Governance News

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

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Remuneration

Report finds support for 'Say on pay' resolutions at Russell 3000 companies averaged over 90% in 2021, support for director nominees also remained high

Semler Brossy's latest report provides insights into proxy voting results and trends for 2021based on analysis of vote results from 2,243 Russell 3000 companies. Our key takeaways from the report are below.

'Say on Pay'

- Approval rate remained high:
  - The average approval rate for 'say on pay' resolutions remained high at 90.4% (down very slightly from 90.5% in 2020 and 2019).
  - The percentage of Russell 3000 companies receiving 90% or more support in 2021 stood at 75% (up from 74% in 2020)
- Slight uptick in the failure rate (from a very low base):
  - There was a slight uptick in the number of 'say on pay' resolutions that failed to pass (received 50% or less support) compared with 2020. In 2021, 2.8% of 'say on pay' resolutions failed vs 2.3% in 2020
  - Looking at it by sector, the failure rate was highest in the Energy and separately, in the Communication Services sector (both 6%) and lowest in the Materials sector (1%)
- Leading causes of failure to approve 'say on pay' resolutions:

- The report identifies 'problematic pay practices' (75% up from 56% in 2020) as the leading cause of failure to approve resolutions
- The report also identifies a spike in failures attributed to COVID-19 related actions - 32% of failures were attributed to COVID-19 related actions in 2021 (up from just 4% in 2020)

Director Elections

- Average support for director nominees standing for election/reelection remained high in 2021 at 95.1% (up from 94.9% n 2020)
- The report flags that the average level of support for the directors of companies where the 'say on pay' resolution in the previous year failed, is lower at only 70%
- The report also highlights that the proportion of director nominees that received 95% or more backing continued its downward trend from a high of 78.3% in 2017 to 75.2% in 2019 to 73.7% in 2021.

E& S resolutions

Environmental resolutions

The report identified a strong uptick in the level of support for environmental resolutions in 2021. For example, according to the report:

- 41% of the 39 environmental resolutions that went to a vote in 2021 received 50% or more support (up from just 16% in 2020)
- The median level of support for environmental resolutions was 46% in 2021 (up from 29% in 2020)
- In the case of every environmental resolution that received majority support, Institutional Shareholder Services (ISS) issued a 'for' recommendation
- The three environmental resolutions that received the highest level of support (all 98%) were: 1) a resolution calling on Bunge Ltd to report on soy supply chain; 2) a resolution to approve S&P Global's emissions reduction plan; and 3) a resolution calling on General Electric to report on criteria for meeting the net zero indicator. All three resolutions had management endorsement.
- Of the remaining environmental resolutions that received majority support, none had management backing.

Social resolutions

Support for social resolutions (eg disclosure of board diversity, disclosure of EEO1 data), also increased 2021 compared in 2020. For example, the report found that:

- Of the 134 social proposals that went to a vote in 2021, 23 received 50% or more support (up from just 9% of resolutions in 2020)
- The median level of support for social proposals in 2021 was 32% (up from 29% in 2020)
- In the case of every resolution that received majority support in 2021, Institutional Shareholder Services (ISS) issued a 'for recommendation.
- Of the resolutions that received majority support, only two had management endorsement. These two – a resolution calling on Wendys to report on human rights risks in its supply chain, and a resolution calling on International Business Machines Group to report annually on diversity and inclusion efforts – received the highest level of support (both 94%).

[Source: Semler Brossy 2021 Say on Pay Report 27/02/2022]

Shareholder Activism

Lazard has released its latest annual review of global trends in shareholder activist activity

Lazard has released its latest annual review of global trends in shareholder activist activity. Our key takeaways are below.

Global trends

- Activist activity globally remains down on pre-pandemic levels (though activity spiked in Q4)
  - According to Lazard's analysis, 173 activist campaigns were launched globally in 2021. For context, this remains well-down on pre-pandemic levels – 209 campaigns were launched globally in 2019
  - Interestingly, Lazard found that campaign activity globally accelerated in Q4 2021 with 50 campaigns initiated, up from just 29 in the previous quarter. For comparison, 58 campaigns were initiated in Q4 2020, and only 46 were initiated in Q4 2019.
  - Looking at total capital deployment in new campaigns, Lazard found that the total for 2021 was slightly up on 2020 ($41.9bn in 2021 vs $40bn in 2020), with the increase driven by the $13.5bn spike in Q4 2021 in line with the uptick in activity
- Regional Activity
  - According to Lazard's analysis, the US led the rest of the world in terms of the overall level of activist activity in 2021, accounting for 55% of total global campaigns and 49% of global capital deployed. For context, this was an increase on 2020 (the US accounted for only 45% of global campaigns)
  - Lazard also found that campaign activity in all other regions decreased in 2021 (compared with 2020). For example: In 2020, Europe represented 31% of total global campaigns, in 2020 this fell to 29%. In the APAC region the decrease was more marked falling from 18% to 11%.
- Lazard found that 'established activists' were responsible for the majority of activity. Elliott Management launched 17 campaigns over the course of 2021, with 11 campaigns launching in H2 alone. For comparison, Jana Partners (the next most prolific activist firm) launched only 7 campaigns in 2021
- Global board seats won
  - 89 board seats were won by activists globally in 2021 (down from 132 in 2020, and 122 in 2019).
  - Of the total board seats secured by activists 92% were secured through settlements (as opposed to proxy fights)
- Activist director appointments: Lazard suggests that there are indications that activists are 'broadening their candidate recruitment efforts'. For example:
  - 84% of director appointments from activists had no previous public company CEO or CFO experience (up from 78% in 2020)
  - 42% of had no previous public company director experience (down from 61% in 2020)
  - 25% were female, up from just 14% in 2020
- Most common activist demands:
  - M&A and board changed remained the most common campaign objectives globally (consistent with previous years)
- CEO turnover
  - Interestingly, Lazard highlights that while less than 5% of campaigns demanded 'management change', CEO turnover within six months of an activist campaign launch occurs at a significantly higher rate.
  - For example, the rate of CEO turnover at European companies targeted by activists in 2020 was 22%. The rate for 2021 currently stands at 19% though Lazard anticipates that this will increase as six months have not yet elapsed following all the campaigns launched in 2021.
  - The report also points out that the trend is less pronounced in the US with CEO turnover within six months of an activist campaign at targeted US companies standing at 12% in 2020 and 5% in 2021 (though again, this is expected to increase).
- ESG Activism

- Lazard highlights that ESG activism is expanding beyond dedicated funds, with several 'blue-chip activists' incorporating ESG into 2021 campaigns
- According to Lazard's analysis, the use of ESG in campaigns ranged from 'fundamental strategic attacks' such as Third Point's campaign at Shell which called on the company to separate its renewables and refining businesses, to what Lazard describes as 'more ancillary “wedge” criticisms intended to curry favour with index funds and other ESG-focused investors'

US: Some key insights

- According to Lazard, there were 95 campaigns launched in 2021 (up from 83 in 2020).
- Small-cap companies (<$5bn) continued to be the primary target of new activist campaigns – 35% of all US campaigns targeted small cap companies. Consumer/Retail and Technology were the most frequently targeted sectors.
- Lazard found the level of capital deployed in the Technology, Retail, Healthcare and Financial Services increased in 2021 and fell across all other sectors. Lazard highlights that taken together, activity in Retail and Healthcare accounted for 29% of US capital deployed in 2021, up from just 9% historically.
- Potential Impacts of Universal Proxy?
  - For context, in November 2021, the US Securities and Investments Commission (SEC) adopted a rule requiring parties in a contested election to use a universal proxy card listing all available candidates, enabling investors to vote for their preferred combination of candidates (as opposed to having the choice to vote either for the candidates endorsed by the company or those listed on a dissenting shareholder proxy card)
  - The report includes some insights from Lazard into the potential impacts of this change. For example, it's suggested (among other things) that:
    - though the changes do not take effect until 31 August 2022, there is 'potential for activists to start demanding the use of universal proxies in advance of that date'
    - the new 'solicitation requirement' (67% of voting power) is 'unlikely to be a deterrent given extreme concentration of most shareholder bases'
    - the change may mean that individual directors (rather than the company) may 'become more direct targets of a public activist campaign'

Europe: Some key insights

- According to Lazard there were 50 campaigns launched in 2021 (down from 57 in 2020). Campaign activity accelerated in Q4, with 16 campaigns launched in that quarter. Lazard comments that this comes 'close to historic highs'.
- Interestingly, 42% of all European campaigns targeted UK companies in 2021 (far outstripping all other countries).
- Companies in Germany and the Netherlands were the next most commonly targeted (each accounting for 12% of total European campaigns)
- Overall, Financial Institutions were the most heavily targeted companies (24% of all campaigns in 2021), with Insurance a particular area of activist attention.
- Lazard comments that '2021 has marked the resurgence of Elliott’s activity in Europe' with the fund behind 18% of total European campaigns.

