Governance News

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

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Boards and Directors

Top Story | How to build better financial services boards?

What skills and capabilities should be represented on the boards of banks and insurers? What skills and capabilities are required to avoid a recurrence of the issues identified by the Hayne Commission? The Actuaries Institute has released a paper discussing these questions and putting forward a suggested approach aimed at strengthening board appointment and nomination processes. Our key takeaways are below.

Key Takeouts

- The paper argues that the gaps in the mix of skills and capabilities represented on the boards of financial services firms enabled the misconduct identified by the Hayne Commission and other reviews of the financial services sector. In light of this, the authors consider identifying and addressing these gaps to be essential to preventing a repeat of past mistakes/failures in oversight
- The paper puts forward a suggested checklist to inform the director appointment/nomination process including a recommended list of skills/capabilities considered necessary in the financial services context
- A key recommendation is that appointing directors with 'golden' or 'unblemished' career records over those with experience of a major crisis or insolvency may not be optimal

Overview

The Actuaries Institute has released a paper written by former Actuaries Institute President Barry Rafe and former Australian Prudential Regulation Authority (APRA) Deputy Chair Ian Laughlin – The Special Needs of Financial Services Boards – aimed at providing financial institutions, and more particularly, banks and insurers with a guide to future director appointments. The focus is on non-executive directors.

The paper makes clear that it is primarily aimed at banks and insurers and does not specifically consider the specific needs of superannuation fund trustees.

Financial services boards are different

The authors argue that financial services firms have certain 'unique features' that differentiate them from other large, complex organisations. Among other things, the authors point to the critical role financial services firms play in society. They observe that virtually every adult necessarily has a relationship with a financial services firm and often has large financial exposure to that firm. They also point to the higher community expectations attaching to financial services firms – their social licence to operate – which reflects their unique role.

They consider that this has implications for board composition – that financial services boards need a specific mix of capabilities/skills in order to be able to exercise their oversight function effectively and ultimately to prevent the recurrence of the sorts of oversight failures identified in the Hayne Commission and other recent reviews.

Mr Laughlin states:

> 'Boards are obliged to act in the best interests of the company but in financial services there are other legal and moral obligations to protect the interests of customers…The skills and capabilities of the Board and individual Directors can have profound implications for conduct and culture.'

Board appointment and/or nomination processes deserve more focus

The authors argue that to date, efforts to tackle the underlying causes of misconduct in the financial services context have largely focused on improving overall governance, remuneration and risk management processes rather than on board composition/effectiveness per se. In the authors view:

> 'evidence suggests that the misconduct identified by all the reviews was enabled by boards of directors that did not adequately understand the complex businesses they directed – clearly reflecting systemic gaps between essential board skills and capabilities and board appointments'

In light of this, they consider that a sharper focus on the existing approach to board nomination/appointment is warranted.

Key skills and capabilities needed on financial services boards?

The authors consider that generally speaking, the following skills and capabilities should be represented on the boards of financial services firms.

- The board should include 'at least one' director with direct experience with a 'solvency issue or business existential challenge'. The rationale for this is that directors with unblemished career records may result in boards lacking directors with 'foresight for emerging challenges and a lack of experience to be able to effectively recognise and manage them'.
- The board should include director with an understanding of broader community standards and expectations who can provide 'ethical leadership to the organisation within the broader community'.
- There should be a 'mix of directors from different industries, to recognise various patterns between industries and enable more lateral thinking that is not limited by industry specific jargon'.
- Boards should have at least three directors with 'deep operational experience [ie hands-on management experience] garnered through working in the financial services industry within which the company operates'.
- The Chair should be a former CEO or senior business line executive of a similar financial services business. The authors consider this to be necessary, among other things, to ensure that the Chair has the experience and insight needed to effectively coach/mentor the CEO. In putting this recommendation forward, the authors acknowledge that as fewer women have held very senior business line or CEO roles compared with men, this 'could introduce a bias against appointing a woman as Chair. The board would therefore need to balance this with its diversity intent'.

The paper includes a more detailed table of suggested board skills at page 18 and a suggested list of board capabilities at page 22.

A suggested tool to inform future board appointments

Appendix A at p17 of the paper is a suggested board assessment matrix, populated with 'illustrative skills and capabilities' (reflected above) that the authors consider should be represented on the board of a complex financial services business, together with a suggested traffic light rating system.

The authors stress that the suggested matrix is intended as a starting point and underline that it will need to be adapted to reflect the needs of specific organisations/to include more detail around specific skills/capabilities. The paper also makes clear that the process of building and maintaining a board with the optimal mix of skills/capabilities is an ongoing and long-term process.

[Source: Actuaries Institute media release 18/10/2021; Dialogue paper The Special Needs of Financial Services Boards]

Remuneration

APRA has released final CPG 511 Remuneration

- Following consultation, the Australian Prudential Regulation Authority (APRA) has released a final prudential practice guide on remuneration – CPG 511 Remuneration - setting out guidance and examples of better practice to support entities in meeting requirements under the new prudential standard, CPS 511 Remuneration (CPS 511) (summarised here).
- In a letter to APRA-regulated entities, APRA said that submissions to the consultation called for clarification of some aspects of the guidance and the inclusion of further examples of better practices, especially around: a) how entities should apply 'material weight' to non-financial measures in virtual remuneration; and b) meeting minimum deferral requirements.
- In response,, APRA states that it has:
  - provided additional examples of better practice, including for applying material weight to non-financial measures
  - updated the guidance to align with the final CPS 511 requirements
  - 'aligned guidance with the government's proposed Financial Accountability Regime (FAR), including for deferral and vesting requirements'.
- APRA notes that some submissions suggested that requirements for deferring variable remuneration should not apply to buyouts. APRA rejected this on the basis that introducing a carve-out for buyouts would both result in misalignment between CPS 511 and the current draft FAR regime and 'introduce complexity, with risks to enforceability and transparency'.
- APRA notes that some submissions also sought clarification regarding implementation timeframes. In response, APRA confirmed that:
  - ADI SFIs will need to comply from 1 January 2023;
  - Insurance and RSE licensee SFIs will need to comply from 1 July 2023; and
  - Non-SFIs (across all APRA-regulated industries) will need to comply from 1 January 2024.
- APRA makes clear that 'CPS 511 requirements would not apply to a person's variable remuneration if the opportunity to earn the variable remuneration arose before the relevant commencement dates of the Prudential Standard'. That is,

  > 'an ADI SFI with a 30 June financial year-end must have incorporated CPS 511 requirements into the variable remuneration arrangements of all staff from 1 July 2023 onwards. APRA considers it appropriate to provide the same flexibility to APRA-regulated entities for new employees, who might join after the commencement date of the Prudential Standard but ahead of the entity's new financial year'.

- APRA reiterated that it will increase its supervisory oversight of remuneration practices ahead of the implementation of CPS 511.
- APRA plans to release new reporting and disclosure requirements on remuneration for consultation in 2022.

[Sources: APRA media release 18/10/2021; Final guidance: CPG 511 Remuneration; Letter to APRA-regulated entities 18/10/2021]

In Brief | Stronger clawback rule? SEC has re-opened consultation on proposed rule change that would see executives having to pay back any incentive-based compensation paid to them based on misstated financials for the three years leading up to the misstatement, regardless of whether the misstatement was due to fraud, errors, or any other factor

[Source: SEC Chair Gary Gensler public statement 14/10/2021]

Meetings and Proxy Advisers

Top Story | Status update: Legislating permanent changes to meeting and execution requirements – Bill introduced

A brief recap of temporary relief measures now in place and an overview of proposed permanent reforms that if legislated in their current form would permanently enable the use of technology in signing and executing documents and holding meetings

Key Takeouts

- Temporary relief 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 – 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.

Overview

Despite (generally) broad support for modernising existing requirements in the Corporations Act 2001 (Cth) around execution and signing of documents and convening of meetings, legislating permanent change has proven to be a less than straightforward process. A brief overview of the temporary relief now in place and the Bill now before parliament proposing to introduce permanent reform - Corporations Amendment (Meetings and Documents) Bill 2021 – is below.

Temporary relief is now in place

Schedule 1 to the Treasury Laws Amendment (2021 Measures No.1) Act (TLA 1 Act) commenced on 14 August 2021. Broadly, the changes in Schedule 1 temporarily enable companies to use technology to meet regulatory requirements under the Corporations Act around convening meetings, distributing meeting related materials and signing/executing documents until 31 March 2022.

