Governance News

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

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Diversity

Top Story | Time for gender targets? Report finds progress towards gender-balanced leadership is unlikely to gain ground without a change in approach

Key takeaways from the CEW's Senior Executive Census 2021

Key Takeouts

- The report found that women remain underrepresented in executive roles across the ASX 300 as well as being underrepresented in the leadership pipeline (meaning that without action, progress will remain slow)
- The report calls on companies to follow the example of (predominantly) larger companies that have set targets and achieved/are close to achieving gender balanced leadership including by adopting 40:40:20 gender targets

Overview

The Chief Executive Women (CEW) Senior Executive Census 2021 tracks progress towards gender balance (ie 40% women, 40% men and 20% open) in the executive leadership teams of ASX 300 companies over the past five years.

The headline finding is that despite evidence of the benefits of diverse leadership and despite increased investor focus on the issue, progress across ASX 300 companies has stagnated at what the report describes as 'unacceptably low levels'. Women remain underrepresented in senior executive roles across the ASX 300 as well as being underrepresented in the leadership pipeline.

Key Findings

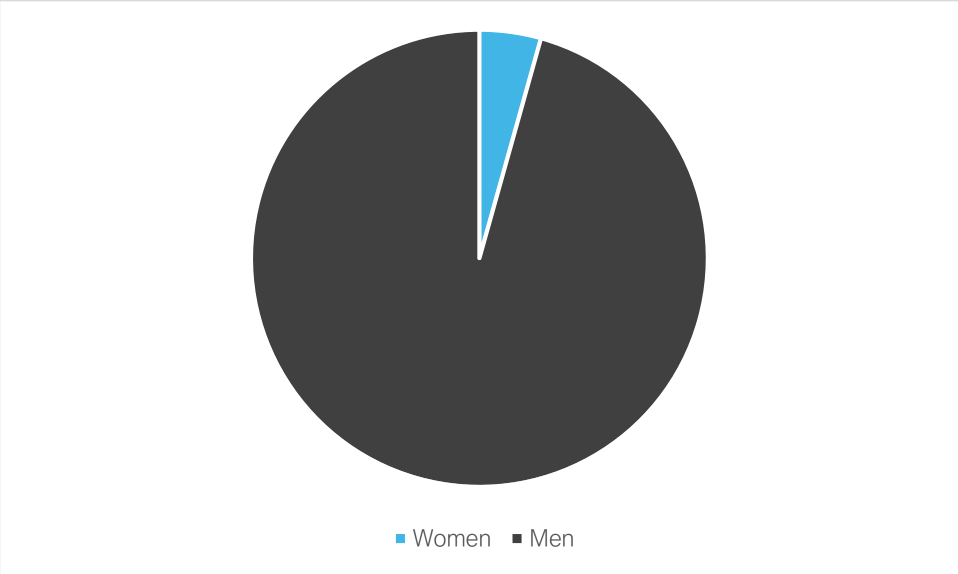
Women remain underrepresented in top roles

According to the report, in 2021, women held only 6% of Chief Executive Officer (CEO) roles in the ASX300, 19% of CFO roles and 26% of positions in executive leadership teams (ie all roles that report directly to the CEO). CEO points out that there has been no progress in the percentage of women in line and CEO roles over the five years to 2021.

Unlikely that this will change in the near term

In 2021, 78% of the 23 new CEO appointments were made from line roles (ie roles that drive key commercial outcomes and usually have profit and loss responsibility). Importantly, the report found that women remain underrepresented in these CEO 'feeder' roles:

- CEW found that 62% of ASX300 companies have zero women in line roles in their executive leadership teams
- Women held only 14% of line roles with profit and loss responsibilities (the most common pathway for future CEOs
- Only one of 23 new CEO appointments was a woman.



The proportion of women in CFO roles (another recognised CEO pathway) was found to be only slightly stronger with women now holding 19% of ASX 300 CFO roles.

Larger companies are leading the way on gender diversity in leadership

The report found that generally, the higher the ASX ranking, the stronger the representation of women in executive leadership teams. For example, the report found that:

- the proportion of women in executive roles increases from 26% in ASX 300 companies, to 27% in ASX 200 companies to 29% in ASX 100 companies.
- the percentage of line roles held by women is again highest (17%) in ASX 100 companies, dropping to 14% in ASX 300 companies.

The case for the adoption of 40:40:20 targets

CEW argues that the lack of progress identified in the report serves to 'underscore both the risk of no significant improvements in coming years and a problem for the Australian economy and society'.   The report states,

> 'With recovery from the pandemic upper-most in our minds, utilising all the talent pool available within Australia makes economic and social sense. Indeed, it is the single most effective thing we can do. Now is the time for action. It is time for gender balance targets for executive leadership teams.

Targets work

The report found that the proportion of companies that have set 40:40:20 (or more ambitious targets) is significantly higher in the ASX100 (at 50%) compared with the ASX300 (29%) and that female representation is higher at the companies that have these targets in place. For example:

- 54% of ASX100 companies have already met, or are 'on the cusp', of achieving gender balance in their Executive Leadership Teams (ELTs)
- 34% of ASX300 companies with 40:40 or better targets have achieved gender balance in their executive leadership teams compared with 16% of companies who have set targets below 40:40:20 and 13% of ASX300 companies without any target.

Based on the findings in the report, the CEW considers gender targets to be one of the most effective mechanisms to drive progress towards achievement of gender balance in executive leadership teams, including in line roles, and calls on companies to implement 40:40:20 targets on this basis.

[Source: CEW Senior Executive Census 2021]

Inclusive culture is key to reaping the rewards of increased diversity: Key takeaways from an expert panel discussion

In a panel discussion at the Governance Institute 2021 Conference, entitled *Board diversity: Who is missing at your table?*, an expert panel - Nicola Wakefield-Evans (Non-Executive Director Macquarie Group, Lendlease and MetLife Insurance), Tanya Hosch (Executive General Manager Inclusion & Social Policy Australian Football League) – Chaired by Byron Loflin (Global Head of Board Engagement Nasdaq) - reflected on the progress that has been made in Australia and globally toward increased board diversity, the shift in mindset around the value of diversity and touched on some of the barriers to progress.

Key Takeaways

Shift in mindset over the last ten year period

- Globally, the value of board diversity is increasingly recognised, understood and accepted both within boardrooms and by external stakeholders including investors. In light of this, pressure on boards to be more representative of diverse voices is only expected to intensify. This is in stark contrast to the position ten years ago.
- In Australia, the efforts of various groups, including the 30% club in Australia, have been instrumental in focusing attention on the value of increased board gender diversity and ultimately in driving progress on the issue.   For example, representation of women on boards has jumped from 19% in 2015 to over 30% across the ASX 200 over the period.

Gender balanced boards

- Asked to comment on why gender balanced boards best represent stakeholder interests, Ms Wakefield said that: a) gender diversity is important from a customer perspective - customers expect to see themselves represented around the board table and b) companies that have more diverse leadership have been shown to perform better operationally and financially.

Progress is welcome (but it isn't fast enough)

- Despite the gains made, and the efforts required to drive those gains, panel members expressed disappointment that the conversation around board diversity still needs to be had in 2021.
- Ms Hosch emphasised the importance of broadening the diversity conversation beyond gender to include all forms of diversity (eg cultural diversity, LGBTIQ+ etc) and in the Australian context, to also include a focus on increasing Indigenous board representation.
- Ms Hosch expressed concern that failure to broaden the focus beyond gender could have damaging consequences in that focusing entirely on increasing the number of women on boards, at the cost of other forms of diversity, could mean more diverse voices continue not to be heard/are shut out.