  [Source: Lazard 2021 Annual Review of Shareholder Activism; Harvard Law School Forum on Corporate Governance and Financial Regulation 26/01/2022]

Engagement drives progress? Trillium has welcomed the Bank of America's decision to eliminate overdraft fees

- On 11 January 2022, the Bank of America issued a statement announcing changes to its overdraft services including: a) plans to eliminate non-sufficient funds (NSF) fees beginning in February 2022; b) plans to reduce overdraft fees from $35 to $10 beginning in May 2022; and c) plans to eliminate the transfer fee associated with its Balance Connect for overdraft protection service. According to the statement, the changes are expected to 'lead to overdraft fee revenues being reduced by 97% from 2009 levels'.

- Trillium Asset Management has welcomed the announcement, which it describes as 'important progress' toward an overdraft system that is more just and equitable. Trillium also welcomed the banks' 'openness to engaging with Trillium on this topic over many years and commend its leadership on taking this critical step forward'.
- Trillium's statement appears to attribute the bank's decision to make changes to its overdraft services in part to engagement efforts by Trillium with the bank on the issue over a number of years including filing a shareholder resolution calling for a shift in the bank's overdraft policy in 2018, and regular engagements with the lender on the issue in the years since.
- Broadly, Trillium's chief concern is the negative impact that charging a $35 overdraft fee for various transactions (eg ATM withdrawal or other electronic transactions) has on vulnerable customers – eg low income, single, non-white and renters.

[Source: Trillium Asset Management media release 27/01/2021]

Follow This renews calls for shareholders to support its climate resolution ahead of upcoming Exxon AGM

In response ExxonMobil's recent announcement of its 'ambition' to reach net zero emissions for its operations (Scope 1 and 2) by 2050, Follow This has reiterated calls for shareholders to back its resolution calling on the company to set Paris-consistent emissions reduction targets across all scopes (Scope 1, 2 and 3) at the upcoming AGM.

Follow This states:

> 'To keep the Paris goal of limiting global warming to 1.5°C alive, more and more investors insist that all emissions have to be down by 45% by 2030, in particular product emissions (Scope 3), which accounts for 80-90% of the emissions of a typical oil major. With this goal, Exxon is like a tobacco producer that promises to reduce smoking while continuing cigarette production. ExxonMobil CEO Darren Woods told the Financial Times that Exxon could

expand its oil and gas production in the coming years and still meet the emissions reduction goals at its operations. His intention to expand oil and gas production shows that he has no intention to contribute to the goal of the Paris Accord, which calls for 'immediate, rapid and large-scale reductions'.

[Source: FollowThis media release 20/01/2022]

Climate resolution calling on Costco to set science based emissions reduction targets across all scopes receives 69.9% shareholder support

- Ceres reports that a Green Century Capital Management coordinated shareholder resolution calling on retailer Costco to set net zero science-based emissions reduction targets for its full value chain (ie including customer emissions or Scope 3 emissions) has received 69.9% support at the Costco AGM (despite not having management backing).
- The CostCo board recommended shareholders vote against the resolution on the basis that:

  'We are committed to meeting the challenges of reducing emissions, as are many of our suppliers. But until wehave more data and more interaction with our suppliers we believe it imprudent to commit now to adopt arbitrary limits and fixed timetables by June 2022, as sought by the proposal. We are committed to disclosing by December 2022 our estimated Scope 3 Purchased Goods and Services emissions and our Scope 3 Action Plan'.
- For clarity, the full text of the resolution (see p28 of the Costco proxy statement) calls on Costco to:

  'adopt short, medium, and long-term science-based greenhouse gas emissions reduction targets, inclusive of emissions from its full value chain, in order to achieve net-zero emissions by 2050 or sooner and to effectuate appropriate emissions reductions prior to 2030'.
- According to Ceres, the result is significant not only for the level of support, but because the resolution is the first of its kind. Ceres comments,

  'This is the first shareholder vote on a proposal directly requesting that a company set targets that include emissions from its full value chain and that are aligned with achieving net zero emissions by 2050 or sooner'.
- Ceres further comments that ahead of the meeting, the resolution had already prompted positive changes in Costco's climate policy. For example: Costco committed to developing a Scope 3 action plan (including 'eventual reduction targets') as well as a reduction in its Scope 1 and 2 emissions.

  [Source: Ceres media release 27/01/2022; Costco proxy statement]

Meetings and Proxy Advisers

Top Story | New proxy reforms: Senate Committee flags concerns, calls on Treasurer to provide answers

Key Takeouts

- The Senate Standing Committee for the Scrutiny of Delegated Legislation has raised concerns about various aspects of new proxy reforms introduced by Treasury Laws Amendment (Greater Transparency of Proxy Advice) Regulations 2021. You can find a brief overview of the reforms and the initial response from industry in Governance News 25/01/2022 at p11
- The Committee has called on the Treasurer to respond to a number of questions about the Regulations by 10 February 2022, 'while they are still subject to disallowance'.

Recap: What are the changes?

Broadly, the Treasury Laws Amendment (Greater Transparency of Proxy Advice) Regulations 2021 (Regulations) extend Australian Financial Services (AFS) licensing requirements to a broader range of proxy adviser activities and introduce new requirements for:

- proxy advisers to provide entities that are the subject of proxy advice with a copy of the advice, on the same day it is provided to the client.
- proxy advisers to be independent of their clients.

The Regulations also amend the Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations) to introduce a new requirement for Registrable Superannuation Entity (RSE) licensees to make publicly available on their website a detailed summary of how they have exercised their voting rights.

The initial response to the Regulations has been mixed with proxy advice firms questioning the rationale for the reforms, the method of introduction and the short timeframe for implementation – the Regulations were made just days for Christmas – as well as raising concerns about their potential impact.

Likewise the Australian Shareholder Association has raised concerns that the changes 'could undermine the ability of shareholders to hold companies to account, reducing confidence in markets and potentially an individual's retirement funds and threatening Australia's economic health'.

Conversely the Business Council of Australia has expressed support for the changes.

The AFR reports that Senator Rex Patrick has also indicated that he plans to move a disallowance motion on 10 February 2022. If this were to occur and if the motion is agreed to, the Regulations would be 'disallowed' which would mean that they would cease to have effect.

If a notice of motion to disallow is not resolved or withdrawn within 15 sitting days after having been given, the Regulations would be deemed to have been disallowed and would cease to have effect.

Senate Committee has raised concerns with the Treasurer

The Chair of the Senate Standing Committee for the Scrutiny of Delegated Legislation (Committee) wrote to the Treasurer on the 27 January 2022 outlining a number of concerns about the design and drafting of the Regulations and seeking responses from him to several questions (see: Committee Correspondence p21).

Broadly, the Committee's chief concern appears to be that in light of the significance of the reforms and their likely impact on industry, it would have been preferable for them to be introduced through primary legislation rather than through regulation. A concern that has previously been raised by industry (eg ACSI).

Below is a brief summary of the Committee's concerns and the questions on which the Committee has sought responses from the Treasurer.

Why introduce the reforms through Regulation?

The Committee has questioned the justification for introducing the 'significant new obligations' through delegated legislation rather than through primary regulation. The Committee comments that:

> 'despite the Regulations imposing obligations that have a significant effect on licensees that provide proxy advice there is no justification in the explanatory statement as to why it is appropriate for the relevant matters to be dealt with by delegated legislation as opposed to primary legislation'.

The Committee has requested the Treasurer's 'advice as to why it is considered necessary and appropriate to use delegated legislation, rather than primary legislation, to introduce significant new obligations on financial services licensees that provide proxy advice, noting in particular that this approach appears to be inconsistent with the guidance provided in the Department of the Prime Minister and Cabinet's Legislation Handbook'.

Lack of clarity around review of the reforms

The Committee is concerned that, 'as the Corporations Regulations are exempt from sunsetting...there is potential for the measures to remain in force indefinitely through delegated legislation.' The Committee considers that if the measures are intended to be ongoing, the reforms would be 'more appropriately contained in primary legislation'.

The Committee is also concerned that 'it is unclear' from the explanatory statement, whether a 'specific review' of the operations of the provisions (to determine whether they remain necessary/appropriate) will occur.