The temporary measures are similar in substance to the measures contained in the Corporations (Coronavirus Economic Response) Determination (No. 3) 2020 (Determination No. 3) which expired on 21 March 2021.

Find more detail on the temporary relief currently in place.

More time to hold AGMs

Following the passage of the TLA 1 Act, ASIC's no-action position on virtual meetings ceased to have effect. However, ASIC's no-action position giving companies with balance dates up to 7 July 2021 an additional two months to hold AGMs has not been withdrawn.

In light of ongoing COVID-19 restrictions and uncertainty, ASIC has formalised and added to this by making a legislative instrument - ASIC Corporations (Extension of Time to Hold AGMs) Instrument 2021/770 - giving all public companies with balance dates between 21 February 2021 and 7 July 2021 an additional two months to hold their AGM, and giving public companies limited by guarantee with balance dates between 24 January 2021 and 7 April 2021 an additional four months to hold their AGM.

Legislating permanent change: Bill now before parliament

The government consulted on draft legislation proposing to permanently modernise meeting and execution requirements under the Corporations Act 2001 (Cth) (summarised here) between 25 June to 16 July 2021.

On 30 August 2021, the government released a revised draft Bill – Treasury Laws Amendment (Measures for Consultation) Bill 2021: Use of technology for meetings and related amendments – for another short round of consultation. Consultation closes on 10 September 2021.

On 20 October 2021 a Bill – Corporations Amendment (meetings and Documents) Bill 2021 – was introduced. It appears to be similar in substance to the revised draft Bill.

Importantly, if legislated in its current form, the proposed permanent changes will differ from the temporary measures now in place in several respects.

Meeting requirements/meeting-related communications

Broadly, if legislated in its current form the Bill would permanently:

- Give companies and registered schemes the option to hold hybrid meetings. However, unlike the temporary measures now in place, companies would have the option to hold wholly virtual meetings only if expressly permitted to do so under their constitution. Under the temporary measures introduced by the TLA 1 Act, companies and registered schemes can currently hold wholly virtual meetings of members, regardless of whether they are permitted to do so under their constitutions, until 31 March 2022.
- Allow 'members entitled to attend the meeting, as a whole, a reasonable opportunity to participate in the meeting'. Section 249S of the Bill sets out what this may entail. Among other things, companies will need to:

  > 'allow the members who are entitled to attend the meeting, and do attend the meeting using that virtual meeting technology, as a whole, to exercise orally and in writing [emphasis added] any rights of those members to ask questions and make comments'.

- Give members of companies and registered schemes the option to elect to receive meeting related documents, electronically or in hard copy. Companies and registered schemes will need to notify their members of their right to elect to receive a document or documents in a specified form (physical or electronic form) 'at least' annually. The explanatory memorandum suggests that this could occur by writing to members or by publishing a notice on the company or share registry's website.
- Allow a member or group of members of a company or registered scheme with at least 5% of the voting power to request to have an independent person appointed to observe and/or prepare a report on a poll conducted at a members meeting
- Require votes on resolutions which are set out in the notice of a meeting of members of a listed company or listed registered scheme to be decided by poll (a listed company's constitution will not be is capable of providing otherwise - the requirement would not be a replaceable rule)

Execution of documents

In respect of execution of company documents the changes would permanently:

- enable companies and their officers (including company agents) to create and sign deeds, as well as other documents, electronically; and
- allow the use of technology to execute documents with a common seal electronically, including by allowing witnesses to validly witness the fixing of a company seal electronically.

The Bill also proposes to enable proprietary companies with a sole director and no company secretary to use the statutory document execution mechanisms.

Preparing for further 'modernisation' of requirements

The Bill also proposes to move existing provisions relating to electronic communications and electronic signatures from Chapter 2G to Chapter 1 of the Corporations Act 2001 (Cth) 'so that they can be extended in the future to include additional types of documents that do not relate to meetings'.

Proposed timing

It's proposed that the permanent measures in the Bill will take effect from 1 April 2022 (ie after the temporary measures in the TLA 1 Act expire on 31 March 2022).

That is, the changes will apply (subject to the passage of the Bill) to documents sent and meetings held on or after 1 April 2022 and to documents executed on/after the day after the Bill receives Assent.

This means that even if the Bill is passed, companies and registered schemes that have sent meeting notices before the commencement of the Bill, but after the commencement of the TLA 1 Act, will be able to hold wholly virtual meetings (even if their constitution does not permit them to do so) until the temporary relief in the TLA 1 Act sunsets.

Shareholder Activism

Shareholder Paris-targets resolution filed at Incitec Pivot Ltd

The Australasian Centre for Corporate Responsibility (ACCR) has filed a shareholder resolution at Incitec Pivot Ltd (full text here).

The resolution is in two parts:

- special resolution seeking to amend the company's constitution
- ordinary resolution (the passage of which is contingent of the passage of the constitutional amendment) requesting annual disclosure from 2022 of:
  - the company's Scope 1, 2 and 3 emissions (Targets) that are align with the goals of the Paris Agreement;
  - details of how the company's capital expenditure, 'including material investments in the development of oil and gas reserves, will be aligned with the Targets'; and
  - 'details of how the company's remuneration policy will incentivise progress against the Target'

Broadly, the ACCR considers that the company's existing approach is not aligned with its commitment to 'examine and develop potential pathways to net zero operational emissions by 2050' or with the goals of the Paris Agreement. The resolution aims to address this by pushing the company to adopt tougher emissions reduction targets; increase the capital allocated by the company to decarbonisation efforts; and executives are incentivised to meet the targets set. You can find the full text of the resolution together with the ACCR's supporting statement here.

Incitec's Notice of Meeting will be published on 17 November and will include the board's response to the resolutions and voting recommendations.

[Sources: ACCR media release 14/10/2021; Incitec ASX release 14/10/2021]

Say on climate: A majority of BHP shareholders have reportedly backed the company's transition plan at the London AGM

- The 2021 AGM of BHP Group Plc was held in London on 14 October 2021.
- The 'say on climate' resolution reportedly (SMH, Reuters, The Australian) received 83% support– though the official poll results will not be released until after BHP's Australian AGM on 11 November 2021 is concluded.
- Ahead of the vote, Glass Lewis recommended against supporting the resolution expressing concern about 'the integrity' of the emissions reduction targets and concern that under the proposal, there would not be a further vote on the transition plan, for another three years.
- Commenting on the reportedly high level of support for the resolution at the London AGM, Director of Climate and Environment at the Australasian Centre for Corporate Responsibility (ACCR) expressed disappointment what he considers to be the failure of investors including institutional investors, to push the company to adhere to Paris Agreement. He said:

  'If reports of 83% support for its climate plan are true, then BHP shareholders have rubber stamped a plan that will see the company mine coal well beyond 2050 - the date by which BHP has committed to achieve net zero emissions….While BHP would have expected near unanimous support, 83% support for a plan that involves significant expansion in fossil fuel production is a terrible signal to send ahead of COP26.

  [Sources: ACCR media release 15/10/2021]

CBA AGM: Shareholder transition planning resolution received 15% support

The CBA AGM was held on 13 October 2021.

Key outcomes:

- Director elections: Two new directors were standing for election: Peter Harmer (whose skills include expertise in managing climate risk and digital innovation) and former financial regulator and Julie Galbo. CBA Chair Catherine Livingstone and one other director were also standing for re-election. All directors were elected with over 98% support.

- **Remuneration report:** The resolution to approve the remuneration report received 95.20% support. The resolution to approve a grant of securities to CEO Matt Comyn received 80.74% support (19.26% against).
- Shareholder ESG resolutions (Market Forces)
  - Constitutional amendment: The special resolution seeking to amend the constitution received 5% support
  - Transition planning: The ordinary resolution seeking alignment with the IEA 1.5 degree scenario received 14.38% proxy support (81.12% against) and was not formally put to the meeting because it was contingent on the passage of the constitutional amendment.
  - Neither resolution had board support.
- BlackRock voted in line with the CBA board recommendations against both resolutions.
  - BlackRock states that it voted against the constitutional amendment because it 'is generally not supportive of constitutional amendment resolutions. Our concern is that the relative ease of filing introduces the risk of potentially distracting and time-consuming proposals being submitted by shareholders whose interests are not necessarily aligned with those of the broader shareholder base'.
  - BlackRock states that it voted against the transition planning resolution because 'it is overly prescriptive and risks unduly constraining management's ability to make business decisions. Further, the company has demonstrated its commitment to integrating climate risks into its long-term strategy, including TCFD-aligned reporting since 2018 and a stated goal of net zero emissions by 2050'.
- In a statement commenting on the AGM, Market Forces notes that a number of questions to the board during the meeting focused on the bank's climate plan. Market Forces considers that this, together with the level of support for the transition planning resolution sends a signal that the CBA 'must address the shortcomings in its approach to climate change'. However, the statement also expresses disappointment that 'many investors failed to live up to their own net zero commitments by supporting the resolution.