Increased representation is not enough: The importance of equity and inclusion and genuinely valuing difference

- The panel discussed the value of building a culture of inclusivity and ensuring genuine acceptance/acknowledgment of the value of difference at some length. There was consensus that increased representation alone is not sufficient to enable the benefits of diversity, including the value of hearing diverse points of view, to be realised.
- Ms Hosch shared that she had had experiences where there was an expectation that she would adopt the tone of the existing board 'and just look different'. This demonstrated that representation in the absence of inclusive culture (genuine acceptance of difference and genuine desire to be inclusive) is merely window dressing and misses the point of/does not reap the benefits of increased diversity of views/experience/skills.
- Ms Hosch also spoke about the challenges facing those bringing difference into the room, and in particular the challenges facing women carrying 'the burden of intersectionality' in this context. In order for diverse members to be heard, she said, it's important that those in the room to recognise that diverse members have a voice and that space is made (and time is allowed) to listen. She suggested that connecting with individual board members outside the boardroom could be important an important enabling factor. Without time and space for diverse voices, important questions may not be asked.
- Ms Hosch also suggested that it might be helpful for boards to think in terms of building balance and achieving balance in the boards' overall ability to address the issues for which they are responsible from a governance perspective – including listening to and making room for a range of views. She suggested that this often starts with the Chair modelling the behaviour.
- Ms Wakefield observed that increased representation of women in leadership is leading to more conversations and richer conversations about diversity and inclusion within organisations including conversations about increasing ethnic/cultural diversity, a trend that she expects to continue and the number of female leaders increases.
- Ms Wakefield suggested that the time needed to see increased ethnic/cultural diversity will likely be shorter than the time needed to increase gender diversity because of the rise in the number of female directors on board.
- Ms Wakefield observed that having a female CEO at Macquarie has meant that the organisation approaches diversity and inclusion differently to the way in which it would have done in the past. Ms Wakefield suggested that ultimately, companies are already facing a question around the diversity of their leadership team and whether they have the 'right people' sitting at the table.

Breaking the status quo

- Asked how boardrooms could be made less threatening for diverse board members, Ms Hosch again emphasised the importance of inclusive and accepting board culture. Responsibility for the diversity agenda she said, should not be left to diverse board members alone - as long as responsibility for the diversity agenda is left to a small minority, board rooms will continue to be intimidating she said.

- Ms Hosch said that it is the responsibility of every board member to ensure the culture is right and that there is accountability around the quality of interactions around the board table. This extends, she suggested, to the way in which new board members are inducted/the way in which board members interact with new board members on an informal/individual basis. Board members should be aware of the assumptions they bring to conversations and thinking about how diverse members can be made to feel comfortable.

Diversity as the foundation of good corporate governance?

- Mr Loflin observed that the global financial crisis (GFC) revealed the foundations of corporate governance within organisations to be weak and suggested that this may have contributed to the shift in focus from 'management excellence' to corporate governance in the years since. He queried whether diversity and inclusion could be a means of shoring up the foundations of good corporate governance.
- The panel agreed suggesting that the focus on good governance, including increased diversity in the wake of the GFC is part of a broader conversation about rethinking how to manage and rethinking what good management (beyond delivery of financial outcomes) looks like.

Board succession planning

Ms Wakefield observed that there is a need to have 'honest conversations' about term limits so that boards know and can plan around when directors will be stepping down. There is also a need to review the capabilities of those around the board table in light of the needs of the particular company in a way that is both more professional and systematic than tends to be the case.

[Source: Notes from the Governance Institute National Conference 2021, Panel Discussion: Board diversity: Who is missing at your table?]

Meetings and Proxy Advisers

A 'quiet' mini-AGM season: Analysis of ASX 300 AGMs over H1 2021 provides potential insights into key trends ahead of the main AGM season

Ahead of the main Australian AGM season, Georgeson has released a report into the trends to have emerged from the AGMs of the 55 ASX 300 companies that held their AGMs between January and June 2021.

Key Takeaways

Support for directors increased

- Support for directors increased:
  - The report found that average support for directors was up slightly on the same period in 2020 rising from 93.2% in 2020 to 96.2% in 2021.
  - The number of directors receiving less than 90% support fell significantly from 19 directors in 2020 to only seven in 2021.
  - The number of directors who received less than 80% support also decreased from five in 2020 to four in 2021.
  - Interestingly, in a separate study Georgeson found that the level of shareholder support for directors across Europe (UK, Netherlands, Germany, Italy, France, Spain and Switzerland) fell rather than increased as it did in Australia. The level of shareholder dissent increased by an average of 37%.
- Key drivers behind dissenting votes in Australia:
  - Director 'over-boarding', perceived lack of independence and lack of audit and remuneration committee independence as well as lack of gender diversity are identified in the report as primary drivers behind dissenting votes.
  - The report also suggests that director capability, oversight and disclosure of climate-related risk is increasingly important to investors and may be reflected in voting behaviour. In particular the report points to BlackRock's decision to vote against the re-election of directors for inadequate climate disclosure as an indicator of this.

Support for remuneration plans slightly up

- Georgeson found that support for remuneration reports increased very slightly from 93.6% in over the January to June period in 2020 to 93.9% over the same period in 2021.
- There were zero second strikes over the period.
- The report highlights the following as examples of pay practices that remain contentious:
  - Resetting pay hurdles to enable a more favourable outcome for executives
  - Excessive termination benefits
  - Long term performance periods that are perceived to be shorter than is appropriate
  - Short term incentives that are bigger than long term incentives

- The report also flags the importance of detailed disclosure as key to securing support, including support from proxy firms. In particular, integration of ESG metrics into short and long term incentive plans is identified in the report as an area where this is particularly important because there is as yet no 'settled market view'.
- Again, Georgeson found that the story looks different in Europe. Georgeson found that shareholder dissent on executive remuneration rose by 18% on average, with all markets but Italy and Switzerland recording increased opposition on remuneration report and remuneration policy votes.

Shareholder resolutions: Climate is a key concern

- According to the report, five of 55 ASX 300 companies analysed faced shareholder resolutions – 100% of which were climate-risk related (though the specifics of each varied).
- Say on climate resolutions:
  - The report comments that 2021 is the first year that a Board has supported a 'say on climate' resolution. Board support in this case meant that the resolution at Rio Tinto received 99% shareholder support.
  - Similar resolutions at Santos, Woodside and Oil Search were withdrawn after the companies committed to giving shareholder the opportunity to vote on an advisory/non-binding say on climate resolution in 2022.
- The report comments that at this stage it is too early to say what the repercussions of dissent on a non-binding 'say on climate' resolution may be for companies. However, the report suggests that the 'message to management and the board will be unequivocal – demonstrate transparency, commitment and progress towards reducing carbon emissions in alignment with the Paris Agreement, or risk further dissent in other areas of your AGM agenda'.
- Overseas trends – an indication of things to come?
  - In Europe, Georgeson found that 'at least 15 companies' gave shareholders an advisory 'say on climate vote'.
  - The report suggests that the record number of shareholder ESG resolutions that have received majority support in the US, the increase in the levels of support for shareholder ESG resolutions and the uptick in the number of negotiated settlements may provide an indicator of the direction of things to come in Australia.

[Source: Georgeson report: Emerging Governance Trends in 2021; Georgeson report: Georgeson's 2021 AGM Season Review (Europe)]

SAFAA supports the measures in the latest draft Bill proposing to permanently modernise meeting and execution requirements

Context

- 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 a another short round of consultation. Consultation closed on 10 September 2021.

SAFAA has expressed broad support for the proposed measures

- The Stockbrokers and Financial Advisers Association (SAFAA) has released its submission on the revised draft Bill, noting that it previously provided feedback on the previous draft Bill in July 2021.
- **Electronic execution:** The submission expresses support for the amendments that if passed, would permanently enable companies to execute company documents, including deeds, electronically describing the changes as 'well overdue'.
- **Participation in electronic meetings:** SAFAA has welcomed the amendment in the draft Bill enabling members who attend a meeting using virtual meeting technology, to ask questions/make comments orally and in writing during the course of the meeting, noting that the absence of this requirement was a key concern raised in SAFAA's submission on the previous Bill. SAFAA considers that the amendment both:
  - 'overcomes our previous concerns that members would only have the option of typing in questions to a chat function and would not have the opportunity to ask questions directly via phone hook-up
  - will ensure that shareholder questions and comments whether they are oral or written will be made available to the whole meeting while it is taking place'.

[Source: SAFAA submission: Treasury Laws Amendment (Measures for a later Sitting) Bill 2021: use of Technology for meetings and related amendments 09/09/2021]

Disclosure and Reporting

Flawed? The UK Investment Association has recommended changes to proposed new TCFD-aligned disclosure requirements put forward by the FCA

Context

From June to September, the UK Financial Conduct Authority (FCA) conducted two separate climate-disclosure consultations:

- CP21/18: Enhancing climate-related disclosures by standard listed companies sought feedback on proposals to enhance TCFD-aligned disclosure requirements including by extending the application of TCFD aligned listing rule to issuers of standard listed equity shares (with certain possible exceptions) and issuers of standard listed debt (and debt-like) securities (with possible exceptions) as well as seeking views on ESG issues in capital markets.
- CP21/17: Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers sought feedback on a proposed new TCFD-aligned climate disclosure regime.
- The consultations followed the release of the UK government's roadmap on making TCFD reporting mandatory across the economy by 2025 and the release of the FCA's policy statement PS20/17 which sets the expectation that commercial companies with a UK premium listing include in their annual financial report a compliance statement confirming whether they have made disclosures aligned with the TCFD and providing an explanation if they have not done so.