The committee has requested the Treasurer's advice on:

- 'whether the Corporations Regulations 2001 can be amended to provide that the measures cease within three years after commencement'
- 'whether there is any intention to conduct a review specific to the relevant provisions to determine if they remain necessary and appropriate, including whether it is appropriate to include the provisions in delegated legislation'

Civil and Criminal penalties

The Committee observes that the new requirements are 'underpinned' by significant civil and criminal penalties and raises concerns that though the Regulations themselves do not directly prescribe any penalty, they do 'modify the general obligations of financial services licensees under the Corporations Act, allowing the amendments to utilise existing criminal offences and civil penalties contained in the Corporations Act'.

The Committee queries the absence of justification for why the penalties are appropriate to the particular offences or provisions.

The Committee's view, in light of the 'seriousness of the offences and quantum of penalties the Regulations would give effect to' is that (again) that it 'would be more appropriate for the amendments to be made by primary legislation'.

The Committee has asked the Treasurer to provide a response to the following questions.

- explain 'the justification for the Regulations giving effect to significant offences and civil penalties, as opposed to these penalties being given effect to by primary legislation'
- 'why the penalties are appropriate, and in particular why custodial penalties are appropriate, with reference to the Attorney-General's Department's Guide to Framing Commonwealth Offences'
- 'whether the Attorney-General's Department was consulted in relation to the effective inclusion of custodial penalties in the Regulations, in accordance with Part 3.3 of the Guide to Framing Commonwealth Offences'.

Lack of clarity in the drafting

The Committee raises concerns about the clarity of the drafting of the new independence obligation in particular.

Specifically, the Committee raises concerns that the term 'independent' and the term 'any other entity' are not defined either in the Corporations Act 2001 (Cth) or in the Regulations, giving rise to uncertainty for proxy advisers around how they would fulfil their obligations; uncertainty for regulators 'trying to enforce the provision' and 'possible uncertainty for other interested parties including entities that are the subject of proxy advice'.

The Committee has asked the Treasurer to advise whether subregulation 7.6.03D(3) 'can be redrafted to provide greater clarity as to: the meaning of the term "independent" and the meaning of the term "any other entity", including clarification of the requisite test or threshold for determining which entities will fall within the concept of "any other entity"'.

Response requested from the Treasurer

The Committee has requested that the Treasurer provide responses to the questions above by 10 February 2022. The rationale given for this request is as follows.

> 'The committee's expectation is to receive a response in time for it to consider and report on the Regulations while they are still subject to disallowance. If the committee has not concluded its consideration of an instrument before the expiry of the 15th sitting day after the instrument has been tabled in the Senate, the committee may give notice of a motion to disallow the instrument as a precautionary measure to allow additional time for the committee to consider information received. Noting this, and to facilitate the committee's timely consideration of the matters above, the committee would appreciate your response by 10 February 2022'.
>
> [Source: Senate Standing Committee for the Scrutiny of Delegated Legislation, Monitor 1 of 2022 - Committee correspondence 25/01/2022]

Disclosure and Reporting

Taskforce on Nature-related Financial Disclosures is partnering with a multi-disciplinary group of expert science and industry bodies

What is the TNFD?

- Building on the Taskforce on Climate-related Financial Disclosure recommendations (TCFD), the Taskforce on Nature-related Financial Disclosures (TNFD) is aiming to develop a risk management and disclosure framework to support consistency in the management and reporting of nature-related risks.
- Importantly, the TNFD envisages that the existing TCFD framework and the TNFD framework (once established) will 'be comprehensive in their coverage of climate and nature-related financial risks, and complementary in their usability and adoption by market participants'.
- Working groups have already been established to build a 'beta version' of the proposed TNFD framework.

Partnering with expert science and industry

- The TNFD's work is being supported by a multi-disciplinary group of expert organisations including: Network for Greening the Financial System (NGFS); Global Reporting Initiative (GRI); CDP; The World Business Council for Sustainable Development (WBCSD); SASB Standards Research Team; and Science Based Targets Network (SBTN).
- The TNFD is also drawing on the scientific work of the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES).
- In terms of timing:
  - the TNFD plans to release a 'beta' version of the framework in March 2022, with pilot testing and consultation set to occur later in the year
  - the TNFD also plans to expand its global network of consultation and implementation partnerships in 2022 including expanding engagement with national conservation and business organisations, particularly those in high nature-risk areas, globally

  [Source: TNFD media release 25/01/2022]

Deadline extended to opt-in to Corporate Emissions Reduction Transparency report pilot

Context – Pilot scheme

- Following consultation, in November 2021, the Clean Energy Regulator launched a voluntary pilot reporting project – the Corporate Emissions Reduction Transparency (CERT) report – aimed at enhancing 'transparency and accountability around [eligible] companies' net zero emissions planning'.
- Participation in the pilot is open to companies reporting more than 50 kilotonnes of emissions a year under the National Greenhouse and Energy Reporting (NGER) scheme.
- Companies that opt-in will be 'able to present': a) 'progress towards their emission reduction commitments'; b) 'their net emissions and renewable electricity position'; and c) 'the volume and percentage of certificates and units voluntarily surrendered'.
- It's envisaged that the first CERT report, due to be published Q2 2022, will show the net emissions and renewable electricity use of all participating companies based on Clean Energy Regulator data.

Deadline for opting into the pilot scheme extended

- According to the regulator, the pilot has so far attracted 'strong interest' from 'major companies' from a range of sectors – eg the industrial, materials, utilities, financial, real estate and consumer sectors – opting into the scheme.
- However, in recognition of the 'challenges' facing many companies as a result of the pandemic, the regulator has decided to extend the deadline for opting into the pilot to 15 February 2022 to enable more companies to join.
- Chair of the Clean Energy Regulator David Parker commented:

'The CERT pilot's kick off has shown that some of Australia's largest companies are actively tackling climate-risk and are keen to demonstrate that they have a sound pathway to reducing emissions and increasing their use of renewable electricity'.

[Source: CERT media release 28/01/2021]

In Brief | The IFRS Foundation, CDP and the Climate Disclosure Standards Board (CDSB) have issued a statement confirming that CDSB has now been integrated into the IFRS Foundation (meaning that no further technical work/content will be produced by the CDSB). CDSB staff as well as core content to support the work of the ISSB are also being transferred. The CDSB notes that until such time as the ISSB publishes its IFRS Sustainability Disclosure Standards, the CDSB's Framework and recent technical guidance on Water, Biodiversity and Social disclosures, as well as wider resources, will remain relevant/applicable

[Source: CDSB media release 31/01/2022]

Institutional Investors and Stewardship

Human Capital Management: Investors push companies to provide paid sick leave to all employees on a permanent basis

- A US$3.6T coalition of 150 international investors, led by the Interfaith Center on Corporate Responsibility (ICCR), has written to over 40 companies, including retail and restaurant companies, making the case for companies to provide paid sick leave to all employees, calling for increased disclosure around paid sick leave policies, and flagging their intention to engage with leaders on the issue.
- More particularly, the letter calls on companies to provide responses to the following questions by 18 February 2022.
  - Workforce information: The letter calls on companies to provide investors with information about the total size of the company's workforce as well as a breakdown of employee's employment status (eg full time, part time, contract worker) as well as demographic information on each category.
  - Sick leave policy: The letter calls on companies to provide a 'detailed description of the company's paid sick leave policy, by worker classification including (among other things): a) how many hours/days of paid sick leave that workers are entitled to and which categories of workers are eligible for the benefit; b) how the existence of the policy is communicated to workers; and c) how workers are 'encouraged (or at least not penalised) for accessing the benefit'.
  - Details of COVID-19 sick leave: The letter calls on companies to provide details of any special paid sick time benefit implemented due to the COVID-19 pandemic eg eligibility requirements and estimates of how many workers accessed the benefit, how the company communicated the policy to workers and details of the current status of these arrangements (eg date at which they ended).

Shareholder 'paid sick leave' proposals filed at four companies

Separately, a sub-group of investors has filed shareholder proposals at CVS, Kroger, Target and TJX calling on them to adopt, and to publicly disclose, paid sick leave policies enabling all employees (whether full time or part time) to accrue paid sick leave for use after working for the company after a 'reasonable probationary period'.

The investors' expectation is that the policy be put in place permanently, rather than being tied in any way to the continuing global COVID-19 pandemic.

You can find the full text of the proposal filed at Target here.