[Source: BlackRock voting bulletin; CBA Chair Address 13/10/2021; Market Forces media release 13/10/2021]

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[Sources: FollowThis media release 11/11/2021; Chevron media release 11/11/2021]

Disclosure and Reporting

Support for the TCFD reporting framework has spiked: Fourth TCFD Annual status report highlights the greatest progress to date on TCFD adoption

The Taskforce on Climate-related Financial Disclosure (TCFD) published its 2021 annual status report on 14 October 2021. The report provides an update on key TCFD-related developments and initiatives supporting the TCFD as well as the results of the Task Force's annual review of climate-related reporting.

Some Key Takeaways

- TCFD-aligned reporting is increasingly acknowledged as best practice:
  - Mandatory TCFD-aligned disclosure: Eight jurisdictions have signalled their intention to mandate TCFD-aligned disclosure in the last year: Brazil, UK, Japan, Hong Kong, EU, NZ, Singapore and Switzerland
  - International standard setters are also building upon the TCFD recommendations to incorporate climate-related considerations into their disclosure standards. For example, the International Financial Reporting Standards Foundation (IFRS) has indicated it plans to build upon the TCFD framework for its international climate related disclosure standards.
- Recent uplift in adoption: The number of TCFD supporters has increased from 1512 in 2020 to 2016 in 2021(a sharper increase than in any prior year assessed)
- Some trends in TCFD reporting:
  - Overall, a review of companies' disclosures found that that alignment with the TCFD framework is improving (though there remains significant room for further improvement). For example:
    - For the first time, over 50% of companies reviewed disclosed their climate-related risks and opportunities

  - Disclosure of the resilience of companies' strategies under different climate-related scenarios increased significantly from 5% of companies in 2018 to 13% in 2020 (though this is still the least reported recommended disclosure)
- Looking at the average level of reporting across the 11 recommended disclosures by geographical region, the report found that:
  - European companies are leading the way with the average level of disclosure for fiscal year 2020 at 50% (up from 22% in 2019).
  - Asian Pacific companies ranked in second place with the average level of disclosure at 34% (up from 15% in 2019)
  - North American countries ranked in fifth place (average level of disclosure stands at 20%) behind, the Middle East and Africa (22%) and Latin America (26%).

- Information that users of financial reports would like to see included: The report also highlights that users of financial reports consider that the following information would improve the usefulness of disclosure from a decision making perspective:
  - disclosure of the amount of expenditure or capital investment currently deployed toward climate-related risks and opportunities
  - disclosure of the amount of expenditure or capital investment to be deployed to meet targets for addressing climate risks and opportunities, often disclosed in transition plans
  - interconnected reporting linking qualitative disclosures with their actual and potential financial impact.

  [Source: TCFD media release 14/10/2021; Full text report: TCFD 2021 Status report]

Scope 3 disclosure the new baseline: The TCFD has issued updated implementation guidance together with new guidance specifically on transition planning and use of metrics

- The Taskforce on Climate-related Financial Disclosures (TCFD) has issued updated and expanded implementation guidance (2021 Annex) to provide additional guidance on disclosing metrics, targets, and transition plan information in line with the TCFD recommendations. The updates reflect developments in/the evolution of climate reporting since the original guidance was released. The revised guidance replaces and expands on the guidance first issued in 2017.
- Key updates: Table 1 at p4 is a summary of the key changes made to the guidance. These include the following.
  - guidance for all sectors on disclosure of Scope 1, 2 and 3 emissions
  - guidance for all sectors on use of targets, including disclosure of interim targets, consistent with TCFD's seven cross-industry, climate-related metric categories (where relevant). These seven categories are: 1) Scope 1, 2 and 3 GHG emissions; 2) metrics on climate-related transition risks; 3) physical risks; 4) climate-related opportunities; 5) capital deployment; 6) internal carbon prices; and 7) remuneration.
  - supplemental disclosure for banks, insurers, asset managers and asset owners on the extent to which their activities/operations are aligned with a 'well below 2 degree' scenario
- Separately, the TCFD has also published Guidance on Metrics, Targets, and Transition Plans which is intended to support financial statement preparers in disclosing 'decision useful information and linking those disclosures with estimates of financial impacts'. The guidance includes information on selecting and disclosing metrics, including the seven broad categories of climate-related metrics that the TCFD considers all organisations should disclose (see Table C1 at p16). Broadly, these are as follows.
  - GHG Emissions: Absolute Scope 1, Scope 2, and Scope 3 emissions
  - Transition Risks: Amount and extent of assets or business activities vulnerable to transition risks
  - Physical Risks: The amount and extent of assets or business activities vulnerable to physical risks
  - Climate-Related Opportunities: The proportion of revenue, assets, or other business activities aligned with climate-related opportunities
  - Capital Deployment: the amount of capital expenditure, financing, or investment deployed toward climate-related risks and opportunities
  - Internal Carbon Price on each tonne of GHG emissions used internally by an organisation
  - Remuneration: the proportion of executive management remuneration linked to climate considerations
- Driving comparability of reporting? In putting these seven categories of metrics forward the TCFD emphasises it 'is not a standard-setting body' and has therefore defined the metric categories broadly. Over time, individual organisations and industries are expected to develop and operationalise specific metrics appropriate to their

circumstances/sector within the broad metric categories. The TCFD encourages preparers to use common taxonomies or methodologies where appropriate in the interests of supporting comparability.

[Sources: TCFD media release 14/10/2021; TCFD Guidance on metrics, targets and transition plans 2021; Updated implementation guidance]

Lifting standards of climate risk governance and disclosure is a key focus for ASIC

Key Takeouts

- ASIC Commissioner Sean Hughes identified supporting the continued improvement in the standard of climate-change governance practices and promoting, true to label, 'decision-useful' climate related disclosure as key priorities from the regulator.
- Mr Hughes made clear that ASIC considers boards have a key oversight role with respect to climate-risk disclosure
- ASIC considers that the voluntary adoption of TCFD-aligned reporting by some larger entities has 'materially improved standards of climate-related governance' (though challenges from a user and preparer standpoint remain)

In his address to the Governance Institute of Australia Fellows Roundtable, Australian Securities and Investments Commission (ASIC) Commissioner Sean Hughes provided an update on the regulator's work priorities for 2022 with a particular focus on ASIC's climate risk related work program.

Key Points

Climate change disclosure and governance

Mr Hughes provided a brief update on ASIC's work on various climate-related projects including ASIC's involvement in the sustainable finance taskforce of the International Organisation of Securities Commissions (IOSCO) and provided an update on ASIC's priorities in this area.

- ASIC's contribution to the IOSCO's sustainable finance taskforce (Taskforce):
  - The Taskforce was formed to address three challenges: a) the comparability and useability of disclosures produced under the multiple and diverse sustainability frameworks and standards in use in global markets; b) greenwashing; and c) lack of common definitions of sustainable activities.
  - The Taskforce has released three reports over the law few months - 1) a final report on sustainability-related issuer disclosures, which includes climate change-related disclosures; 2) a consultation report on sustainability-related practices, policies, procedures and disclosure in asset management; and 3) a consultation report on ESG ratings and data providers – which highlight the key issues, challenges and pressure points in the global landscape and suggest a number of recommendations around how these challenges can be met.
  - Through its membership of the Taskforce, ASIC contributed to the first two of these reports which provide context for ASIC's forward workplan with respect to climate risk.
- A possible global sustainability reporting standard: ASIC is also monitoring international developments that may impact climate disclosure including the possible development by the International Financial Reporting Standards (IFRS) of an international baseline reporting standard. Separately, ASIC is following the US Securities and Exchange Commission's consultation on climate-related disclosure for US listed companies. Mr Hughes said that though it remains to be seen 'where these initiatives will ultimately land, they are important developments and ASIC is following them very closely, particularly with reference to their potential relevance to listed companies in Australia'.