Investment Association calls for the FCA to go further

The UK Investment Association (IA) made submissions to both consultations. In both cases, the IA considers that the regulator should strengthen its proposals in various ways.

IA recommends changes to the proposals in CP21/18: Enhancing climate-related disclosures by standard listed companies

The IA's submission expresses strong in principle support for proposals to enhance existing disclosure requirements. In particular, the IA is supportive of the proposed extension of existing requirements to a broader range of issuers as proposed, and of the proposal to encourage issuers to consider using SASB's sector specific metrics in making TCFD disclosures.

However, the IA considers there is opportunity for the FCA to 'go further' in their approach to enhancing TCFD disclosures and makes a number of recommendations around this. Key recommended changes include:

- **Setting a timeline for when the rules will apply on a mandatory basis**. The IA states that its members would expect that the new requirements would be made mandatory by 2025 'if not earlier' given the urgency of the need to tackle climate change. The IA argues that this timeframe also allows sufficient time to prepare for the introduction of mandatory reporting and is consistent with the timelines outlined in the UK's Joint Government-Regulator TCFD Roadmap. The submission also makes clear that though the IA supports the process being undertaken by the IFRS Foundation to develop an International Sustainability Standards Board, the timing on when this will occur is at yet unclear and as such, it should not be a barrier to the FCA mandating disclosure.
- **Introducing a 'limited assurance' requirement:** The IA expresses strong disagreement with the proposal not to require third-party audit and assurance for issuers' climate-related disclosures. Assurance is necessary, the IA considers, to ensuring investors have confidence in the 'robustness and accuracy' of disclosures. Accordingly, the IA recommends that in-scope companies be required to 'seek limited assurance for reported sustainability information, while including an option to move towards a reasonable assurance requirement at a later stage', consistent with the EU Corporate Sustainability Reporting Directive. The IA further recommends that the FCA should ensure alignment of this new assurance requirement with the government's Audit and Corporate Governance reforms.

The IA's submission also rejects the need for a new UK green bond standard.

On the question of the possible establishment of a UK green bond standard, the submission expresses the view that the FCA 'should not be pursuing this approach'.

The IA states,

'There are already a number of different bond standards in existence which has led to fragmentation and a lack of consistency in green bond issuances. The FCA should not contribute an additional standard to this landscape, further reducing the consistency of bond issuances, instead it should be encouraging alignment with existing international standards.

IA recommends changes to CP21/17: Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers

Though broadly supportive of the aims of the proposals put forward, the submission concerns that without amendment, the FCA's proposed approach has potential to result in 'misleading disclosures to clients and as a result, potential mis-pricing of assets and misallocation of capital'. The submission raises concerns that:

- There is a 'mismatch between the mandatory and more granular nature of the proposals on asset managers and asset owners, in comparison to the comply or explain regime for corporate issuers disclosing under the TCFD framework'.
- The proposed approach does not do enough to address 'coverage gaps in TCFD reporting across UK companies' or at asset class level. The submission raises concerns about the lack of data available for some assets, stating that: 'We do not support the use of proxy data and assumptions to fill these gaps: these can be subjective, lacking in comparability and volatile, and as a result unlikely to be decision-useful for investors'.

To address these issues, the submission recommends that the FCA adopt the 'as far as they are able' approach utilised by the Department of Work and Pensions (DWP) in its TCFD regime for pension funds in respect of reporting on metrics, targets and scenario analysis. The IA argues that this would be 'a pragmatic recognition of the situation as it exists today with respect to data gaps and in the short-to-medium-term will provide reassurance to investment managers and their clients that the quantitative disclosures they make would reflect the reality of data availability at any given point in time'.

Other recommended changes

- **Remove unnecessary duplication:** The submission recommends that Occupational Pension Scheme (OPS) firms be exempt from the FCA's TCFD proposals to avoid unnecessary duplication. The submission argues that this is appropriate as the parent pension schemes of OPS firms (their sole client) are already covered by the DWP's TCFD regime rendering the extension of the proposed FCA TCFD reporting requirements unnecessary. The submission also raises concerns that Local Government Pension Scheme (LGPS) pools and their LGPS fund clients, who are expected to be subject to their own TCFD reporting obligations in time, will also face being covered by two schemes if the FCA's proposals are not amended.
- **Provision of climate-related metrics of underlying portfolio holdings**: The submission notes that licensing agreements with data providers usually prevent firms from sharing climate-related metrics at the security level with third parties. In light of this, the submission argues that a requirement to disclose such information at the portfolio/asset class level would be more compatible with current market practice.
- **Calculation of metrics on a TCFD and EU Sustainable Finance Disclosure Regulation (SFDR) basis is unnecessary:** The submission argues there is no need for calculations to be made on a TCFD and SFDR basis. The IA considers that imposing the dual requirement would both increase the reporting burden on firms and potentially confuse investors. Accordingly, the IA recommends that the FCA use 'only one set of formulae, in line with TCFD'.
- **The submission raises concerns about the provision of detailed metrics to retail investors** on the basis that it is as yet unclear how retail investors are likely to engage with the information/use it in their decision making.

[Sources: IA submissions: FCA CP21/18: Enhancing Climate-Related Disclosures by Standard Listed Companies and Seeking Views on ESG Topics in Capital Markets - 10 September; FCA: CP21/17: Enhancing Climate-Related Disclosures by Asset Managers, Life Insurers and FCA-Regulated Pension Providers - 10 September]

Institutional Investors and Stewardship

Implementing the Paris Agreement will create investment opportunities: A coalition of 587 global investors has called on governments to implement five climate policy actions ahead of COP26

Ahead of the COP26 Conference, 587 investors with US$46 trillion in assets under management (AUM) have signed on to the 2021 Global Investor Statement to Governments on the Climate Crisis which urges governments globally to rapidly implement five key climate policy actions not only to tackle the climate crisis but to take advantage of the 'significant investment opportunities' associated with full implementation of the Paris Agreement.

The initial signatories to the statement, which included 457 investors with US$41 trillion assets under management, were announced in June 2021, before the G7 Summit.

Five policy actions

The statement calls on governments to:

- Align their Nationally Determined Contributions (NDCs) with limiting warming to 1.5-degrees Celsius and ensuring a planned transition to net-zero emissions by 2050 or sooner, ahead of COP26.
- Commit to net zero emissions by 2050 and outline a path with 'ambitious interim targets' including 'clear decarbonisation roadmaps' for each carbon-intensive sector.
- Implement domestic policies to deliver on these targets, incentivise private investments in zero-emissions solutions and ensure ambitious pre-2030 action. The statement makes clear that this should include:
  - implementing 'robust' carbon pricing,
  - phasing out fossil fuel subsidies by stated deadlines
  - phasing out coal-based electricity generation by set deadlines in line with credible 1.5-degrees Celsius temperature pathways
  - 'the avoidance of new carbon-intensive infrastructure' such as new coal power plants
  - the development of just transition plans for affected workers and communities.
- Ensure COVID-19 economic recovery plans support the transition to net-zero emissions and enhance resilience.
- Commit to implementing mandatory TCFD-aligned climate risk disclosure requirements to help ensure 'comprehensive disclosures that are consistent, comparable, and decision-useful'.

Stronger climate policies in Australia could create US$46 billion in fresh investment opportunities to 2025

CEO of the Asia Investor Group on Climate Change (AIGCC) and Investor Group on Climate Change (IGCC) (Australia/New Zealand) and Investor Agenda Steering Committee member, Rebecca Mikula-Wright, said

> 'Our analysis shows that the investment opportunities in the Asian energy sector alone from a Paris-aligned transition to net-zero emissions could reach US$37 trillion by 2050 – a century-defining investment theme. Meanwhile in Australia, stronger climate policies would create around US$46 billion in fresh investment opportunities to 2025. By working with investors to put in place robust policies, strong targets and a clear roadmap to reach net-zero emissions, Asian, Australian and New Zealand governments can unlock these enormous investment opportunities and the jobs, economic growth and competitive advantage they will bring.'
>
> [Source: Investor Agenda media release 14/09/2021; 2021 Global Investor Statement to Governments on the Climate Crisis]

Report concludes no European bank has a comprehensive plan to ensure sustainability across all topics, ShareAction has called on investors to push banks to lift standards

ShareAction has released a report assessing the extent to which the 25 largest European banks live up to their sustainability claims across five key areas: 1) net zero targets/alignment; 2) high carbon disclosures; 3) sector specific policies (eg fossil fuels); 4) biodiversity; and 5) executive remuneration.