Why enhanced disclosure is needed

- According to ICCR's statement, though a number of companies have provided support to employees during the pandemic – eg paid leave to cover quarantine and confirmed illness, free COVID testing, and access to additional healthcare services – it is as yet unclear whether these policies are tied to the pandemic or whether they are now permanent.
- Investors consider policies such as paid sick leave, workplace flexibility and childcare support are key from a staff retention and staff attraction perspective. Accordingly, investors are calling for increased transparency around this/how companies are 'managing this human capital management issue'.

  [Source: ICCR media release 25/01/2021]

Vanguard confirms voting policy for US companies: Board members may face voting action to signal concern over a range of issues including climate concerns

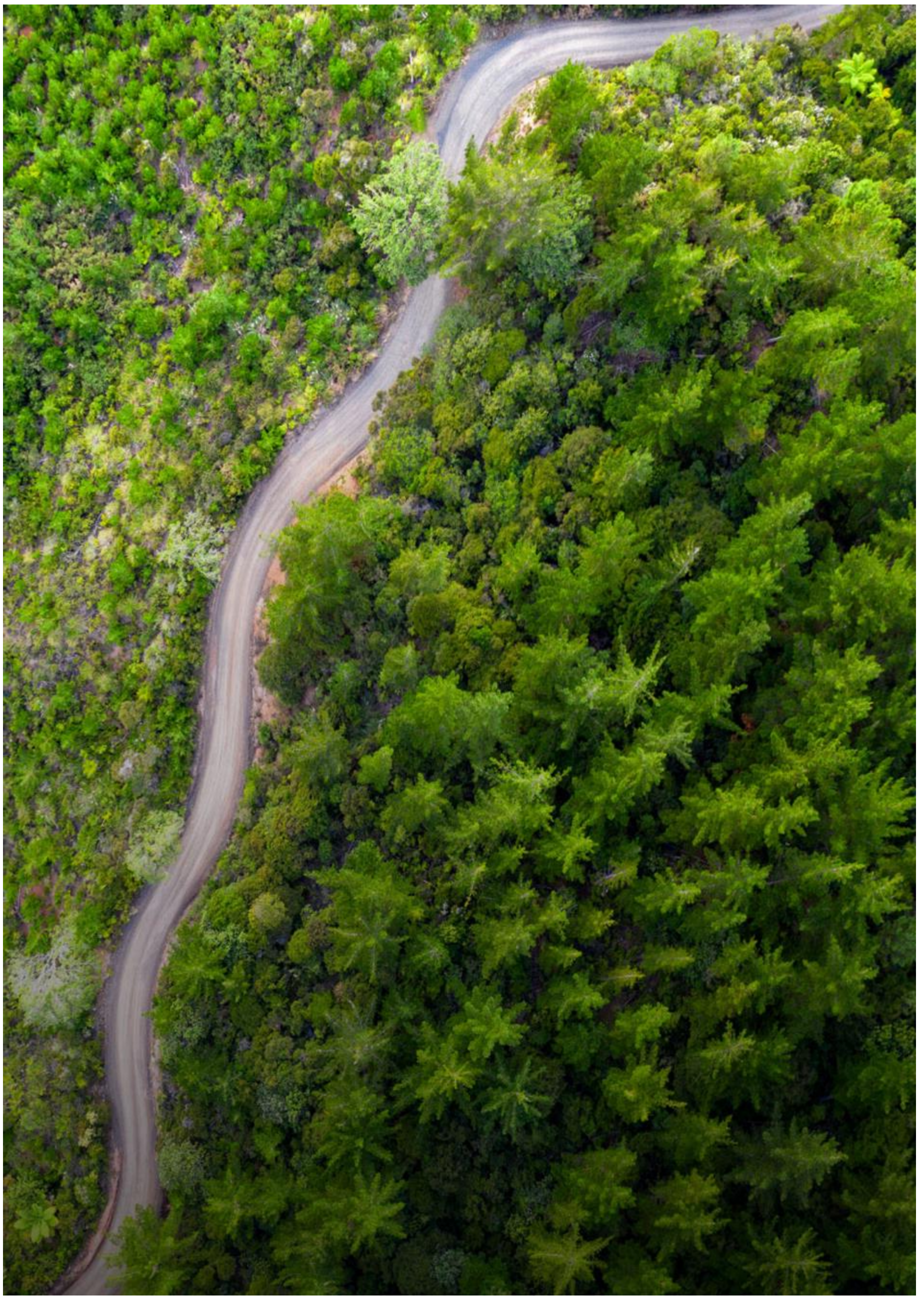
Vanguard has confirmed its voting policy for US based companies for 2022 including (among other issues), Vanguard's general stance on shareholder ESG proposals.

Vanguard makes clear that every proposal will be considered on a case by case basis.

Environmental/social proposals

- Vanguard states that generally, a fund is likely to support shareholder ESG proposals if the following three criteria are met. The proposal should:

- 'Address a shortcoming in the company's current disclosure relative to market norms or to widely accepted frameworks endorsed or referenced by Vanguard's Investment Stewardship program (eg, the Sustainability Accounting Standards Board, the Task Force on Climate-related Financial Disclosures);
- reflect an industry-specific, materiality-driven approach; and
- are not overly prescriptive about time frame, cost, or other matters'.



- Vanguard provides the following non-exhaustive list of environmental proposals that it is likely to support (if the criteria outlined above are met).
  - Request for disclosure related to companies' Scope 1 and Scope 2 emissions. Vanguard may also support disclosure of Scope 3 emissions where 'climate related risks are material'
  - Assessment of the impact of climate on the company including disclosure of scenario analysis/related impacts on strategic planning
  - Goals or target-setting for' relevant greenhouse gas emissions'
- Vanguard provides the following non-exhaustive list of social proposals that it is likely to support (if the criteria outlined above are met):
  - Request for the publication of EEO-1 reports and/or request for disclosure on workforce demographics including gender and racial/ethnic categories
  - Request for inclusion of sexual orientation, gender identity, minority status, or protected classes in employment and diversity policies. On this point, Vanguard also specifies that a fund will 'generally not support proposals asking companies to exclude references to sexual orientation and/or gender identity, interests, or activities in their employment and diversity policies'.
  - Request for disclosure of the board's role in overseeing material diversity, equity, and inclusion risks/other material social risks.
  - Request for adoption of targets or goals related to board diversity (without prescribing what such targets should be, unless otherwise specified by applicable laws and regulatory requirements).
- Corporate political activity proposals: Vanguard will take a case by case approach to assessment of shareholder proposals requesting increased disclosure of a company's political spending and/or lobbying activities, policies or practices. In making its voting decision, a fund will consider (among other things):
  - 'the prevalence of corporate political activity within a company's industry'

- 'disclosure regarding trade associations or other groups that a company supports, or is a member of, that engage in lobbying activities'
- 'recent controversies, litigation, fines, or other manifested risks associated with the company's corporate political activity'.

Director elections

Vanguard may vote against individual board members to signal concern over a range of issues including (among others) the following.

- Non-responsiveness to proposals: Vanguard states that it will 'generally vote' against either the independent chair or lead independent director and members of the relevant committee if it considers they have failed to have 'adequately' responded to management or shareholder proposals that have received majority support at a prior year's shareholder meeting.
- Oversight failure.
  - Vanguard states that it may also vote against the relevant board committee chair to signal concern where the board committee has failed in its oversight of material risks under its purview. Where there has been a failure that does not fall under the purview of a specific board committee, a fund will 'generally vote' against the lead independent director or chair to signal concern.
  - Importantly, Vanguard makes clear that these 'material risks' may include 'material social and environmental risks, inclusive of climate change'.
  - When assessing climate risk oversight failure, Vanguard states that it will consider:

    > 'the materiality of the risk; the effectiveness of disclosures to enable the market to understand and price the risk; whether the company has disclosed business strategies including reasonable risk mitigation plans in the context of the anticipated regulatory requirements and changes in market activity in line with the Paris Agreement or subsequent agreements; and consideration for company-specific context, market regulations, and expectations. The fund will also consider the board's overall governance of and effective independent oversight of climate risk.'
- Lack of board diversity:
  - Nominating and/or governance committee chairs or other directors 'if needed' may also face an 'against' vote, if Vanguard considers the board is not making sufficient progress on board diversity and/or in 'addressing its board diversity-related disclosures'.
  - Vanguard's expectation is that boards should:

    > 'take action to reflect a board composition that is appropriately representative, relative to their markets and to the needs of their long-term strategies. Given that many boards still have an opportunity to increase diversity across different dimensions, such boards should demonstrate how they intend to continue making progress'.
  - In terms of disclosure, Vanguard's expectation is that companies disclose: a) directors' personal characteristics (eg self-identified race/ethnicity) either at an aggregate or individual director level; and b) director qualifications, skills and experience.

