical and transition risks within each scenario (possibly with input from external experts)
  - be used to assess the possible impact of climate risks on a range of business obligations and considerations eg capital adequacy, liquidity and the ability to meet obligations (eg obligations to depositors or superannuation fund members where appropriate)
  - incorporate 'forward-looking information such as: considering future trends in catastrophe risks, technology innovation or policy development'

- The guidance identifies the following as 'key considerations' when building such scenarios.
  - Future temperature rise: APRA suggests that scenarios could include global average temperatures continuing to rise eg temperature increases in excess of 3˚C by 2100 (rather than 4˚C as suggested in the consultation draft) and global average temperatures rising by well below 2˚C (rather than limiting warming to 2˚C as suggested in the consultation draft).
  - The economic pathway to transition: scenarios should reflect the potential impacts of an 'orderly transition' to a lower-emissions economy and a 'disorderly transition'
- The guidance also includes a paragraph (not included in the consultation draft) clarifying that where institutions elect to publicly disclose the results of the climate risk scenario analysis or stress testing 'they should also disclose significant design features and decisions that are necessary for stakeholders to be able to effectively interpret the results and compare them between institutions'.
- Entities required to complete an ICAAP:
  - APRA considers that a narrative-driven process is 'a useful approach to considering climate risk scenario analysis and stress testing to assess potential risk exposures and available capital resources'.
  - The guidance suggests that it is good practice to maintain appropriate documentation of the process and results climate risk scenario analysis and stress testing.

Disclosure of material climate risks

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

Implementation

- APRA encourages APRA-regulated entities 'to begin using the finalised guidance immediately to enhance their management of climate change financial risks in a manner that is appropriate to their business and its particular circumstances'.

Looking forward

- APRA has flagged plans to undertake a survey 'to help gauge the alignment between institutions' management of climate change financial risks, the guidance set out in CPG 229, and the Financial Stability Board's Taskforce for Climate-related Financial Disclosures' in 2022.
- APRA will also push forward with its other climate-related program of activities, including the climate vulnerability assessment that is underway with Australia's five largest banks.

[Sources: APRA media release 26/11/2021; APRA Consultation on draft Prudential Practice Guide on Climate Change Financial Risks; APRA Response Paper: Prudential Practice Guide CPG 229 Climate Change Financial Risks 26/11/2021; Final Prudential Practice Guide CPG 229 Climate Change Financial Risks markup; CPG 229 Climate Change Financial Risks]

In Brief | The Law Society of NSW has released a briefing paper providing a high level overview of emerging trends in climate-related litigation in Australia and globally, as well as insights into the future direction of such litigation. A headline message is that the volume of climate-related litigation in Australia is likely to continue to increase

[Source: Law Society of NSW Briefing Paper: Climate Change Litigation: Trends, Cases and Future Directions November 2021]

Jenkins Review released: The independent review into parliamentary workplace culture was tabled on 30 November 2021

- The Australian Human Rights Commission's review into parliamentary workplace culture, led by Sex Discrimination Commissioner Kate Jenkins calls on government to 'set the standard' for safe workplaces in Australia.
- Overall, the review found that the parliamentary workplace 'does not meet the standards that the nation's Parliament should meet'. For example 51% of all people currently in Commonwealth parliamentary workplaces (CPWs) have experienced at least one incident of bullying, sexual harassment or actual or attempted sexual assault in a CPW.
- Commissioner Jenkins attributes these issues to a number of factors including: limited accountability, power imbalances, lack of clear standards of conduct, the 'high intensity, high stakes nature of the work', 'the pursuit of political power', 'frequent blurring' of personal and professional life and the 'intense loyalty to political parties'.
- The Commissioner also found that existing systems and reward structures 'encourage, tolerate and enable misconduct and processes that are not equipped to prevent or address the consequences of that behaviour'.
- The review includes 28 recommendations for 'structural reform' to lift standards including (among other things): recommending the establishment of an independent body to enforce parliamentary codes of conduct; setting gender targets and encouraging a culture of responsible alcohol use.
- The Prime Minister has acknowledged the report findings that 'people, particularly women, in Parliamentary workplaces have experienced bullying, sexual harassment and sexual assault' and that change is required.
- In terms of responding to the recommendations, Mr Morrison said that as a first step Special Minister of State Ben Morton would consult with the Opposition, minor parties and the independents on 'a way forward to respond to the review'. Mr Morrison emphasised that a 'multi-party' approach is necessary and the most appropriate way to forward.

  [Sources: Set the Standard: Report on the Independent Review into Commonwealth Parliamentary Workplaces (2021); AHRC media release 30/11/2021; Prime Minister Scott Morrison media release 30/11/2021]

Contacts

Mark Standen
Consultant

—

mark.standen@minterellison.com
T +61 2 9921 4902 | **M** +61 412 104 902

Siobhan Doherty
Partner

—

siobhan.doherty@minterellison.com
T +61 2 9921 4339 | **M** +61 413 187 544

Kate Hilder
Consultant

—

kate.hilder@minterellison.com
T +61 2 9921 8785