ASIC's Domestic agenda: climate-change risk governance

- Climate-risk disclosure is a key area of focus: ASIC's latest Corporate Plan sets out the regulator's climate-risk related priorities. These include:
  - supporting continuing improvement in the standard of climate-change governance practices
  - promoting 'decision-useful' climate related disclosure by listed companies to ensure investors have the information they need to make informed decisions

- monitoring the continued evolution of TCFD reporting standards in the Australian market and statutory disclosure requirements such as those that apply to operating and financial reviews and disclosure documents
- continuing to engage on climate change disclosure related issues through stakeholder engagement, the work the Council of Financial Regulators working group on climate risk and through the ongoing work of the IOSCO Sustainable Finance Taskforce. ASIC is also engaging on potential new sustainability reporting frameworks under the proposed International Sustainability Standards Board through participation in an IOSCO Technical Experts Group.

- **Greenwashing:** Mr Hughes said that ASIC has a program of work examining the area of potential greenwashing of financial products. Mr Hughes flagged that ASIC will be 'conducting targeted surveillance of financial products to identify misleading statements relating to environmental, social and governance claims, particularly across social media' and seeking to improve consumer outcomes by 'changing industry practices to mitigate the risk of greenwashing and contribute to the international work of IOSCO in this area'.

- **Four core messages on climate change risk:** Mr Hughes said that ASIC's 'core messages on climate change-related matters remain unchanged from those we set out in 2018 under ASIC Report 593'. That is, ASIC expects:
  - directors and officers of listed companies to understand and continually reassess existing and emerging risks that may be applicable to the company's business, including both physical and transitional climate risk
  - boards to consider whether they are comfortable with the level of oversight they have over climate risks and opportunities and the governance structures they have in place to assess, manage and disclose these risks and opportunities
  - directors to carefully consider the statutory requirements relating to the operating and financial review for listed companies and other requirements for prospectuses or continuous disclosure announcements
  - companies to disclose 'useful information to investors' about climate risk (eg to consider reporting under the TCFD reporting framework)

- **TCFD-aligned disclosure:** ASIC's most recent round of surveillance found that voluntary adoption of TCFD reporting by some larger listed companies has 'materially improved standards of climate-related governance and disclosure in our market'. In particular Mr Hughes said that ASIC has observed a 'meaningful increase' in the level of engagement and disclosure on climate-related matters by larger listed entities. Despite this improvement, he said that challenges remain from both a user and preparer standpoint with respect to TCFD disclosure eg scenario analysis and physical risk disclosures.

Other priorities

- **Four key priorities will support Australia's post-COVID economic recovery:** Referencing ASIC's latest Corporate Plan, Mr Hughes said that ASIC has four priorities. These are: 1) promoting economic recovery from the COVID-19 pandemic 'including through better and more efficient regulation, facilitating innovation, and targeting regulatory and enforcement action to areas of greatest harm'; 2) reducing risk consumer harm (eg from poorly designed products and increased investment scam activity); 3) supporting enhanced cyber security and cyber resilience in ASIC-regulated entities; and 4) 'driving industry readiness and compliance' with various law reform initiatives eg the planned Financial Accountability Regime among other reforms. Mr Hughes also emphasised ASIC's focus on taking a 'targeted outcomes-based and less prescriptive approach to regulation' drawing on the full range of regulatory 'tools' available.

- **Whistleblower policy reminder:** Referencing ASIC's 13 October letter to CEOs (summarised in a separate post of this issue of Governance News) reminding them of their obligations under the whistleblower protection regime, Mr Hughes reiterated calls for reporting entities to review their whistleblower protection policies, systems and processes to address gaps identified in ASIC's 2020 whistleblower policy review. In particular, Mr Hughes called on entities to ensure that they: a) clearly articulate how a potential whistleblower can make a disclosure that qualifies for legal protections; b) ensure whistleblower policies are compliant with current legal requirements; and c) that the legal rights and remedies available to whistleblowers (if they make a qualifying disclosure) are accurately described.

- **Reducing the regulatory burden on business:**
  - Mr Hughes said that ASIC is also focused on reducing the regulatory burden on business. For example ASIC is participating in the government's Deregulation Taskforce, which is exploring solutions to lower the costs of regulation.
  - ASIC will engage with Treasury on 'business modernisation' measures that the government may wish to adopt, such as: electronic signatures; electronic lodgement of forms; virtual meetings; and increased use of digital reporting.

[Source: Speech by ASIC Commissioner Sean Hughes at the Governance Institute of Australia Fellows Roundtable, Corporate governance update: climate change risk and disclosure 14/10/2021]

In Brief | The UK government has released a its plan - 'Greening Finance: A Roadmap to Sustainable Investing' – setting out an indicative pathway and timeframe for the introduction of a new economy-wide Sustainability Disclosure Requirements framework

[Note: Figure C at p19 of the roadmap summarises the proposed timelines for the roll-out of proposed new disclosure requirements for companies, asset owners and asset managers and financial advisers as well as proposed new investment product disclosure requirements.]

[Source: UK government media release 18/11/2021; Greening Finance: A Roadmap to Sustainable Investing October 2021]

JobKeeper disclosure: ASIC has issued a suggested form of notice and guidance for listed entities

- Jobkeeper was a temporary government wage subsidy program to assist businesses impacted by the COVID-19 pandemic. The scheme commenced on 30 March 2020 and finished on 28 March 2021.
- The Treasury Laws Amendment (2021 Measures No. 2) Act 2021 amended the Corporations Act 2001 (Cth) to introduce new requirements for listed entities who received Jobkeeper assistance to disclose certain details about the assistance they received (as set out in s 323DB) and for the Australian Securities and Investments Commission (ASIC) to consolidate the notices provided into a public report (as set out in s323DC).
- To assist entities to comply with their Jobkeeper disclosure obligations ASIC has issued a suggested Jobkeeper notice form (or template) together with guidance on completing it. While using the notice form is not mandatory, ASIC strongly encourages entities to use it to ensure that they include all necessary information in line with what is required under s323DB.
- Notice deadline:
  - Listed entities that have received Jobkeeper payment in a prior financial year and lodged their annual report for that year before 14 September 2021 have until 13 November 2021 to notify the market.
  - Listed entities that lodge their annual financial reports after 14 September 2021 will have 60 days from the date their annual financial report was lodged with ASIC to notify the market.
  - All other listed entities that have received Jobkeeper support must give notice to ASX within 60 days.

[Source: ASIC media release 15/10/2021]

Institutional Investors and Stewardship

DOL consults on proposed removal of barriers to pension funds factoring ESG considerations into their decision making

- The US Department of Labor (DOL) has released a draft rule – Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights – for a 60 day comment period. Submissions are due 13 December 2021.
- Broadly, the draft Rule proposes amendments to the Investment Duties regulation under Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA), to clarify that there is no barrier to pension funds factoring material ESG considerations into their investment decision making and/or proxy voting decisions. The DOL states:

  > 'The Department is concerned that the current regulation has created a perception that fiduciaries are at risk if they include any ESG factors in the financial evaluation of plan investments, and that they may need to have special justifications for even ordinary exercises of shareholder rights. The amendments proposed in this document are intended to address uncertainties regarding aspects of the current regulation and its preamble discussion relating to the consideration of ESG issues, including climate-related financial risk, by fiduciaries in making investment and proxy voting decisions, and to provide further clarity that will help safeguard the interests of participants and beneficiaries in the plan benefits. Accordingly, the proposal makes clear that climate change and other ESG factors are often material and that in many instances fiduciaries to should consider climate change and other ESG factors in the assessment of investment risks and returns.'

- Announcing the consultation, Acting Assistant Secretary for the Employee Benefits Security Administration Ali Khawar said that the proposed rule will 'bolster the resilience of workers' retirement savings and pensions by removing the artificial impediments – and chilling effect on environmental, social and governance investments – caused by the prior administration's rules…A principal idea underlying the proposal is that climate change and other ESG factors can be financially material and when they are, considering them will inevitably lead to better long-term risk-adjusted returns, protecting the retirement savings of America's workers.'

  [Source: DOL media release 13/10/2021]

In Brief | The Asian Investor Group on Climate Change, Ceres and the Investor Group on Climate Change have jointly released a report - the G20 Countries' Climate Policy Report Card – measuring G20 countries' progress towards five policy recommendations which the groups consider key to attracting green investment. The report ranks Australia among the least attractive countries from a green investment perspective alongside Argentina, India, Indonesia, Mexico, Russia and Saudi Arabia. The UK and the EU are ranked as the most attractive destinations (though the group considers they have substantial improvements to make)

[Sources: IGCC media release 18/10/2021; Full text report: G20 Countries' Climate Policy Report Card]

Regulators

ASIC Annual Report 2020/21 released

The Australian Securities and Investments Commission has released its 2020/2021 Annual Report.