Stance on meeting format

- Vanguard will generally support proposals seeking to conduct hybrid or virtual meetings, provided that:
  - 'meeting procedures and requirements are disclosed ahead of a meeting'
  - 'a formal process is in place to allow shareholders to submit questions to the board'
  - 'real-time video footage is available and attendees can call into the meeting or send a recorded message'
- Vanguard makes clear that where a meeting is held entirely virtually, it is important that shareholder rights are not 'curtailed' eg by limiting the ability of shareholders to ask questions.

[Source: Harvard Law School Forum on Corporate Governance and Financial Regulation 26/01/2022]

In Brief | Why investors should ensure that their portfolio companies are conducting political engagement responsibly: PRI has released a white paper explaining the risk and putting forward principles to guide investors

[Sources: PRI media release 27/01/2022; Full text of the white paper: The investor case for responsible political engagement]

Regulators

Top Story | Cybersecurity and risk culture among APRA's top priorities for the year ahead

APRA has outlined its supervisory and policy priorities for the next 12 to 18 months. A high level summary of some of the regulator's key areas of focus and planned actions is below.

Key Takeouts

- Risk Culture: Rolling out the employee risk culture survey to 40 additional regulated entities' in the insurance and superannuation sectors is among the regulator's key priorities for 2022.
- Climate risk: APRA has flagged plans to roll out a cross-industry climate risk self-assessment to 90 entities (across APRA-regulated sectors) in H1 2022. The aim it to enable APRA to understand the alignment between entities' management of climate-relate financial risks, the guidance set out in CPG 229, and the recommendations of the Task Force on Climate-related Financial Disclosures
- Cyber risk:
  - APRA identifies improving cyber resilience as 'a key cross-industry supervision priority'. Over the next 12 months, APRA plans to: a) continue its CPS 234 Information Security independent compliance assessments of regulated entities (in tranches); b) continue its 'deep dive thematic reviews' at selected entities; c) collect 'cyber resilience data; and d) work with industry and government agencies to 'expand the cyber information sharing community and collaboration opportunities, thereby improving situational awareness'.
  - In addition, APRA flags and cyber resilience as a key area of focus in the private health insurance context.
- Modernising 'prudential architecture': APRA has said it will commence work toward this multi-year objective in 2022. This will involve APRA focussing (among other things) on how digitalisation could help support better and more adaptable regulation.

APRA's policy and supervisory priorities for the next 12-18 months

The Australian Prudential Regulation Authority (APRA) has released two information papers setting out its policy and supervision priorities for the next 12 to 18 months to enable regulated entities and other stakeholders to 'prepare and proactively engage' with the regulator on key priority areas.

APRA's priorities are underpinned three key outcomes, aligned to the regulator's long term strategy, namely: 1) ensuring resilient and prudently managed financial institutions; 2) promoting the stability of the Australian financial system; and 3) contributing to the community's ability to achieve good financial outcomes.

In addition, APRA has indicated its intention to commence work on its new multi-year objective of modernising the prudential architecture, consistent with its 2021-25 Corporate Plan.

A high level summary of some of APRA's key policy and supervisory priorities is below.

[Note: Annex B of the policies document is a table summarising the proposed actions/timelines for delivering APRA's policy objectives. Attachment A of the supervisory document is a table summarising APRA's supervisory activities and timelines.]

Modernising the prudential architecture

From a policy perspective, APRA's plans to commence a multi-year project to modernise the existing 'prudential architecture'. This work is expected to involve a focus on:

- 'Better regulation': For example, APRA plans to focus on ensuring prudential standards and guidance are easy to 'understand, find and navigate'. APRA also plans to explore how to 'embed and operationalise simpler requirements for smaller entities' to reduce regulatory burden as far as possible' as well as look to support effective board oversight through engaging with directors on 'ways to assist them in understanding their prudential obligations such as a comprehensive handbook or enhanced guidance'.
- Digitalisation: APRA will consider how digitalisation could help to support better and more adaptable regulation. In 2022, APRA plans to engage an advisory panel of experts and industry stakeholders, and explore the potential for suptech and regtech solutions with industry.

- Regulation of emerging risks – APRA will also continue to monitor emerging risks and consider their potential impact, from a regulatory perspective. On this point, APRA states that:

  …'there will be a need for innovation in regulation and new rules, such as the prudential treatment of crypto-assets under consideration by the Basel Committee on Banking Supervision. APRA is also monitoring the regulatory perimeter, to understand how the regulatory architecture will need to evolve to cater to new risks and new business models'.

APRA's primary focus this year will be on 'progressing initial steps and scoping the longer-term path ahead'. Looking forward to 2023-2025, APRA envisages launching a 'series of initiatives' to improve the accessibility and adaptability of APRA's prudential framework to ensure alignment with user needs.

APRA makes clear that it intends to 'engage closely and consult with industry' throughout the project as well as to learn from the approaches taken in other jurisdictions.

Cross industry policy and supervisory priorities

Contingency and resolution planning

Improving crisis preparedness remains a focus for APRA in 2022.

- Policy priorities: In late 2021, APRA consulted on draft Prudential Standard CPS 190 Financial Contingency Planning (CPS 190) and draft Prudential Standard CPS 900 Resolution Planning (CPS 900). APRA expects to finalise these standards in 2022 with a view to the standards taking effect from 2024 (with a one year transition period for RSE licensees to meet CPS 190). APRA also plans to develop guidance to support entities in meeting the new requirements in 2022.
- Supervisory priorities: APRA states that supervisory activity will 'focus on enhancing the maturity of financial contingency (recovery and exit) planning, and reducing the risk of disorderly failure'. APRA states that this will include both ensuring all APRA-regulated entities have recovery plans in place as well as 'increasing the quality' of plans 'to improve their credibility'. In addition, APRA flags that 'preparatory work on expectations for resolution planning under CPS 900' will be a priority for 2022.

Governance, Culture, Remuneration and Accountability (GCRA) remains a priority

Remuneration

- Policy priorities: CPS 511 Remuneration and the accompanying guidance take effect from 2023. APRA envisages that the new standard will be 'supported' by new reporting/disclosure requirements to 'promote transparency and accountability'. Finalisation of these new disclosure requirements is identified as a policy priority for the regulator in 2022. In terms of timing, APRA plans to consult on the new requirements in the first half of 2022 with a view to finalising them by the end of the year.
- Supervisory priorities: APRA is currently conducting a pre-implementation review of implementation of CPS 511 Remuneration across a 15 entities (5 entities per industry, superannuation, banking, insurance). No timeframe for completion is indicated.

Governance, Culture and Risk Management

- Policy priorities: APRA plans to conduct a review of its governance and risk management standards in 2023. APRA envisages that this review will consider 'how to improve' existing standards in a number of areas including: 'board and senior management roles and expectations, board obligations for risk culture, the relative emphasis on financial and non-financial risks, and requirements for compliance and audit'. In terms of timing, APRA's plans that the review of Prudential Standard CPS 510 Governance (CPS 510), Prudential Standard CPS 220 Risk Management (CPS 220), and the equivalent superannuation standards will commence in 2023. APRA does not envisage that the changes would come into effect until 2025.
- Supervisory priorities:
  - Following completion of a successful pilot with 10 general insurers in early 2021 and the subsequent roll-out of the employee risk culture survey to 18 of the largest ADIs in November 2021, APRA plans to roll out the survey to 'approximately 40 additional regulated entities' in the insurance and superannuation sectors. APRA plans to publish insights on the broader themes that emerge from the survey results and engage directly with entities to discuss how any issues identified through the survey will be addressed.
  - APRA plans to conduct 'risk culture "deep dives"' at a small number of large entities.

- APRA will also continue to assess entities' actions in response to risk governance self-assessments and regular prudential engagements. APRA states that this will include assessing whether 'issues that are currently resulting in capital overlays or enforceable undertakings have been resolved'

Supporting the (proposed) Financial Accountability Regime or FAR

- From a policy perspective, and assuming the passage of the legislation to establish the FAR regime (which will replace and expand on the existing BEAR), APRA identifies the following as policy priorities:
  - publication of a joint administration agreement (with ASIC) setting out principles for administering the new regime, as well as regulator rules and implementation guidance
  - APRA also plans to review Prudential Standard CPS 520 Fit and Proper (CPS 520) to ensure consistency with the FAR.
- From a supervisory perspective, APRA flags 'working with the Government and ASIC to establish and plan' for implementation of the planned FAR as a priority.