The headline message is that no bank analysed in the report was assessed as having a comprehensive plan across all five areas.

For example:

- Net zero targets/alignment: Despite the fact that 20 of 25 banks analysed have made net zero by 2050 commitments, few were found to have taken sufficient concrete actions to enable them to achieve this goal.
- High carbon disclosures: 18 of 25 banks currently report their exposure to high-carbon sectors and only 11 provide a breakdown by fossil fuel assets.
- Sector specific policies:
  - Coal policies: Less than half of the banks have committed to phasing out financing of thermal coal-related activities within a Paris-aligned timeframe. ShareAction considers that where policies are in place they are in most cases 'ridden with loopholes'
  - Oil and gas policies: No European bank has committed to stopping financing new fossil fuel expansion entirely. Though most banks have put some restrictions on direct financing of unconventional sources of oil and gas (eg gas extracted from the Arctic), they still have indirect exposure through financing diversified companies such as oil majors
  - Biomass policies: ShareAction considers that the sector is 'neglected' by banks, despite the fact that the climate impacts can be more significant than for coal. Currently, 13 European banks still list biomass as a sustainable form of energy
- Biodiversity policies: ShareAction considers that the banking sector's approach to biodiversity loss is still in its infancy. Only 10 of 25 banks were found to have a biodiversity policy in place.
- Remuneration targets: Though most banks have integrated some form of sustainability metric into their remuneration strategies, ShareAction questions whether the metrics chosen have 'relevance to the bank's overall impact on climate'. As an example, ShareAction found that in most cases the metrics selected are not designed to incentivise executives to reduce banks' financed emissions or financing of Paris misaligned activities but rather on reducing banks' operational activities.

Call to action for investors

ShareAction calls on investors to use the leading practices highlighted under each area in the report and the suggested engagement questions targeted at each of the five areas (included at p64-67) to inform their engagement with banks and challenge them to improve.

ShareAction suggests that where this does not result in sufficient action, investors should vote against individual directors and/or file and vote for shareholder climate change and biodiversity resolutions at banks' 2022 AGMs.

[Sources: ShareAction media release 06/09/2021; Full text report: Countdown to COP26]

Investors push for the removal of barriers to investment in the Australian energy market

- The Clean Energy Investor Group (CEIG) representing 18 domestic and global investors with a combined Australian portfolio value of over A$24 billion, has launched new Clean Energy Investor Principles for the reform of Australia's energy market aimed at removing existing barriers to investment.
- Ultimately CEIG considers that a 'step change' is required in order for the Australian energy market to attract new investments and 'create investable markets' including an overhaul of the governance and rules of the National Electricity Market (NEM).
- The 5 Clean Energy Investor Principles are: a) to align NEM development with global markets; 2) to redesign governance for transformation; 3) to improve revenue certainty; 4) to allocate risk effectively; and 5) to build investable and innovative markets.
- Board Chair and CEO of the CEIG, Simon Corbell said that 'Clean Energy Investors currently face significant risks in the NEM, which is holding back the capital needed. To unlock an investment pipeline worth up to $70 billion we need effective market reforms and policy certainty, which could also save up to $7b in capital costs, or up to 10% of the cost of Australia's clean energy transition'.

[Source: Clean Energy Investment Group media release 13/08/2021]

Regulators

Hayne implementation: Inaugural Financial Regulator Assessment Authority members appointed

Context

- Hayne Commission recommendation 6.13 recommended that both APRA and ASIC be 'subject to at least quadrennial capability reviews'. Commissioner Hayne further recommended that 'a capability review should be undertaken for APRA as soon as is reasonably practicable'.
- Hayne Commission recommendation 6.14 recommended the establishment of a new, three member independent oversight body to carry out these capability assessments and report to the Minister 'at least biennially'.
- The Financial Regulator Assessment Authority Act 2021 and the Financial Regulator Assessment Authority (Consequential Amendments and Transitional Provisions) Act 2021 give effect to the government's response to both recommendations 6.13 and 6.14. The legislation commenced 1 July 2021.

Inaugural members of the Financial Regulator Assessment Authority (FRAA) appointed

- The government has announced the appointment of former CEO of Macquarie Group Ltd Nicholas Moore as Chair and the appointment of Cass-Gottlieb and Craig Drummond as the inaugural members of the Financial Regulator Assessment Authority (FRAA).
- Announcing the new appointments, Treasurer Josh Frydenberg commented:

> 'Together, the inaugural members have an in-depth understanding of Australia's regulatory framework and first-hand experience working with ASIC and APRA over many years. They also have strong organisational experience which will assist in their assessment of the operational performance of both ASIC and APRA'.

ASIC capability review announced

The FRAA has been tasked with assessing the effectiveness and capability of ASIC in its first year. The Treasurer states that this will 'assist recently appointed ASIC Chair Joseph Longo in ensuring ASIC is operating effectively and consistently with the Government's Statement of Expectations'.

[Source: Treasurer Josh Frydenberg media release 10/09/2021]

Shift in focus? ASIC's latest enforcement report

Key takeaways from ASIC's latest enforcement report: ASIC Report 699 ASIC enforcement update January to June 2021 (REP 699)

Overview

The Australian Securities and Investments Commission (ASIC) has released its latest enforcement activity Report - ASIC Report 699 ASIC enforcement update January to June 2021 (REP 699) - outlining its key enforcement actions during H1 2021.

Direct comparison with the previous report (REP 688) covering the period July to December 2020 is not straightforward as the two reports present information differently in some instances. Notably, Report 699 does not appear to provide comparable statistics on ASIC's progress towards closing out Hayne Commission-related enforcement actions.

A high level overview of the key takeaways from ASIC's latest report, including some points of comparison with the previous report is below.

Court-based outcomes

ASIC's previous enforcement report for H2 2020 highlighted the regulator's increased focus on securing court-based outcomes. For example, the report highlights that during the H2 2020 period:

- the courts imposed a total of $159.8 million in civil penalties (up from $12 million in H1 2020), including ASIC's two largest ever civil penalty outcomes
- there was a 164% increase in civil penalty proceedings, a 27% increase in the number of briefs referred to the Commonwealth Director of Public Prosecutions, and a 36% increase in criminal proceedings (as compared with the 2018 and 2020 calendar years).

The latest report (REP 699) arguably has less focus on this aspect of ASIC's enforcement work and does not include comparable statistics.

Having said this, REP 699 does highlight both 'significant enforcement outcomes' and the penalties imposed to deter misconduct and separately the 'priority areas' in which the regulator commenced enforcement court action over the period in different sectors (listing the actions taken in each area).

Hayne-related investigations

- ASIC's previous report (REP 688) included an update on the progress of Hayne related investigations to 31 December 2020. At that point of the 45 Hayne related investigations still on foot as at 31 December 2020: 11 had resulted in litigation that was still on foot and 11 investigations were continuing.
- ASIC 699 does not contain directly comparable information. The report does highlight that one Hayne Commission related action had resulted in a $7 million penalty against a major bank.

Overall results

Prosecutions

- The number of individuals charged in criminal proceedings decreased from 27 in H2 2020 to 19 in H1 2021
- The number of criminal charges laid fell from 194 in H2 2020 to 143 in H1 2021
- There were 5 non-custodial sentences (down from 14 in H2 2020)
- 5 people were imprisoned (up from 4 in H2 2020)
- 133 defendants were prosecuted for strict liability offences (up from 90 in H2 2020)
- 256 criminal charges were laid in summary prosecutions for strict liability offences (up from 185 in H2 2020)

Civil Penalties

- $29.6m in civil penalties was imposed by the courts down from $159.8m in H2 2020
- 12 civil penalty cases commenced, down from 14 in H2 2020
- 36 civil penalty cases were currently before courts, up from 18 in H2 2020

Bannings

- 70 people or companies removed or restricted from providing financial services or credit (up from 28 in H2 2020)
- 19 individuals disqualified or removed from directing companies (down from 28 in H2 2020)

Infringement notices and court enforceable undertakings

- 1 court enforceable undertaking was recorded (down from 2 in H2 2020)
- 3 infringement notices issued
- $392,000 in infringement penalties was paid

Investigations

- 52 investigations commenced (down from 107 in H2 2020)
- 204 investigations ongoing (down from 211 in H2 2020)

Financial Services

In H1 2021, ASIC recorded 50 financial services-related enforcement outcomes (up from 37 in H2 2020). Looking more closely:

- ASIC reports that there were 12 civil enforcement outcomes recorded across a range of areas including: credit misconduct (5); financial advice misconduct (3); investment management misconduct (3); superannuation misconduct (1); and 'other financial services misconduct (0). Overall, the total is slightly down on the 16 civil enforcement results/outcomes recorded in H2 2020.
- There were 33 administrative enforcement outcomes recorded across a similarly wide range of areas including: credit misconduct (5); financial advice misconduct (7); investment management misconduct (2); superannuation misconduct (0); and 'other credit misconduct' (19). This is substantial increase on the 12 recorded in H2 2020.
- There were 5 criminal enforcement outcomes recorded in the areas of: credit misconduct (4); financial advice misconduct (0); investment management misconduct (0); superannuation misconduct (1); and 'other financial services misconduct (0).
- There were zero court enforceable undertakings recorded.
- As at 1 July 2021, ASIC reports that 26 criminal and 18 civil actions across a wide range of areas were still before the courts.