Key Takeaways

- **COVID-19 recovery:** Supporting Australia's recovery from the economic impacts of the COVID-19 pandemic has been central to ASIC's work over the 2020-21 period and is expected to continue to be a priority looking forward to the year ahead.
- **Enforcement activity:** ASIC Chair Joe Longo highlighted that in 2020–21 ASIC 'finalised many of the enforcement matters arising from the Royal Commission and increased its enforcement action generally' in line with its COVID-19 enforcement priorities. For example:
  - In 2020–21, ASIC completed 46 court actions, of which 93% were successful. The total value of penalties for the cases was $189.4 million (up from $24.9 million in 2019/20)
  - In 2020–21, 53 new criminal actions were commenced (up from 41 in 2019/20) and 29 people were convicted of criminal offences following ASIC investigations, with 10 people receiving custodial sentences (including those fully suspended)
  - In 2020–21 ASIC issued three infringement notices and received a total of $392,000 in payments pursuant to these.

  Commenting on ASIC's enforcement approach Mr Longo states:

  > 'Our approach to enforcement is also key to our effectiveness as a regulator. ASIC must be an active and credible law enforcement agency and we will use our full enforcement toolkit as appropriate. Criminal charges, civil cases, enforceable undertakings, product interventions, financial penalties, bannings and licence conditions – they are all on the table and will be used to achieve what's right. We will hold individuals and corporations to account and will act quickly and decisively to disrupt, deter and punish misconduct'.

- **Supporting implementation of key reforms:** ASIC published 36 new or revised regulatory guides in 2020/21 (up from 29 in 2019/20) and published 50 new/revised information sheets (up from 31 in 2019/20) including guidance to support implementation of key reforms eg new design and distribution obligations, breach reporting obligations and the deferred sales model for add-on insurance.
- **Internal risk and compliance capability:** Internally, ASIC implemented a number of the recommendations of the Thom Review including implementing enhancements to its risk management framework and changes to operational strategy and management.

  [Sources: ASIC media release ; ASIC 2020/21 Annual Report]

Financial Services

Top Story | Key word guidance COVID-19 business interruption insurance policies

In Australia's second test case for business interruption insurance relating to COVID-19, the judge provided some useful guidance around keywords throughout the policies. MinterEllison has released an expert summary and discussion of this guidance. The full text of the article is available here.

ASIC calls on general insurers to urgently review their pricing practices and update their systems/processes to ensure consumers receive the full value of any discounts offered

- The Australian Securities and Investments Commission has called on general insurers to review their pricing practices to ensure that customers receive the full value of any discounts they are offered.
- More particularly, ASIC Deputy Chair Sarah Court suggested that insures should review their 'pricing systems and controls' to:
  - 'identify any differences between the prices (including discounts) they promised their customers (over at least the past five years) and what those customers were charged';
  - ensure compliance with breach reporting obligations
  - ensure that any customers impacted are remediated (including refunding overpaid premiums)
  - urgently update any 'systems, processes, controls and governance practices that have led to promised discounts not being honoured' eg by updating legacy IT systems, implementing improvements across compliance, governance and culture.
  - may require insurers to update legacy IT systems and make improvements across compliance, governance and culture.
- ASIC cautions that it will use the full range of regulatory tools available to protect consumers and that insurers who fail to implement the actions outlined 'run the risk of further enforcement action'.
- The call follows what the regulator describes as 'industry-wide failures' that have led to insurers repaying more than $400 million to over two million customers since 2018. The call also follows the regulator launching civil proceedings in the Federal Court against Insurance Australia Limited (IAL) over the insurer's (alleged) historical failure to apply promised discounts. You can find the details of ASIC's allegations in the originating process and concise statement.

[Source: ASIC media release 15/10/2021]

Rebuilding trust in the sector: ASIC calls on insurance to focus on conduct risk, embrace regulatory reforms and invest in appropriate systems

In her address to the 2021 Annual Industry Forum of the Insurance Council of Australia, Australian Securities and Investments Commission (ASIC) Deputy Chair Karen Chester said that from ASIC's perspective there are three actions insurers can take to 'move from trust deficit to trust dividend': a) maintaining their focus on conduct risk; b) keeping pace with legislative step-changes in regulatory obligations; and c) investing in data, systems and processes – essential prerequisites for delivering good consumer outcomes.

A key theme running through the speech is that insufficient focus on customer needs (eg in the context of product design and sale) combined with insufficient investment in appropriate systems and processes to ensure customer needs are met, has led over time to the loss of trust in the sector.

Ms Chester suggested that had recent regulatory reforms (eg design and distribution obligations, breach reporting and internal dispute resolution reforms, prohibition on the use of unfair contract terms, claims handling reforms, add-on insurance reforms) been in place and had industry invested in appropriate systems, processes and controls in 2015 many of the issues now facing the sector may not have eventuated. Ms Chester said:

> 'If this had all happened six years ago, would we now be seeing the current levels of breach reporting, remediation and refunds for things such as the mis-selling of credit insurance? Or for the mis selling of add on insurance with car sales?'

On this basis, Ms Chester called on industry to view recent regulatory changes and investment in data and systems not as a regulatory burden but as 'simply good risk management' and an 'insurance policy for you, your board and your investors'.

Investment in data, systems and internal controls

Ms Chester said that ;investment in getting data, systems and internal controls right is essential' and 'long overdue' from ASIC's perspective. In particular, Ms Chester flagged ASIC's concern 'about the risk of ongoing and legacy misconduct being masked or facilitated by under-investment in systems and processes'.

Having appropriate systems and controls in place, she said is a prerequisite for enabling firms to identify whether customer needs are being met and to identify consumer harm.

Ms Chester said that 'ASIC has been frustrated by the delay in addressing under-investment in data, systems and controls' noting that the regulator now has a 'pipeline of cases in the insurance sector, mostly stemming from poor management of non-financial risk' including legacy systems.

> [Source: Speech by ASIC Deputy Chair Karen Chester at the 2021 Annual Industry Forum of the Insurance Council of Australia, General insurers: from trust-deficit to trust-dividend, 13/10/2021]

APRA calls on insurers to step up their focus on risk management and customer needs

In her first address to the insurance industry since her shift to having primary responsibility for APRA's oversight of insurance Australian Prudential Regulation Authority (APRA) Deputy Chair Helen Rowell identified two areas where the regulator considers industry could improve namely:

- ensuring that the 'basics of good insurance risk management' are in place, and
- strengthening customer focus to ensure there is genuine focus on customer needs, clear communication about what is/is not covered

Ms Rowell provided an update on the work APRA is undertaking in response to these issues and called on insurers to adopt a proactive approach to addressing them. With respect to addressing the 'expectation gap' in particular, Ms Rowell said that a collective response from policy makers, industry and from regulators will be required

Key Takeaways

A sense of déjà vu

Ms Rowell observed that coming back to the sector after a period of 10 years focused elsewhere she felt a 'sense of déjà vu….10 years on, we still see major risk and compliance weaknesses, with further significant risk uplift programs underway in response to the Royal Commission and other issues. I find myself wondering why the industry didn't get more traction in embedding substantive improvement a decade ago, and what it will do to ensure the outcome is different this time'.

Strengthening risk management, culture and oversight

- Business Interruption Insurance (BI):
  - Ms Rowell said that the 'biggest issue for the industry' over the past 12-18 months has been the uncertainty around BI policies which she described as a 'wake up call' for the sector', a 'significant mis-step in managing insurance risk' and a poor reflection on the risk management practices within the industry.
  - In light of this, APRA has asked the 10 general insurers most exposed to BI to conduct a self-assessment of their insurance risk management practices in the context of their BI policies, and also 'run a lens over other products or exposures where similar problems could occur'. APRA also asked that the review include consideration of cyber insurance. APRA expects to receive these self-assessments 'at the end of next month' and will public industry feedback once it has reviewed them.
  - Ms Rowell said that should any 'red flags' emerge as a result of the exercise, it 'may result in a supervisory response' but underlined that the review 'is not intended to be punitive'. Rather, APRA desires to 'work with the industry to help them identify and address any weaknesses before they manifest in a similar way to BI'.