Operational risk management/resilience

- Policy priorities: From a policy perspective, APRA will focus on lifting standards of operational risk management.
  - In 2022, APRA plans to consult on 'enhanced requirements for operational risk management' including setting minimum expectations for 'systems, controls and remediation, business continuity and arrangements with third parties'.
  - New Prudential Standard CPS 230 Operational Risk Management (CPS 230) is 'expected' to come into effect from 2024. The new standard will replace existing requirements in Prudential Standard CPS 231 Outsourcing (CPS 231) and Prudential Standard CPS 232 Business Continuity Management (CPS 232), as well as the equivalent superannuation standards.
- Supervisory priorities: From a supervisory perspective, APRA will have a strong focus on the actions being taken by regulated entities to strengthen their operational resilience particularly in the context of oversight of third party service provision. APRA plans to:
  - monitor regulated entities' improvements in contingency planning, business continuity arrangements, and management and oversight of third-party providers;
  - develop a non-financial risk data collection in 2022 to provide data-driven insights and drive supervisory resource allocation.
  - APRA will also 'devote attention to changes in entities' operational risk and compliance profiles'. For example, changes resulting from regulatory reforms such as the ADI (Authorised Deposit-Taking Institution) transition from Advanced Measurement Approach (AMA) for Operational Risk Regulatory Capital to the Standardised Measurement Approach (SMA), entity driven transformation programs and/or merger and acquisition activity

Other cross industry supervisory priorities

Improving cyber resilience

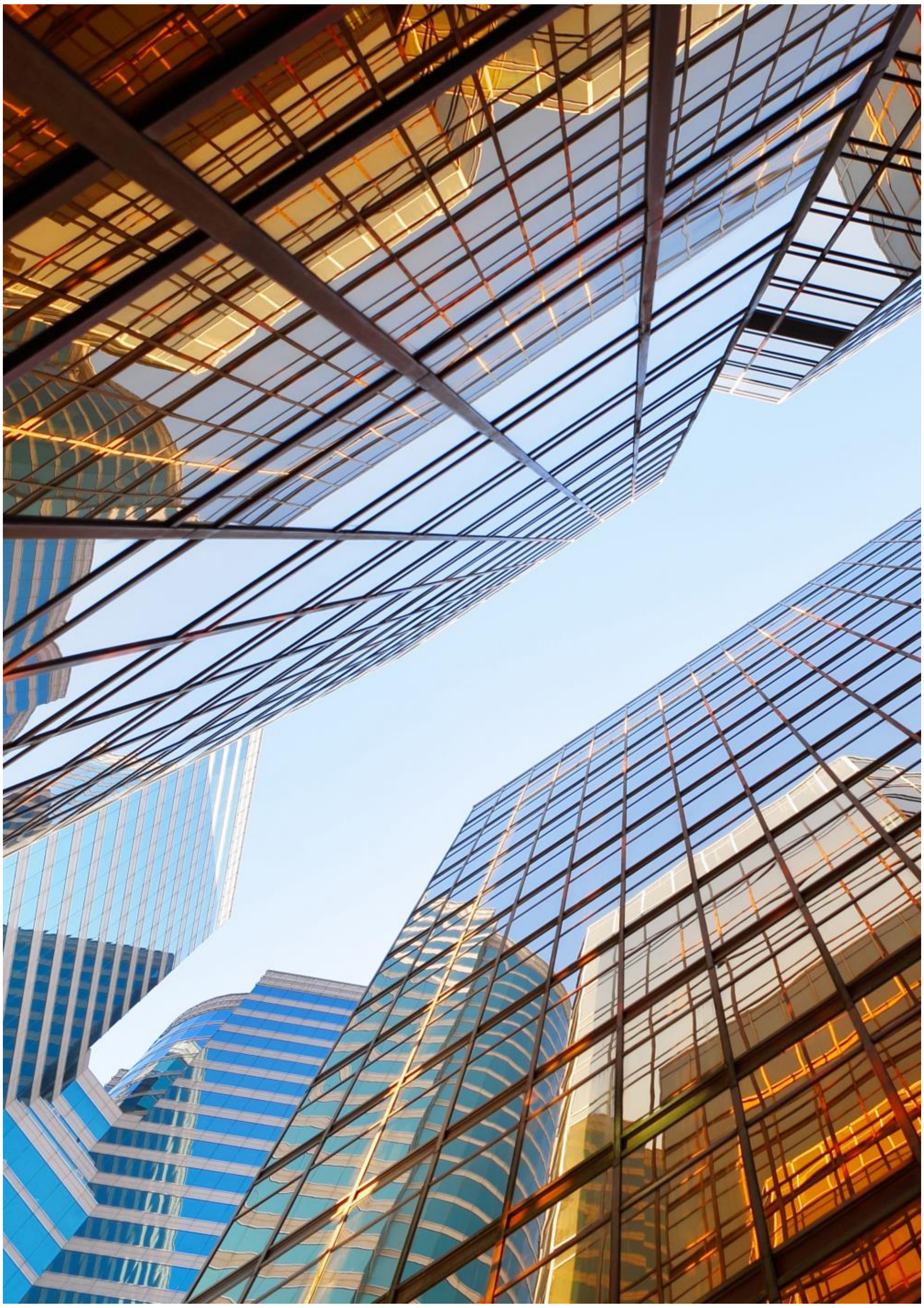
APRA identifies improving cyber resilience as 'a key cross-industry supervision priority'. Over the next 12 months, APRA plans to:

- continue its CPS 234 Information Security independent compliance assessments of regulated entities (in tranches) and share insights with industry
- continue its 'deep dive thematic reviews' at selected entities
- collect 'cyber resilience data, to improve APRA's ability to target supervisory activities and profile the industry for cross-industry insights'
- work with industry and government agencies to 'expand the cyber information sharing community and collaboration opportunities, thereby improving situational awareness'.

Climate-related financial risks

Following the finalisation of Prudential Practice Guide CPG 229 Climate Change Financial Risks APRA states that it 'will be seeking to develop additional tools to evaluate climate-related financial risks, and increasing its scrutiny of entities' progress in addressing the impact of climate risk'. In the 'near term' APRA's priorities include:

- Asking 'approximately 90 entities' to complete a climate-management self-assessment survey in H1 2022, to enable APRA to understand the alignment between their management of climate-related financial risks, the guidance set out in CPG 229, and the recommendations of the Task Force on Climate-related Financial Disclosures.
- Completion of the Climate Vulnerability Assessment (CVA) currently on foot.



Sector specific focus areas

APRA has also outlined specific policy and supervisory focus areas for the banking, insurance and superannuation sectors.

Banking sector

- From a policy perspective, APRA states that its key focus will be on implementation of the bank capital reforms including finalising guidance and progressing revisions to market risk standards. APRA is also reviewing the prudential standard for purchased payment facilities in the context of the recent payments system review and other recommendations. You can find a summary table of the proposed timeline for revisions to specific standards/guidance at p19 of the policy information paper.
- From a supervisory perspective, APRA states that there will be 'a strong focus on upgrading contingency and continuity frameworks in the banking industry, in addition to an ongoing focus on the areas of credit, capital and liquidity'.

Insurance sector

- From a policy perspective APRA's priorities for the three insurance industries (general, life and private health insurance) for 2022 are focused on the completion of reforms to the insurance capital standards, including AASB 17 and LAGIC updates and the capital standards for private health insurers (PHI). In 2023, APRA plans to review prudential requirements and guidance on insurance risk management. A summary table detailing the proposed timeline for revisions to specific standards/guidance is included at p20 of the policy information paper.
- From a supervisory perspective: APRA will focus on monitoring the steps being taken by insurers to address the 'availability, affordability and sustainability' challenge.

Further detail

General insurance

- APRA will continue the work commenced in 2021, examining the 'root causes' behind the uncertainty in the drafting/design of business interruption insurance (BI) with the aim of 'minimising the risk of similar issues manifesting in other product lines'. 3.2.1 Strengthening insurance risk management
- APRA will review and benchmark the results of the risk management self-assessments conducted by some insurers in the first half of 2022 and work with insurers to ensure any issues identified are addressed. APRA will also publish 'learnings and best practice'.
- Ensuring all general insurers have 'credible and robust recovery plans in place by the end of 2022' is also flagged as a priority.