Markets

In H2 2020, ASIC recorded 17 market-related enforcement results (up from 12 in H2 2020):

- 2 criminal enforcement outcomes both in the area of market manipulation
- 2 civil enforcement outcomes, both in the area of 'other market misconduct'
- 12 administrative outcomes: 2 in the area of continuous disclosure and 10 in the area of 'other market misconduct'
- There was one court enforceable undertaking recorded over the period concerning 'other market misconduct'

As at 1 July 2021, ASIC had 14 criminal and seven civil market-related matters still before the courts.

Corporate Governance

- Over H1 2021, ASIC concluded 20 corporate governance enforcement matters: one civil action concerned directors' duties/governance failures; 19 actions concerned auditor misconduct (11 administrative actions were recorded and 8 'negotiated outcomes'). In contrast, in H2 2020 ASIC recorded only one corporate governance result.
- As at 1 July 2021, ASIC had 13 criminal and two civil corporate governance related matters still before the courts. Of the 13 criminal actions, most (10) concern directors' duties/governance. In the previous period ASIC had 12 criminal and three civil actions (all in the areas of directors' duties and governance failures) still before the courts.

Small Business

- In H1 2021, ASIC concluded 180 small business–related enforcement matters: 136 criminal actions and 144 administrative actions. This is a substantial uptick on the previous period where ASIC recorded 129 small business results.
- As at 1 July 2021, ASIC had 142 small business–related criminal matters still before the courts all of which are actions against persons or companies. There were no actions concerning misconduct related to registration and licensing recorded. This is slightly down on the previous period in which ASIC reports that 149 matters were still before the courts.

  [Sources: ASIC Report 699 ASIC enforcement update January to June 2021; ASIC Report 688 ASIC enforcement update July to December 2020 (REP 688); ASIC media release 09/09/2021]

APRA Chair's opening statement to the second House Committee hearing into APRA's 2019/20 Annual Report

In his opening statement to the second House Committee Hearing into the Australian Prudential Regulation Authority's (APRA's) 2019/20 Annual report on 10 September 2021, APRA Chair Wayne Byres outlined a number of key initiatives implemented/undertaken by the regulator since his last appearance before the Committee in March and touched on APRA's 2021-25 Corporate Plan (summarised in Governance News 8 September 2021 at p26) and the broader range of priorities identified under it.

Mr Byres also flagged that APRA is currently revisiting its workplan for the coming months.

Key Takeaways

- Mr Byres reiterated that APRA's 2019/20 Annual Report outlined the regulator's shift from a broad regulatory/supervisory agenda to a narrower and more targeted one in response to the disruption caused by the pandemic. This enabled the regulator to be proactive in responding to the disruption including by providing regulatory relief to regulated entities to enable them to support their customers and to facilitate broader government and industry initiatives.
- Mr Byres also reiterated that as was the case in March when he last appeared before the Committee, APRA regulated entities have 'stood up to the challenges of the pandemic, both financially and operationally'.

2021-25 Corporate Plan

- Mr Byres observed that APRA has now released its 2021-25 Corporate Plan and is 'close to finalising' its Annual Report for 2020/21.
- Speaking briefly about the updated Corporate Plan, Mr Byres said that though COVID-19 'remains the dominant influence on the current economic and financial environment' and that this is likely to remain the case for some time, the plan 'recognises that there are many other factors influencing the shape and risk profile of the financial system, and to which APRA needs to respond'.
- Accordingly he said that the plan outlines a broader range of priorities aimed at ensuring the continued strength and resilience of the financial system over the next four years, while also focusing on preparing for future challenges.

Your Future Your Super reforms and the performance test

Commenting briefly on the results from the inaugural MySuper product performance test, Mr Byres said that

> 'APRA has no tolerance for members to remain in underperforming products, particularly where the product is closed to new members and as we noted when releasing the results, trustees of the 13 failing products now face an important choice: they can urgently make the improvements needed to ensure they pass next year's test or start planning to transfer their members to a fund that can deliver better outcomes'.

Mr Byres said that since the release of the performance test results, APRA has stepped up its supervision of trustees with products that failed the test and has required them to provide a report identifying the causes of their underperformance and their action plans for addressing it.

Ms Byres said that more broadly, the Your Future Your Super reforms 'complement and reinforce' APRA's existing superannuation industry strategy and will enable the regulator to drive higher standards in the superannuation sector. In particular, Mr Byres said that both the 'sharpening' of the best interests duty and the reverse onus of proof (which will require trustees to be 'able to demonstrate that their decisions to invest or spend members' funds are based on well-founded analysis of expected member benefits' will be important in this context.

Mr Byres said that over the period ahead, APRA will be revising its standards and guidance in a number of areas to make sure they are aligned with the new legislative provisions.

Recap of other key initiatives since the regulator's last appearance before the Committee

Mr Byres listed some of the initiatives the regulator has undertaken since it last appeared before the Committee. These initiatives include:

- consulting on draft cross-industry guidance on the financial risks of climate change and separately, releasing an information paper on the Climate Vulnerability Assessment we are undertaking with the five largest banks.
- the announcement of regulatory support for ADIs offering temporary financial assistance to borrowers impacted by COVID-19 restrictions. Mr Byres said that APRA is also providing regulatory relief to assist these banks in supporting their customers through this period.

- requiring a number of general insurers to undertake a review of the 'soundness' of their existing risk management frameworks to ensure there are no 'gaps', including in the area of cyber risk, in light of 'recent issues' with business interruption insurance policies.
- the revision of APRA's approach to licensing and supervising new banking institutions following the failure of Xinja Bank in early 2021, including the imposition of stronger requirements for being granted a banking licence and closer supervision of new entrants.
- the release of the final prudential standard on remuneration (CPS 511) which implements APRA's response to three Hayne recommendations.

APRA's workplan is under review in light of ongoing uncertainty

In light of ongoing disruption/uncertainty, APRA is keeping its workplans under review and intends to issue a revised program for the coming months with a view to providing a 'clearer picture' of the regulator's upcoming priorities/timelines.

In undertaking this review, APRA will factor in the need to reduce the regulatory burden on entities.

Stakeholder survey – reducing regulatory burden is also a focus for APRA

Commenting briefly on the results of APRA's latest biennial stakeholder survey, Mr Byres said that it showed a 'strong positive impact from APRA's activities on the industries it regulates' including for example: 95% agreement from entities that APRA's public communications are clear and effective; 93% agreement that APRA is effective in identifying risks across their industry; and 87% agreement that APRA's increased focus on risk culture had a positive impact on their entity.

Mr Byres said that regulatory burden was a key issue of concern and that in response, APRA is looking at ways to actively respond both through revisiting its immediate workplan as flagged above, and through modernising the prudential framework over the longer term.

> [Source: APRA Chair Wayne Byres opening statement to the House of Representatives Standing Committee on Economics Second hearing into the APRA 2019/2020 Annual Report 10/09/2021]

No evidence that large institutional investors are pursuing interests that are materially different from those of the broader shareholder base: APRA Chair Wayne Byres' opening statement to the Inquiry into Common Ownership and Capital Concentration

In his opening statement to the House of Representatives Standing Committee on Economics Inquiry into Common Ownership and Capital Concentration, Australian Prudential Regulation Authority' Chair Wayne Byres made clear that though there are 'some points of intersection with APRA's prudential role', many of the issues contained in the Inquiry's Terms of Reference extend well beyond APRA's mandate.

That said, Mr Byres offered his observations about: a) existing regulatory limits on the ownership/control of financial firms; b) capital concentrations in ASX-listed banks and insurers; c) the growth in superannuation funds as institutional investors; and d) access to capital.