- **Strengthening risk management practices more broadly: Risk culture survey**
  - In March and April this year APRA asked 10 general insurers to pilot a new Risk Culture Survey, which involved APRA directly collecting risk culture survey responses from employees of those insurers. The survey contained over 40 questions including: 'Do people feel safe to speak up? Do their leaders role model good risk management behaviours? Are adequate resources and training committed to deliver continuous improvement in risk management across the organisation?'
  - Ms Rowell said that APRA will publish an article with details about the survey outcomes. Broadly, the three areas with the 'lowest scoring risk culture dimensions' were: 1) Risk governance and controls; 2) decision making challenge; and 3) responsibility and accountability.

    [Note: APRA has since published the article: Transforming risk culture: observations from APRA's pilot survey.]
  - APRA intends to discuss the survey results with participating entities to 'support a mature risk culture'.
- **Broader roll-out**
  - Given the success of the pilot, APRA will roll-out the risk culture survey across other APRA-regulated industries over the next 12 months, and will publish further insights/engage with entities to ensure any identified weaknesses are addressed.
  - Ms Rowell said that the 'enhanced benchmarking and transparency on practices and outcomes in this important area will support APRA's strategic objective of transforming governance, risk culture, remuneration and accountability across APRA-regulated industries'.

Increased customer focus: affordability, accessibility and closing the expectation gap

- Opportunity to close the 'expectation gap':
  - Ms Rowell said that 'APRA has been encouraged' in recent times by 'a more deliberate effort by insurers and the ICA to better communicate with their customers and the community-at-large' about their role. Ms Rowell said this is important in closing the 'expectation gap between insurance companies and their customers'.
  - Ms Rowell said that closing this expectation gap is an area where 'there is significant opportunity for the industry, and I would encourage you to step back and review past practices and consider how your products and processes need to change, particularly to provide more clarity and certainty for your customers on what is, and is not, covered by their insurance products'.
- The growing 'protection gap':
  - Ms Rowell said that insurers and regulators in Australia and overseas, are grappling with a growing 'protection gap' that is 'potentially larger than perhaps we have observed in the recent past'. This is not limited to areas with a 'high prevalence' of extreme weather events (eg Northern Australia), but extends to access to insurance by the business community in a range of industries and classes of insurance products.
  - Ms Rowell said that while it is 'entirely within an insurer's rights to decide which risks to select, and which to avoid' when 'risk exclusion and avoidance burgeon across multiple products and insurers, it leads to prices that are unaffordable, or products that are simply not available'. This in turn impacts consumer confidence as well as having implications for business, many of which are unable to operate without insurance.
  - Ms Rowell said that affordability and accessibility of insurance for small and medium enterprises (SMEs) has declined in recent years due to a range of factors including both the increased threat of natural disasters and other climate-related risks and 'an increasingly litigious society'.
  - Ms Rowell said that addressing these challenges requires the combined efforts of regulators, policy makers and industry, noting that APRA's Corporate Plan specifically calls out insurance accessibility and affordability as one of APRA's key priorities over the next four years. APRA's key focus is on 'building the evidence base to better understand the issues, and magnifying our influence on contributing to a solution' for example through 'leveraging supervision insights and system-wide perspective' to advise stakeholders on the nature and extent of accessibility and affordability issues, and the risks that exacerbate these challenges.
  - Ms Rowell called on insurers to action on the issue stating that:

    > 'This response needs to go beyond what has often been the response of insurers to deterioration in profitability in a class of insurance business: namely significant increases in premiums and/or withdrawal of cover. Some variation in profitability is to be expected over time – but not the extreme cycles we have seen in some product classes that seem to continually repeat. There is a need for a different, more innovative approach by insurers to how they design and distribute products, manage claims, and communicate with consumers to help lessen such volatility in the pricing cycle and improve accessibility and affordability for policyholders'.

  [Source: APRA Deputy Chair Helen Rowell - Speech to the Insurance Council of Australia Virtual Industry Forum, Insuring Australia: Are you the best you can be? 13/10/2021]

ASIC has released updated guidance about the distribution of superannuation products following recent law reforms, flags plans to conduct a thematic review

Following recent law reforms affecting the distribution of superannuation products - product design and distribution obligations (DDO), the hawking prohibition, the 'stapling' measure (that will come into effect on 1 November 2021) and changes affecting the prohibition in s68A of the Superannuation Industry Supervision Act 1993 (Cth) (SIS Act) – the Australian Securities and Investments Commission (ASIC) has released updated guidance for trustees and employers.

- Information Sheet 89 Communicating with employees about superannuation fund choice: what you can and cannot do (INFO 89) provides guidance to employers about communicating with employees about superannuation choices, including guidance on what employers should avoid saying/doing eg providing financial product advice or engaging in distributing superannuation products on others' behalf. The guidance reflects:
  - the need for employers to ensure they do not contravene the hawking prohibition, particularly when engaging with new employees about their choice of fund
  - clarifies that employers are not a distributor when providing a product disclosure statement for their default fund to an employee, even if the employee has a 'stapled' superannuation fund
  - information on how the new 'stapling' measure will work.
- Information Sheet 241: Prohibition on influencing employer's superannuation fund choice (INFO 241) provides guidance to trustees on complying with the obligations under section 68A of the Superannuation Industry (Supervision Act) 1993 (Cth) (SIS Act). The guidance has been updated to reflect the removal of an exemption under s68A allowing a trustee to supply or offer goods or services to an employer on the basis that the supply or offer was available to all the employer's employees by the Superannuation Industry (Supervision) Amendment (Your Future, Your Super—Improving Accountability and Member Outcomes) Regulations 2021).

ASIC to conduct a thematic review

- ASIC has called on trustees to familiarise themselves with the guidance in both information sheets to 'ensure appropriate engagement with employers and employees'.
- ASIC plans to conduct a thematic review 'this financial year' looking at how trustees use employers to distribute superannuation products. Following the review, ASIC states that it may consider regulatory action where misconduct causing consumer harm is identified.

[Source: ASIC media release 15/10/2021]

ASIC consults on extending its CFD product intervention order

- **Context:** The Australian Securities and Investments Commission (ASIC) made a Contracts for Difference (CFD) product intervention order in October 2020 after it found that CFDs have resulted in, and are likely to result in, significant detriment to retail clients. The order is set to expire on 23 May 2022 unless it is extended.
- **The order has been effective in reducing consumer detriment**:
  - According to analysis by ASIC there have been 'significant improvements in a number of key metrics and indicators of retail client detriment from CFD trading' in the three months since the order has come into effect. For example, ASIC found that retail clients' aggregate net losses dropped from a quarterly average of $372 million in the year prior to the CFD Order to $22 million during the three months that the order has been in place.
  - ASIC observes that this positive finding is consistent with the experiences of similar regulatory measures in other jurisdictions such as the UK and the EU and with academic research assessing the impact of CFD leverage on retail client outcomes.
- **Consultation on extension of the order:**
  - ASIC considers that in light of the proven effectiveness of the order, it should remain in force until it is revoked or sunsets on 1 April 2031. This is appropriate, ASIC considers, as it will avoid having to consult on further temporary extensions of the order thus providing both CFD issuers and retail clients with regulatory certainty.
  - ASIC is seeking feedback on this proposed extension. The details of ASIC's proposed extension and further detail on the outcomes of ASIC's analysis of the effectiveness of the order detailed in Consultation Paper Extension of the CFD product intervention order (CP 348)
  - Submissions are due **29 November 2021.**

– ASIC's proposal is subject to consultation, further analysis of the effectiveness of the order and Ministerial approval.

[Sources: ASIC media release 18/10/2021; Consultation Paper Extension of the CFD product intervention order (CP 348)]

FPA backs FSC's proposed advice reforms in principle

- The Financial Services Council (FSC) recently released a White Paper on Financial Advice, setting out a proposed framework and timeline to simplify and streamline the existing financial advice regulatory framework to reduce the current compliance and costs burden on individual advisers (summarised in Governance News 13/10/2021 at p18)
- The Financial Planning Association (FPA) has issued a statement welcoming the release of the white paper and its 'goal to reduce the cost of providing financial advice, allowing financial planners to spend more time with new and existing clients'. The FPA states that the white-paper 'closely aligns' with the FPA's own five year policy-platform roadmap.
- In particular, the FPA's statement expresses strong support for the 'establishment of a principles-based professional and ethical advice model' and a shift away from the existing rules-based 'tick a box' approach.
- The FPA considers that an overhaul of the registration model (as has previously been recommended by the FPA) is also an important reform. 'The creation of a personal obligation to register is an essential component of any professional framework and this is essential to achieving the outcomes the FPA and FSC have recommended in our respective policy visions'.