Life insurance

- APRA states that the key supervisory focus is product sustainability, including 'on-going availability of suitable products and policyholder affordability'. This will include monitoring the individual disability income insurance (IDII) products released in late 2021.
- APRA will also continue to pay 'close attention to the areas of risk governance and data quality in life insurance'.
- Friendly societies: Over the first half of 2022 APRA plans to finalise its work on an APRA-led industry-wide stress test of friendly societies. In addition to completing the stress test, a review of risk management and governance practices will be undertaken.

Private Health Insurance

- APRA plans to continue to engage with industry to assess insurer strategies to respond to the challenges of affordability and increasing claims costs.
- APRA also flags operational and cyber resilience as a key area of focus in this sector. APRA states:

  > 'The PHI industry relies extensively on service providers to fulfil policyholder obligations and the collection of both financial and health data elevates the importance of matters such as information security. APRA is developing data collections covering these areas, to inform thematic reviews across a selection of insurers over the course of 2022. APRA will also continue to review the strength of relationships with systemic service providers to the PHI industry'.

- Prudent management of the 'unwinding' of the Deferred Claims Liability will also be a focus area.
- APRA will also continue to engage with industry and other government agencies to police insurers' commitment not to profit from COVID-19.

Superannuation sector

- From a policy perspective APRA states that it is focused on 'strengthening financial resilience in superannuation and improving outcomes for members'. You can find a summary table detailing the proposed timeline for revisions to specific standards/guidance at p20 of the policy information paper.
- From a supervisory perspective, APRA identifies two key objectives: a) 'rectifying sub-standard industry practices'; and b) 'eradicating unacceptable product performance'. Among other things, APRA plans to focus on: monitoring the extent to which RSE licensees have incorporated the Your Future Your Super obligations into decision making frameworks and business operations, preparation for the proposed Retirement Income Covenant and entities' 'readiness for the associated changes'.

[Sources: Information Paper: APRA's policy priorities 01/02/2022; Information Paper: APRA's supervisory priorities 01/02/2022]

GCRA risk: APRA's latest 'Year in Review' report recaps the steps APRA has taken to lift GCRA standards in 2021

The Australian Prudential Regulation Authority (APRA) has released its latest 'Year in Review' Report, recapping key actions taken by the regulator to progress key priorities and objectives under its corporate plan and outlining APRA's view on the broader financial environment.

Among other things, the report provides a recap of the measures implemented by the regulator to lift governance, risk culture, remuneration and accountability (GCRA) standards across industry in 2021.

GCRA highlights

Key GCRA measures highlighted in the report include the following.

- CPS 511: APRA identifies the release of CPS 511 Remuneration (summarised) as one of the 'significant milestones' achieved in 2021. Deputy Chair John Lonsdale commented:

    'As the Royal Commission made clear, poorly designed or implemented remuneration practices can incentivise behaviour that is harmful to consumers, and detrimental to long-term financial soundness. CPS 511 will impose genuine financial consequences on senior banking, insurance and superannuation executives when their decisions lead to poor risk management or conduct that is contrary to community expectations. It ensures financial performance alone is no longer enough when companies reward employees; companies must also consider their impact on customers and risk management outcomes. Where executives fall short, they now stand at risk of losing their bonus. We have been sensitive to minimising the regulatory burden on smaller institutions that typically make limited use of variable remuneration. The sharp end of CPS 511 is deliberately aimed at significant financial institutions (SFIs), where there is a heavier reliance on bonuses'.

- Follow up on 2018 risk governance self-assessments: In 2018, APRA requested that 36 regulated entities conduct a risk governance self-assessment against the findings in the final report from the CBA Inquiry (summarised) and provide it to APRA. In 2021, APRA followed up with the same entities to review their progress on implementation of actions to address issues identified through this process. APRA's follow-up review identified that:
    - many entities had implemented actions to raise the profile of non-financial risk management practices for example through establishing dedicated non-financial risk committees at the executive level, or the inclusion of non-financial risk as a standing agenda item at Board Risk Committee meetings
    - risk appetite statements have been revised to include non-financial risk metrics
    - material non-financial risks are captured on risk registers
    - there is 'increased ownership and accountability for both risk and compliance'. For example, was evident, frontline business units now identifying more risk issues than they had previously.
    - the banking sector has also made progress toward clarifying accountabilities (which APRA attributes to implementation of the Banking Executive Accountability Regime or BEAR)
    - awareness and focus on risk culture had increased though APRA considers that 'the approach of many entities towards risk culture would still benefit from further maturity through the use of more consistent methodologies, frameworks and a range of data sources'.

- GCRA is integrated into APRA's supervisory approach
    - APRA states that it has 'elevated the profile of GCRA in its Supervision Risk and Intensity model', with APRA supervisors now 'explicitly assessing GCRA-related risks when they determine the level of supervisory intensity applied to each regulated entity.
    - APRA states that supervisors are 'assisted' in this through APRA's new supervisory approach for assessing risk culture, the 'Risk Culture 10 Dimensions'.

- Roll out of APRA's risk culture survey: Following the successful pilot of an employee 'risk culture' in July 2021 (insights from the pilot survey summarised here), APRA sent the risk culture survey to the employees of 18 banks in October/November 2021. APRA intends to 'roll out the survey to a further 40 regulated entities across the insurance and superannuation sectors in 2022'. APRA considers that the information gathered through this process will be 'an important source of information for APRA, which is one of only a few regulatory bodies worldwide that directly collects survey data at an industry level'.

- Outlook for the coming year: Generally, APRA considers that industry has made/is making good progress but has flagged that the regulator is now focused on how changes are being embedded. APRA states that in the 'coming year' it will be 'looking for evidence that work on non-financial risks has shifted beyond design effectiveness to also ensure operating effectiveness, and that boards and senior management are being vigilant to ensure weaknesses do not re-emerge'.

    [Source: APRA 2021 Year in Review]

ASIC capability review: Submission calls for increased cooperation between the regulators to reduce unnecessary duplication and confusion

- The Financial Regulator Assessment Authority (FRAA) was established on 29 June 2021 by the Financial Regulator Assessment Authority Act 2021 in response to Hayne recommendations 6.13 and 6.14.
- Broadly, the FRAA is tasked with assessing and reporting on the effectiveness and capability of the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA).
- On 29 November 2021, the Treasurer announced the launch of FRAA's inaugural review of ASIC. As part of the review process, a consultation paper was released outlining the FRAA's planned approach to the ASIC Review and to future reviews. The paper also included 19 specific questions for feedback. The due date for submissions was 28 January 2022. You can find our overview here.

AIST submission

The Australian Institute of Superannuation Trustees' (AIST) submission expresses agreement that 'ASIC's approach to the industry is generally proactive, flexible and communicative' but suggests that 'ASIC's effectiveness and capability could be improved' in various respects.

In particular, the submission calls for:

- Greater cooperation/communication between ASIC and APRA to 'reduce regulatory overlap and duplication of administrative burdens on trustees'.
- The submission also calls on ASIC to be more specific and targeted in its information requests – calling for specific information in the first instance and then undertaking a further 'deep dive if required - and to take into account (as far as practicable) the timing of requests to improve efficiency for both the regulator and industry.
- The submission calls for ASIC and APRA to issue joint guidance, as early as is feasible, where there is interaction between regimes to clarify expectations and avoid unnecessary confusion. The submission points to the interaction between the product design and distribution regime and the member outcomes standard as one example of an instance in which earlier joint guidance could have reduced the regulatory burden on industry.
- The submission calls on ASIC and APRA to be more forthcoming on providing 'input on policy impasses and interpretations', again on the basis that earlier guidance from the regulators would 'reduce confusion and cost' for industry.
- The submission also expresses support for a suggestion put forward by Industry Fund Service as part of a separate consultation, that ASIC provide a 'private ruling service' to 'consult and obtain certainty ahead of releasing any potentially non-compliant services'. The submission argues that such a service would also support ASIC in 'delivering its vision to "promote strong and innovative development of the financial system"'.
- Finally, the submission calls for ASIC to make a concerted effort to 'embed technology neutrality as much as possible in the regulatory regime so as to limit the requirement to amend the regime to amend new technologies'.