The source of existing regulatory limits on the ownership and control of financial sector firms

- Mr Byres observed that the source of regulatory limits on ownership are generally contained in the Financial Sector (Shareholding) Act 1998 (FSSA) which regulates shareholdings in 'financial sector companies' (eg ADIs, general and life insurers and their holding companies). The FFSA provides that a person may not hold a stake in a financial sector company that exceeds 20% without the approval of the Treasurer (which can be granted where it is considered to be in the national interest with some exceptions). Mr Byres observed that 'by design, the FSSA is concerned with shareholdings in individual financial sector companies as opposed to concerns relating to common shareholding across financial institutions'.
- In addition, Mr Byres observed that changes in control of ADIs, general and life insurers and their holding companies are also regulated. APRA also has power (since 2019) to approve changes of control of superannuation trustees though some types of superannuation transactions do not require direct regulatory approval, eg superannuation mergers that don't involve trustee shareholder changes, or the retirement of a trustee and appointment of a new trustee.

- Mr Byres observed that there are also no control provisions for APRA in relation to the ownership of private health insurers.

Capital concentrations in ASX-listed banks and insurers – no sign that large institutional investor have 'sought to pursue interests that are materially different from those of the broader shareholder base'

- Mr Byres observed that despite the ownership limits imposed under the FFSA, there is 'clearly a level of common ownership by some large asset managers'. To illustrate, Mr Byres said that the two largest shareholders in each of the major banks hold approximately 5-6% of the shares of each of those banks.
- Mr Byres attributed this to a number of factors including both: a) the growth in Australia and globally of large-scale asset managers; and b) the fact that large listed financial institutions represent a material share of market capitalisation of ASX and its indices. Mr Byres opined that 'Together, the importance of the financial institutions to the ASX, and the size of the asset managers managing Australian equity exposures, makes a degree of common ownership inevitable'.
- Importantly Mr Byres stated that though large institutional investor have a degree of influence over the companies in which they invest, 'APRA has not to date seen evidence that they have sought to pursue interests that are materially different from those of the broader shareholder base'.

Growth in superannuation funds as institutional investors

- Mr Byres stated that as at June 2021, APRA-regulated superannuation funds held assets valued at almost $2.3 trillion, including $500 billion of Australian listed equities or 20% of the market capitalisation of the ASX.
- He noted that this percentage share has not materially altered over the past five years, though consolidation within the superannuation sector means 'holdings are held in a smaller number of (on average, larger) funds'.
- Mr Byres opined that as the size of the superannuation sector continues to grow, and consolidation within the sector continues, the 'importance of superannuation funds as investors in all types of assets will likely grow'.

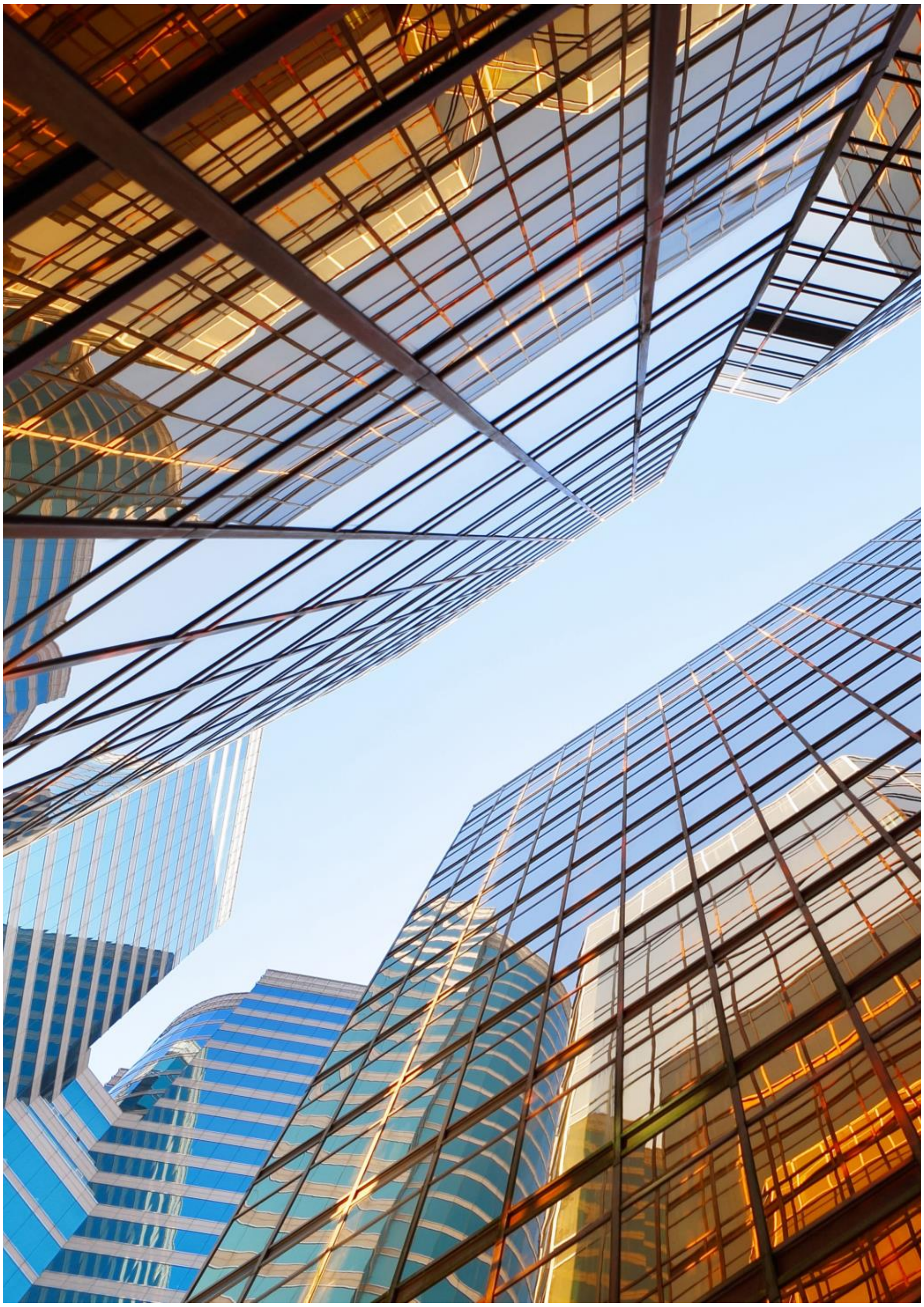
Access to capital

- Generally Australian and international equity investors have been supportive of Australian financial institutions seeking to raise new capital, including during the pandemic where Australian superannuation funds were an 'important and material source of new capital being some of the largest individual investors in the new capital raisings'.
- APRA would have concerns from a stability perspective if there were developments that meant that capital would become less accessible when needed, particularly in times of stress.

[Source: APRA Chair Wayne Byres, Chair Opening Statement to the House of Representatives Standing Committee on Economics Inquiry into Common Ownership and Capital Concentration 10/09/2021]

Financial Services

Top Story | A guide on breach reporting requirements for AFS and credit licensees



ASIC's new breach reporting requirements introduced by the Financial Sector Reform (Hayne Royal Commission Response) Act 2020 will commence 1 October 2021.

The changes strengthen the existing obligation on Australian financial services licensees to self-report certain breaches to ASIC. They also extend the obligation to credit licensees.

MinterEllison has released a guide to help firms to comply with the new rules. The guide can be accessed here.

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 two (plus) 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 or have been deferred due to COVID-19.

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.

The latest update reflects the appointment of the inaugural Financial Accountability Authority members and the Treasurer's confirmation that the FRAA has been tasked with undertaking a review of the Australian Securities and Investments Commission (ASIC) in its first year of operation.

The updated table can be accessed here.

Proposed changes to upcoming DDO obligations

In response to industry feedback received in the lead up to the October 2021 commencement of the Design and Distribution Obligations (DDO) regime, the government has signalled its intention to make a number of amendments 'to achieve its intended operation of these reforms'.

Planned changes

Treasury has published a paper that includes a high level list of proposed changes and the rationale behind them here.