[Source: Financial Planning Association media release 14/10/2021]

Financial Advice: ASIC further extends temporary COVID-19 'record of advice' relief measure

- ASIC Corporations (Amendment) Instrument 2021/848 amends the ASIC Corporations (COVID-19—Advice-related Relief) Instrument 2021/268 to give effect to two temporary relief measures aimed at supporting 'access to timely and affordable personal advice for existing clients…that is in connection with the adverse economic effects of COVID-19'.
- The instrument temporarily:
  - extends 'record of advice' relief enabling financial advisers to provide existing clients requiring urgent COVID-19 related financial advice with a record of advice rather than a statement of advice in certain circumstances. The temporary measure will end on 15 April 2022
  - reintroduces a relief measure (that expired on 15 April 2021), giving financial advisers more time to give their clients a statement of advice after time-critical advice has been provided. Under this measure financial advisers have up to 20 business days (instead of 5 business days).
- The Instrument commenced on the later of 14 October 2021 and will remain in effect for six months – it will be repealed on 15 April 2022.
- Temporary measures only: ASIC states that it will 'continue to monitor the appropriateness of these temporary relief measures as circumstances change and may consider ending the relief before the six-month period if appropriate. ASIC will give sufficient notice to industry before any early repeal is implemented'.

[Source: ASIC media release 14/10/2021]

Insolvency and Reconstruction

Consultation on possible changes to the treatment of corporate trusts under insolvency law

Following the small business insolvency reforms that came into effect on 1 January 2021, the government is consulting on possible further 'complementary' changes to the treatment of corporate trusts under insolvency law to 'help companies in distress to reorganise and survive, while further reducing regulatory burden for business'.

Feedback is sought on:

- whether the treatment of corporate trusts under existing insolvency law needs to be clarified, and the potential benefits of this;
- the most appropriate way to extend the statutory insolvency regime to these entities, should a case be made for legislative change.

The due date for submissions is 10 December 2021.

[Source: Treasury Consultation: Clarifying the treatment of trusts under insolvency law 15 October-10 December 2021]

Risk Management

Top Story | Transforming GCRA: APRA to roll out a risk culture survey to all APRA-regulated entities

Key Takeouts

- APRA has released the results of a pilot risk culture survey conducted with 10 insurers earlier in the year. The survey provides an employee perspective on risk behaviours and the effectiveness of the risk management structures within the participating organisations.
- APRA intends to roll out the risk culture survey to other APRA-regulated entities over the next 12 months
- The survey is part of APRA's broader focus on 'transforming' governance, culture, risk and accountability (GCRA) practices across APRA-regulated entities.

The Australian Prudential Regulation Authority (APRA) has released an article presenting a summary of the results of the pilot risk culture survey conducted with the employees of 10 general insurers in March and April 2021.

The survey involved APRA directly collecting responses from the employees at participating entities – the survey was sent to every employee and completed on a voluntary basis. Questions were designed to measure employee perceptions of the entities' risk culture. Questions included for example: Do people feel safe to speak up? Do their leaders role model good risk management behaviours? Are adequate resources and training committed to deliver continuous improvement in risk management across the organisation?

As such, APRA considers that the results provide a 'unique employee view' of the risk management practices and behaviours within particular entities and an important basis for comparison across regulated entities.

Following the success the pilot program, APRA intends to roll out the survey to other APRA-regulated sectors over the next 12 months as part of its broader focus on transforming governance, risk culture, remuneration and accountability (GCRA) practices across regulated entities. This is part of APRA's Hayne response.

APRA's approach to measuring risk culture

The survey contained over 40 questions aligned with a framework developed by APRA – the Risk Culture 10 Dimensions – to assess the risk culture of regulated entities.

The Risk Culture 10 Dimensions are framed around two elements that APRA considers contribute to risk culture within organisations: a) observable actions and behaviours; and b) the 'risk architecture' or formal systems, policies, processes and governance structures that support risk management within organisations.

For context, the Risk Culture 10 Dimensions are as follows.

Risk behaviours

- Leadership: 'Leaders at every level deliberately and consistently champion risk management, setting a clear tone and role-modelling appropriate risk behaviours to instil the desired risk culture throughout the entity'.
- Decision-Making and Challenge: 'There is a demonstrated willingness to proactively consider diverse viewpoints and to give and receive constructive challenge across the entity'
- Communication and Escalation: 'Risk issues are openly communicated across the entity, supported by an environment where people feel safe to speak up without fear of retribution'.
- Risk Capabilities: 'The level of skills and learning, well-being, processes, systems and data across the three lines of defence support effective risk management practices and behaviours'.
- Alignment with Purpose and Values: 'The entity's espoused Purpose and Values promote and support good risk management practices and behaviours'.

Risk Architecture

- Risk Culture Assessment and Board Oversight: 'The Board has a robust approach for overseeing the assessment of risk culture in order to form a view, identify desirable changes and ensure steps are being taken to address these changes'.

- Risk Appetite and Strategy: 'Business and strategic decisions align with the Risk Appetite Statement'.
- Risk Governance and Controls: 'Across the entity there is effective oversight of risk, and risk management is supported by appropriate risk frameworks, policies, controls and reporting'.
- Responsibility and Accountability: 'Responsibilities and accountabilities for risk are clearly understood, embraced and discharged across the three lines of defence.'

Key Findings from the pilot survey of 10 general insurers

- Areas identified as potentially warranting 'additional focus':
  - On the 'risk architecture' side: Employee Perceptions of Risk governance and controls and Decision Making and Challenge were the lowest scoring dimensions.
  - On the behaviour side: Responsibility and Accountability scored the lowest
- Perceptions varied across different business areas: APRA assessed how each business area within a surveyed entity responded relative to other areas within the same organisation. APRA also considered how the views from employees in the same business area across all surveyed entities compared with those in other business areas. According to APRA's analysis:
  - The business areas of Underwriting and Customer Service had some of the most negative perceptions, particularly with respect to the Responsibility and Accountability, and Risk Governance and Controls Dimensions.
  - In contrast, employees in the Financial Control business area and employees in Legal, Compliance and Risk were the most positive across all 10 risk culture dimensions including the dimensions that employees in the Underwriting and Customer Service areas felt most negatively about. APRA considers that there is opportunity for entities to 'understand what is working well' and to consider applying a similar approach in areas where employees have a less positive outlook.
- Benchmarking: Overall two entities had results that 'predominantly fell into the top quartile' and beyond that, results 'were more varied, although generally concentrated across four entities'. APRA emphasises that falling into the top quartile is not an indication that there is no room for improvement.

Timeline for the roll-out to other sectors

Following what it considers to be a successful pilot, APRA intends to roll out the survey to other sectors over the next 12 months according to the following timeline:

- Banking sector: Q4 2021
- Insurance sector (general insurance, life insurance and private health insurance): Q1 2022
- Superannuation Q2 2022

APRA's expectations of how the data will be used

APRA makes clear that they survey results are only one of 'a number of qualitative and quantitative approaches used to assess risk culture' within regulated entities, though APRA will take into account an individual entity's survey results when assessing the entity's risk culture.

Going forward, APRA expects that the data from the surveys will be useful in:

- gauging changes in risk culture over time – both in terms of highlighting the extent to which positive changes are occurring and in terms of identifying weaknesses/areas for improvement.
- benchmarking results across industry sectors
- providing entities with valuable additional insights to supplement their own internal indicators and help to build a more comprehensive picture of their risk culture.

[Source: APRA Insight - Transforming risk culture 14/10/2021]

RBA underlines climate risk as a 'first order risk' to the financial system

Key Takeouts

- RBA Deputy Governor Guy Debelle said that 'climate change is a first-order risk for the financial system'.
- The comparability and accuracy of climate disclosure is a key area of focus for regulators
- Mr Debelle observed that 'to date, we have only isolated examples of divestment from Australia because of climate risk, but the likelihood of more significant divestment is increasing' as investors move to decarbonise their portfolios

In his address to the CFA Australia Investment Conference, Reserve Bank of Australia (RBA) Deputy Governor Guy Debelle spoke about the risks and the opportunities that climate change presents to the Australian financial system. A key message is that climate change is a 'first order risk' that requires action, and that failure to take the necessary steps may result in 'significant divestment'.

Key Points

- Mr Debelle described climate change as a 'first order risk for the financial system' and an increasing area of focus for Australian financial regulators, and for financial regulators globally.
- Mr Debelle flagged disclosure of climate-related risk and more particularly improving the quality, consistency and comparability of clear and reliable data, as a key area of focus for the Council of Financial Regulators (CFR) working group and for international regulators more broadly. Mr Debelle said that CFR members are actively engaged with international efforts on the issue.

Specific projects

- Projects to build understanding of the potential scale of the risk under different scenarios:
  - Mr Debelle described the Climate Vulnerability Assessment (CVAs) exercise currently being undertaken with the major banks (led by APRA) under two scenarios. He acknowledged that the CVA is as yet imperfect but that the regulators consider it to be 'a necessary first attempt' and learning exercise which is expected to be refined, adapted and improved over time. Constructive feedback on the initial CVA is expected to contribute to this. In addition, Mr Debelle said that Australian regulators are drawing on the learnings from the experiences of other central banks and prudential regulators that are conducting similar exercises. Mr Debelle also suggested that the CVA scenarios, modelling and risk assessment infrastructure could have broader application. For example, he said that it could potentially be used by asset managers to assess the climate risks of their equity and loan portfolios. The CVA may also, he suggested provide insurers with 'useful inputs and comparisons'.
  - Mr Debelle also spoke about the complementary 'top-down risk assessment' being undertaken by the RBA looking at the possible scale that climate-related risks pose to banks' housing and business exposures. Mr Debelle said that the results of the RBA's 'top down' assessment suggest that a 'small share of housing in regions most exposed to extreme weather could experience price falls that might subsequently result in credit losses. However, the overall losses for the financial system are likely manageable. Banks are also exposed to transition risks from their lending to emissions-intensive industries, but their portfolios appear to be less emissions intensive than the economy as a whole'.
- Climate disclosure: Mr Debelle stated that whether the government should mandate climate disclosure is ultimately a question for government but that 'for many companies, this question has already been answered by their investors – both foreign and domestic. The investors are already requiring climate disclosures'. The focus for Australian regulators is on improving the consistency and comparability of climate disclosure both through encouraging companies to report in line with the TCFD reporting framework and contributing to international efforts to support the development of global sustainability standards (through the IFRS Foundation proposals).
- Accuracy of climate disclosure – focus on Taxonomies: Mr Debelle explained that taxonomies define what can be labelled as a 'sustainable activity' and as such are an important mechanism for ensuring against 'greenwashing' and supporting increased comparability of disclosures. The need for an agreed taxonomy in Australia is especially important he said given the need to differentiate between 'many shades of green' as we transition to a lower carbon economy. Mr Debelle said:

  > 'The transition path to net zero needs to be funded, and that will require funding for projects with varying degrees of emissions intensity, not just those with zero…To ensure the transition is funded effectively, we need

taxonomies that define activities that are consistent with that transition. We need a taxonomy that suits the structure and trajectory of the Australian economy. At the same time, it will be highly desirable to have a taxonomy that is consistent with those developed elsewhere in the world that investors find straightforward to use'.

Risk of divestment is increasing

- Mr Debelle observed that climate risk is an increasing area of focus for foreign investors and asset managers. Though there has as yet not been an 'obvious change' in investor appetite for Australian bonds or equity (with some exceptions), the risk of 'significant divestment' as investors move to decarbonise their portfolios is increasing. Mr Debelle said that 'irrespective of whether we think these adjustments are appropriate or fair, they are happening and we need to take account of that. The material risk is that these forces are going to intensify from here'.
- This has implications for the cost of and ease of access to capital for Australian corporates, and also for Australian governments.

Climate opportunities

Mr Debelle said that the transition to a low-carbon economy is also an opportunity for Australia. For example, Australia could continue to be an energy exporter (though of renewable energy). Though the transition will have an 'undeniable negative impact' on certain communities/regions, the same communities could also benefit from new opportunities with appropriate planning and investment.

[Source: RBA Deputy Governor Guy Debelle speech: Climate Risks and the Australian Financial System, 14/10/2021]

Childrens Investment Fund Foundation calls on central banks to address the climate emergency

- Chair of the Childrens Investment Fund Foundation (CIFF) Chris John has written to the heads of the European Central Bank, European Banking Authority, the US Treasury Secretary calling for 'commitments to clear action' to limit global warming to 1.5 degrees. You can access the full text of the letter to the ECB and the EBA here; the letter to the BoE here and the US Treasury here.
- Mr Hohn argues that banks overall have significant exposure to fossil fuel producers and high emitters and continue to finance many existing and new fossil fuel projects. In his view, action is needed at a regulatory level to supplement private sector efforts to push lenders to take concrete actions to plan for and push the transition of a low-carbon economy forward.
- Accordingly, the letters call, among other things, for the central banks/regulators to:
  - require banks to set and disclose 5 year emissions reduction targets for their loan books and underwriting
  - require banks to disclose a five year Climate Action Plan for achieving these targets
  - require banks to disclose the absolute carbon emissions of their loan book and underwriting business by sector, using the Partnership for Carbon Accounting Financials (PCAF) or an equivalent framework
  - impose 'additional systemic risk buffer capital requirements' requiring banks to 'ensure that all lending for fossil fuel expansion is treated as equivalent to equity exposure to reflect the risky nature of this activity'

[Source: CIFF media release 15/10/2021]

ASIC calls on reporting entities to urgently review their whistleblower policies, processes and systems to ensure they comply with legal requirements 'without delay'

- Since 1 January 2020, public companies, large proprietary companies, and trustees of RSEs have been required to both have in place a whistleblower policy and to make the policy available to its officers/employees.
- During 2020, the Australian Securities and Investments Commission (ASIC) undertook a review of a sample of 102 whistleblower policies from entities subject to this requirement. ASIC concluded that 'the majority of the policies we reviewed appeared not to include all the information required by the Corporations Act, including information about the legally enforceable protections available to whistleblowers'.
- ASIC states that the 'most prevalent and concerning' issues identified in the review concerned 'unclear, incomplete or inaccurate information about how potential whistleblowers can make a qualifying disclosure and about the protections available under the Corporations Act'. For example, policies:

- did no list all the categories of people to whom a whistleblower can report misconduct and instead included only the entities' preferred reporting channels
  - contained inaccurate information about whistleblower protections; and
  - did not mention or inaccurately described the legal protections available to whistleblowers.

- ASIC is concerned that the gaps in policies identified could discourage whistleblowers from coming forward because they may not understand the protections available/how to make a disclosure that qualifies for protection. ASIC is also concerned that the reporting gaps may indicate that 'entities are not handling whistleblower disclosure' in line with their legal obligations.

- ASIC has written to the CEOs of reporting entities calling on them to review their whistleblower policy and accompanies processes and systems to ensure compliance with legal requirements. ASIC Commissioner Sean Hughes said:

  > 'We call on CEOs and RSE trustees to discuss this letter within your organisation and to think about the culture of speaking up in your workplace. If the issues we observed from our review are present in your policy, we expect you to address and correct them without delay.'

- Specifically the letter calls on entities to take the following actions:
  - Clearly articulate how a person can make a disclosure that qualifies for the legal protections for whistleblowers, including to whom
  - Carefully update their whistleblower policy to reflect the whistleblower protection regime that started on 1 July 2019
  - Accurately describe the legal rights and remedies whistleblowers can rely on if they make a qualifying disclosure, which are identity protection (confidentiality), protection from detriment, compensation and other remedies, and civil, criminal and administrative liability protection.
  - The letter also calls on entities to review their whistleblowing systems/processes to ensure they 'reflect' the protections described in their whistleblower policy.

  Page 5 of the letter is a table the compliance issues identified in ASIC's review in detail.

- ASIC states that it will continue to monitor compliance with whistleblower policy requirements and entities' handling of whistleblower disclosures including conducting a further review of whistleblower policies 'in the future'. Where non-compliance is identified ASIC states that it will 'consider the full range of regulatory tools available, including enforcement action'.

  [Sources: ASIC media release 15/10/2021; Letter to CEOs on whistleblower policies]

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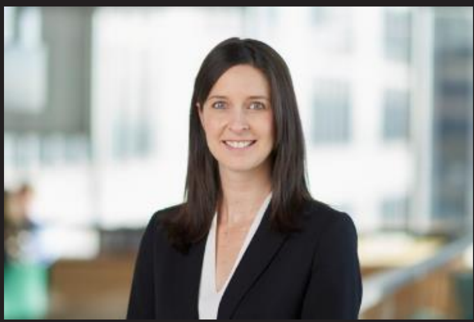

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