The proposed changes include (among others):

- removing the requirement 'nil' reporting requirement for distributors
- confirming that where a product disclosure statement (PDS) is given in the course of providing personal advice, this conduct is within the scope of excluded conduct
- expanding the employer exemption to ensure that employers are not regulated as distributors when providing a PDS for their default fund product to employees
- exempting the Government's Cashless Debit Card and the BasicsCard from the DDO regime

Legislating the changes

Treasury has indicated it will consult on these changes 'in due course', as well as other amendments, including:

- 'making clear that more streamlined obligations (ie only record keeping and notification obligations) for distributors only apply where the intermediary has a duty to act in the consumer's best interests, such as where personal advice is provided under the Corporations Act, or where mortgage brokers engage in similar conduct;
- ensuring that the DDO regime applies to consumer leases; and
- considering the operation of the complaints reporting regime to ensure that it is fit-for-purpose, following immediate action to remove the requirement for distributors to report nil complaints and nil information to issuers'.

Interim measures to be in place prior to the 5 October commencement of the DDO regime

To provide certainty on the application of the DDO regime in the period before the changes are legislated, ASIC will consult on and 'consider making short-term interim changes', in line with the planned legislative changes using its modification and exemption powers under s994L of the Corporations Act 2001 (Cth).

This short term relief is expected to be in place prior to the 5 October 2021 commencement of the DDO regime to 'prevent industry needing to implement product governance arrangements, ahead of commencement, for products that are ultimately not intended to be caught by these reforms'.

SAFAA has welcomed the planned removal of the 'nil' reporting requirement

In a short statement, the Stockbrokers and Financial Advisers Association (SAFAA) welcomed in particular the planned removal of the requirement for distributors to report 'nil complaints' to issuers, given the reporting burden this places on stockbrokers and investment advice firms.

SAFAA CEO, Judith Fox commented:

> 'SAFAA has been advocating for a change to the DDO regime to exempt distributors from the requirement to provide "nil complaints" reports to issuers. The requirement to report "nil complaints" was a significant and unnecessary regulatory burden placed on distributors from which issuers would not gain any benefit…SAFAA's members are pleased that the government has listened to them and made a common sense decision to cut unnecessary red tape…Both distributors and issuers can now focus on complaints, rather than the fact that no complaints have been received in relation to particular products.'
>
> [Sources: Treasury Update on the Design and Distribution Obligations; (DDO) regime SAFAA media release 15/09/2021]

No longer needed: APRA expects ADIs to phase out reliance on the CLF by the end of 2022

- The Australian Prudential Regulation Authority (APRA) has said it expects all locally incorporated Authorised Deposit-taking Institutions (ADIs) subject to the Liquidity Coverage Ratio (LCR), to phase out their reliance on the Committed Liquidity Facility (CLF) by the end of 2022 (subject to financial market conditions).

- More particularly, APRA's expectation is that no ADI will need to rely on the CLF to meet its minimum 100% LCR requirement from the beginning of 2022 (although ADIs may continue to count any remaining CLF as part of their liquidity buffer). ADIs should then reduce their use of the CLF to zero by the end of 2022.
- To facilitate this, APRA expects ADIs to 'purchase the HQLA [high-quality liquid assets] necessary to eliminate the need for the CLF'.
- APRA considers that the use of the CLF should no longer be necessary after the end of 2022 because APRA and the Reserve Bank of Australia (RBA) expect there to be sufficient HQLA for ADIs to meet their LCR requirements without needing to rely on the CLF.
- APRA states that the CLF will remain available should it need to be reactivated to meet future shortfalls in the availability of HQLA.
- APRA makes clear that it will continue monitor financial market conditions and may change these expectations if needed.

[Sources: APRA media release 10/09/2021; APRA's letter to all locally incorporated LCR ADIs]

Revised Global Principles for Sustainable Securities Lending aim to introduce and embed ESG principles into securities lending

- The Global Principles for Sustainable Securities Lending (Global PPSL) is a UK based but globally focused voluntary initiative that aims to introduce and ultimately to embed ESG principles into the practice of securities lending. Global PSSL has received significant funding from the Economic and Social Research Council (ESRC), part of UK Research and Innovation, through the Sustainable Finance – Law – Stakeholders (SFLS) Network at Exeter Law School.
- Signatories to the initiative commit to promoting/integrating ESG considerations and Sustainable Development Goals (SDG) into their securities lending activities in line with the nine Global PSSL principles. These principles have been developed since the launch of the initiative in 2018 and incorporate feedback from industry and from other relevant stakeholders.
- The nine principles are aimed at fostering ESG integration among signatories. They include (among other things) measures aimed at: a) increasing transparency and accountability in securities lending; b) fostering cooperation with international organisations/regulators/other stakeholders; and c) supporting stakeholder inclusion/diversity. Principle 6 explicitly supports values-based short selling on the basis that 'covered short selling…contributes to achieving values beyond mere financial gain' and 'an opportunity for market participants to discover poor governance and fraud'. Principle 7 underlines the importance of voting and engagement in the context of securities lending and in particular the 'need to weigh voting and corporate engagement alongside stakeholder values'.
- Opening signatories to the initiative include (among others): Sumitomo Mitsui Trust Bank, BNP Paribas Securities Services and Standard Chartered. A full list of signatories is here.

[Source: Global Principles for Sustainable Securities Lending media release 07/09/2021]

29% of banks failing to meet direct debit compliance obligations

- The Banking Code Compliance Committee (BCCC) released a report into banks' compliance with the requirement under the Banking Code of Practice (Code) requiring them to promptly cancel a customer's direct debit upon request by the customer.
- The report found that in 29% of cases, banks are falling short of expectations.
- In particular, the BCCC flags the importance of banks actioning a request without asking/suggesting that the customer needs to first contact a merchant or service provider to cancel the direct debit.
- The BCCC has called on lenders to take additional steps to improve their compliance, including: updating information on websites, providing staff training/communication programs and undertaking additional monitoring activities.
- The BCCC has indicated it will continue to monitor banks' progress to improve their compliance with the direct debit obligations.

[Sources: BCCC media release 13/09/2021; Full text report: BCCC compliance update: cancellation of direct debits]

US financial advisers remain cynical about ESG investment performance, despite growing client demand according to ISS survey

Institutional Shareholder Services (ISS) conducted a survey of 779 US financial advisers between July-August 2021.

According to ISS:

- Client interest, especially from younger clients is increasing:
  - Most (67%) of advisors surveyed who either currently invest client funds into ESG or anticipate doing so, nominate client interest as the primary driver
  - 31% of advisers said that they had noticed an uptick in the number of clients actively brining up ESG in investment discussions over the last 12 months
  - 48% of advisers said that the majority of clients interested in ESG are under 40 years of age

- Advisers expect this to continue: Of the advisers who currently invest in ESG, 88% anticipate either investing the same or investing more over the next 12 months (55% anticipate investing more, 33% anticipate investing the same)

- Investment performance: Unsurprisingly, investment performance was identified as playing a key role in the investment screening/evaluation process. The survey found that perceived ESG investment performance (relative to other investments) is the key barrier to wider adoption. According to the survey:
  - 43% of advisors who do not currently invest in ESG believe ESG products are below average relative to non-ESG solutions.
  - Only 28% consider ESG investment performance to be equal to that of other investments.
  - A further 27% of advisers who do not current invest in ESG products are undecided when it comes to performance.

  [Source: ISS media release 09/09/2021]

Risk Management

AUSTRAC banking sector risk assessments released

AUSTRAC has released four money laundering and terrorism financing (ML/TF) risk assessments aimed at assisting the banking sector to better identify and mitigate the risks posed by financial crime. The assessments examine the following four sectors: 1) Australia's four major banks; 2) other domestic banks (12 operating in Australia); 3) foreign subsidiary banks (seven operating in Australia); and 4) foreign bank branches (48 operating in Australia).

The overall ML/TF risk ratings for the banking sector range from medium (foreign subsidiary banks and foreign bank branches) to high (major banks and other domestic banks).

AUSTRAC CEO, Nicole Rose said it's vital the banking sector in Australia uses the assessments to help them to identify threats and strengthen their response:

> 'Criminals will exploit any gaps and use sophisticated methods for their own personal greed. We are navigating a rapidly changing financial system and advances in technologies and platforms. That is why government, law enforcement and the finance sector must continue to work together to protect Australia's financial system and Australians from serious and organised crime.'

Some Key Takeaways

AUSTRAC has published a one-page summary of the risk rating for each of the four sectors in each risk category here.

The table below provides some background behind the overall risk rating for each sector and AUSTRAC's view on where AML/CTF programs could be improved.

SECTOR	OVERALL ML/TF RISK RATING	KEY FINDINGS
Australia's four major banks (you can access the full text of the risk assessment for this subsector here)	High	▪ AUSTRAC concludes that banks are 'widely exposed to predicate offences and money laundering methodologies at all stages of the money laundering cycle'. ▪ Major banks face a high level of 'inherent ML/TF vulnerability due to: a) their very large customer base; b) 'significant number of high-risk customers'; c) 'very high exposure to cash'; d) 'extensive product offerings; and e) substantial exposure to foreign jurisdiction risk'. ▪ AML/CTF programs/controls: AUSTRAC considers that major banks have a 'mixed record of applying risk mitigation strategies'. While there have been 'significant and systemic deficiencies' detected in the subsector in recent years, major banks continue to make significant investments to counter ML/TF risk and to engage regularly with AUSTRAC. AUSTRAC flags that 'governance and assurance around AML/CTF compliance' as an area of particular concern. h
Other domestic banks (you can access the full text of the risk assessment for this subsector here)	High	▪ AUSTRAC considers that domestic banks, like major banks, face a high level of 'inherent ML/TF vulnerability' due to: a) their large customer base and high exposure to cash; b) increasing use of remote service delivery channels; c) exposure to foreign jurisdiction risk; and d) the 'displacement' of some higher-risk customers (eg members of serious/organised crime groups and/or individuals linked to terrorism) from major banks. ▪ AUSTRAC concludes that this subsector is exposed to a 'range of predicate offences, some sophisticated money laundering methodologies and a moderate level of suspected terrorism financing'. ▪ AML/CTF programs/controls: AUSTRAC comments that risk mitigation strategies are applied in this subsector with 'varied results'. AUSTRAC comments that though this subsector continues to invest in risk mitigation systems/controls, AML/CTF programs within some smaller banks remain less well-resourced/sophisticated than in larger entities. In addition, AUSTRAC considers that some banks could make improvements to transaction monitoring programs and SMR submissions to AUSTRAC.
Foreign subsidiary banks (you can access the full text of the risk assessment for this subsector here)	Medium	▪ Foreign subsidiary banks are also considered to face a high level of inherent ML/TF vulnerability due to their: a) high exposure to cash; b) 'heavy reliance on remote delivery channels'; c) high exposure to foreign jurisdiction risk; and d) the 'displacement' of some higher-risk customers from major banks. ▪ However, overall the subsector has not experienced the same volume or sophistication of money laundering as Australia's domestic banks. ▪ AUSTRAC considers that the key threats facing this subsector are frauds/scams which can be 'exacerbated by use of online delivery channels'. The key threats ▪ AML/CTF programs/controls: AUSTRAC found that many reporting entities indicate they have implemented risk mitigation strategies. However, AUSTRAC comments that because AML/CTF programs are often developed offshore by head office, the effectiveness of the program is influenced by head office's understanding of local risks. In addition. AUSTRAC also flags that 'some technological capabilities could be improved' (an improvement area which has been

SECTOR	OVERALL ML/TF RISK RATING	KEY FINDINGS
		acknowledged by the subsector). In addition, AUSTRAC considers that banks could make improvements to the quality and quantity of SMR submissions.
Foreign bank branches (you can access the full text of the risk assessment for this subsector here)	Medium	▪ Overall AUSTRAC considers that this subsector faces a medium level of inherent ML/TF vulnerability with key contributors to this being: a) the large number of high-risk customers they service; and b) exposure to foreign jurisdictions. ▪ AUSTRAC also notes that the subsector also faces 'inherent vulnerability' due to the use of: a) correspondent banking and agent bank arrangements; b) the fact that their customers are engaged in international trade; and c) 'private and investment banking products and services that help disguise the true source and destination of funds'. ▪ Criminal threat environment: AUSTRAC considers that the overall extent of criminal activity in this subsector to be low with reporting entities 'not significantly exposed to transnational, serious and organised crime groups, or entities linked to terrorism or terrorism financing activities'. The primary threats identified for this subsector are: a) frauds and scams committed against their customers; b) tax evasion; and c) money laundering. ▪ AML/CTF programs/controls: AUSTRAC found that many reporting entities indicate they have implemented risk mitigation strategies. However, consistent with its assessment of foreign subsidiary banks, AUSTRAC considers that this subsector could improve its technological/data capabilities. AUSTRAC also comments that because AML/CTF programs are often developed offshore by head office, the effectiveness of the program is influenced by head office's understanding of local risks. In addition, AUSTRAC considers that banks could make improvements to the quality and quantity of SMR submissions.

[Sources: AUSTRAC media release 06/09/202;1 Key findings overview: Australian Banking Sector Money Laundering and Terrorism Financing Risk Assessments; Individual assessments]

NYU Stern School of Business study finds that finance experts generally agree that climate risk is not being adequately 'appreciated' by major asset markets

An NYU Stern School of Business backed survey of finance experts' (academics, regulators/policy makers and professionals) views on the emerging financial and economic risks associated with climate change has identified that there is 'significant consensus' on a range of key issues, despite differences in respondents' profession, age or geographical location. For example, the survey found that:

- There is general agreement that climate risk is currently being 'underappreciated' by major asset markets. For example the proportion of respondents who consider that stock prices do not adequately reflect climate risks outweigh those who consider that stock prices reflect climate risk 'too much' by 20:1.
- Key short term and longer term risks:
  - Transition risk is generally considered to be the primary climate risk over the next five years.
  - Over the next 30 years, there was near universal agreement that the physical risks of climate change will be the most important.
- Forces for change: Overall, respondents considered carbon taxes and institutional investors as the two most important forces for change, followed by government subsidies and pressures from customers. Looking more closely, academics and policy makers tended to view carbon pricing mechanisms as more important. Private sector respondents tended to view institutional investors and customers as more important.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 03/09/2021]

In Brief | Banks need to do more about the physical risks of climate change: A report from Ceres has found that in a 'worst case' scenario, even if adaption methods are implemented, the annual value-at risk from the physical impacts on the syndicated loan portfolios of major US banks could be 10%. The report calls on banks to commit to implementing 14 recommendations to assist them in better identifying, assessing and acting to mitigate the physical effects of climate change within the next twelve months, including aligning their strategies with the goals of the Paris Agreement

[Source: Ceres report: Financing a net zero economy: The consequences of physical climate risk for banks September 2021]

In Brief | Lagging on climate could hurt Australia's economic recovery from the pandemic according to the OECD's Economic Survey of Australia. The report observes that though 'uniquely vulnerable' to climate change, Australia is also 'uniquely placed to benefit economically from the global move towards carbon neutrality'. The report calls on Australia to implement 'a coherent national strategy that defines clear goals and policies to move to net zero'. In a statement welcoming the report, the government confirmed that it remains 'committed to its approach of technology, not taxes, in reaching net zero emissions as soon as we possibly can, preferably by 2050'

[Source: OECD media release 15/09/2021; OECD economic survey; Treasurer Josh Frydenberg media release 15/09/2021]

In Brief | Taking shortcuts: Global survey of 2920 compliance managers has identified that 65% agree that the pandemic has forced them to take shortcuts with know your customer and due diligence checks

[Source: Refinitiv report: Global Risk and Compliance Report 2021, How data, technology and collaboration are reshaping risk]

Insolvency and Reconstruction

Three men gaoled for their parts in an illegal phoenix scheme

The Australian Taxation Office (ATO) has issued a media release announcing that three men have been gaoled for eight, five and four years respectively, for their parts in an 'elaborate illegal phoenix operation'.

According to the ATO, the scheme involved establishing six labour hire companies to provide workers to vineyards, fruit and vegetable growers, and meat processers in SA and QLD. Though the companies charged their clients GST and 'supposedly withheld' PAYG, they did not remit either GST or PAYG to the ATO.

Over a 25 month period, the three men withdrew more than $23m from the entities' accounts, leaving insufficient funds at the time of liquidation to enable recovery of the outstanding debts.

The three also attempted to hide their illegal activities by appointing shadow directors to the companies.

Assistant Commissioner Ian Read welcomed the sentence commenting,

> 'This type of behaviour is blatant fraud against the Commonwealth, and we will not tolerate it. Phoenixing is an intentional act that requires planning and the alleged behaviour in this case demonstrates a deliberate attempt to defraud the tax and super system'.

Chair of the ATO-led Phoenix Taskforce Will Day observed that the ATO's ability to take action on phoenix activity will be 'dramatically enhanced' by the introduction of Director Identification Numbers (DINs).

> [Note: You can find more information about the Director Identification Number (DIN) roll-out on the ATO website here. The ATO states that at this stage, the DIN regime will be rolled out progressively and 'You don't need to do anything now'.]
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> [Source: ATO media release]

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