[Source: AIST submission: ASIC Capability Review]

Financial Services

FAR Bill: APRA has outlined the preparatory steps being taken by the regulators in anticipation of the passage of the legislation

Context

- On 25 November 2021, the Senate referred the provisions of the Bills that would (if legislated) establish the Financial Accountability Regime (FAR) and the Compensation Scheme of Last Resort (CSLR) – the Financial Accountability Regime Bill 2021, Financial Sector Reform (Hayne Royal Commission Response No. 3) Bill 2021, Financial Services Compensation Scheme of Last Resort Levy Bill 2021 and the Financial Services Compensation Scheme of Last Resort Levy (Collection) Bill 2021 - to the Economics Legislation Committee for inquiry and report by 15 February 2022. You can find our overview of the proposed FAR here. You can find our overview of the proposed CSLR in Governance News 03/11/2021 at p25
- The Committee held a public hearing on 27 January 2022. When a transcript of the hearing is released, you will be able to access it here.

APRA's opening statement

In his brief opening statement, Australian Prudential Regulation Authority (APRA) Executive Director Sean Carmody briefly outlined the steps APRA has taken to prepare for the implementation of the FAR (assuming the passage of the legislation), and insights into APRA's experience of the existing Banking Executive Accountability Regime (BEAR).

The Committee heard that:

BEAR has been/is an effective tool in terms of lifting GCRA standards

- APRA considers the BEAR to 'a key regulatory lever for APRA to drive action by ADIs through the identified accountable persons and to transform governance, risk culture, remuneration and accountability outcomes across the banking industry'. Further, 'APRA uses the BEAR in its day-to-day supervision to influence preventative or remedial action to be taken by ADIs and accountable persons well before there is a threat to the ADIs' financial viability'.
- APRA has observed 'positive outcomes from the BEAR' and supports the proposed expansion of the regime from 143 ADIs to 435 APRA-regulated entities.

Preparation for the commencement of the FAR

- Joint administration framework and infrastructure: In light of the fact that the proposed FAR will be jointly administered by APRA and the Australian Securities and Investments Commission (ASIC), the regulators have commenced work on the development of 'the joint administration framework and infrastructure' for the FAR, in anticipation of the passage of the legislation.
- The JAA will cover oversight of FAR arrangements, exercise of powers, industry communication, information sharing and enforcement and investigations.
- APRA's submission to the inquiry provides more detail around the JAA. According to the submission the framework will:
  - clarify and define the roles/responsibilities of each of the regulators;
  - ensure appropriate resourcing is in place for ongoing coordination/interaction between the regulators and that training/support is provided to supervisors
- Industry communication and guidance will also be published to support compliance
- The Regulators are also developing a 'single point of contact for engagement for entities in relation to the FAR'. APRA states that this 'single portal — which will use APRA's new data collection system, :"APRA Connect" — will avoid the need for entities to report to APRA and ASIC separately'.

[Sources: Sean Carmody, APRA Executive Director Opening Statement to the Senate Economics Legislation Committee's Inquiry into the Financial Accountability Regime Bill 27/01/2022; APRA's submission to the Committee]

FSC submission on draft FFSP Bill: Treasury Laws Amendment (Measures for Consultation) Bill 2021: Licensing exemptions for foreign financial services providers

- Over the Christmas break, the government completed a short consultation on its plans for the new regime for Foreign Financial Service Providers (FFSPs) in the form of the Exposure Draft legislation: Treasury Laws Amendment (Measures for Consultation) Bill 2021: Licensing exemptions for foreign financial services providers. Submissions closed on 12 January 2022.
- You can find our summary of the proposed reforms here. The full text of MinterEllison's submission to the consultation is here.

Financial Services Council is broadly supportive of the proposed changes

The Financial Services Council's (FSC) submission is broadly supportive of the proposed reforms.

However, the submission does raise four issues of concern. These are outlined briefly below.

1. The FSC considers that there is a 'lack of clarity' around how the proposed notification process will work in practice

- The FSC observes that under the draft Bill, a person wishing to rely on the exemption under s911A(2)(eo) or (ep) in relation to a financial service would be required to notify the Australian Securities and Investments Commission (ASIC) that they wish to rely on the exemption 'as soon as practicable, and before the 15th business day, after the first time (the start time) after the commencement of this section that the person starts to provide the financial service' using the a form prescribed by ASIC.
- The submission suggests that some examples of what 'starting to provide' the financial service means would be 'useful in this context'.
- This submission also calls for more detail around the information to be included on the approved form and the way in which 'it is envisaged it can be delivered to ASIC'.

2. Inclusion of three additional jurisdictions

- The submission expresses agreement that 'the initial list of recognised regulators should be the jurisdictions that have already been assessed by ASIC as being sufficiently equivalent to the Australian regulatory regime for the regulation of financial services'.
- However, in addition, the submission calls for 'sufficient equivalence' be extended to the following three additional jurisdictions all of which are Board members of IOSCO (not just members of IOSCO).
  - Swiss entities which are banks or securities brokers regulated by the Swiss Financial Markets Supervisory Authority (FINMA)
  - Chinese entities which are registered as private investment fund managers with the Asset Management Association of China (AMAC)
  - Japanese entities which are overseen by the Financial Services Agency of Japan. The FSC suggests that the inclusion of Japan is further justified as it is also part of the Asian Regional Funds Passport.

3. Fit and proper person exemption

- The FSC considers that the proposed fit and proper person test exemption that would apply to FFSPs that are authorised, registered or licensed by a comparable regulator and only provide financial services to wholesale clients, should be broadened to include controlled entities of the applicant.
- The FSC considers this is justified because

  > 'the relevant financial business will comprise several group entities and it would not make sense to exempt only the "person" applying when in fact several other subsidiaries of the group may be providing financial services and employing relevant personnel that would need to provide extensive documentation which continues to be very time consuming and costly to obtain'.

- The submission also calls for 'consideration' to begiven 'to making the fit and proper person test materially less burdensome for APRA-regulated entities'. The submission states that:

> 'the FSC recommends that appropriate consideration be given to materially reducing the impact of the fit and proper test on APRA-regulated entities to ensure a level playing field between FFSPs and Australian APRA-regulated businesses. Our concern is that Australian businesses regulated by APRA will be required to comply with a time consuming - and at times very difficult and inefficient process - in circumstances where competitors regulated outside Australia would not'.

4. Clarity around transition arrangements

The submission calls for more clarity around transition arrangements including certainty around

- existing licence applications (ie 'certainty' for FFSPs that may have already commenced the application process for a foreign financial services licence
- more certainty around 'anticipated effective dates for the implementation of the new regime'
- more detailed information around transitional arrangements for the replacement of the current professional investor exemption with the new professional investor exemption. The FSC comments that this is necessary as

> 'FFSPs relying on the current exemption will no longer be exempt unless they take the significant steps required to have the benefit of the new professional investor exemption (lodging a notice with ASIC, notifying clients, etc)'.

[Source: FSC submission: Treasury Laws Amendment (Measures for Consultation) Bill 2021: Licensing exemptions for foreign financial services providers]

Consumer groups have urged ASIC to proceed with proposed product intervention orders

- Consumer groups and financial counsellors have called on the Australian Securities and Investments Commission (ASIC) proceed with proposed product intervention orders aimed at banning the use of certain 'harmful lending models' employed by Cigno.

  [Note: For context, ASIC recently concluded its consultation (CP 355) (summarised) on two proposed product intervention orders, the first targeted at banning certain short term lending arrangements and the second targeting certain continuing credit arrangements.]

- Acting Director of Casework at Financial Rights Legal Centre Amy Knox commented:

> 'The interventions proposed by ASIC will reduce the number of truly shocking examples of exploitation we see at our Centre, including people being charged unjustifiable fees and chased for amounts vastly in excess of the amount borrowed – we have seen cases of more than $1000 being sought to repay a $150 loan…ASIC's intervention to shut down these exploitative and predatory lending models is urgently needed.'

- Representatives from the Consumer Action Law Centre and Financial Counselling Australia also expressed strong support for ASIC proceeding with its proposals for similar reasons.

[Source: Financial Rights Legal Centre media release 24/01/2022]

ASIC is consulting on proposals to remake relief for business introduction services

The Australian Securities and Investments Commission (ASIC) has released a consultation paper - Consultation Paper 357 Remaking relief for business introduction services: ASIC Instrument 2017/186 (CP 357) – setting out its proposed approach to remaking, with amendments, relief for business introduction services under ASIC Corporations (Repeal and Transitional) Instrument 2017/186 (ASIC Instrument 2017/186).

The relief is otherwise due to expire on 1 April 2022.

Broadly, ASIC proposes to:

- extend the relief for interests in managed investment schemes to 1 April 2025. ASIC states that it considers

> 'the relief for scheme interests continues to form a necessary and useful part of the legislative framework for managed investment schemes, particularly as these entities recover from the impact of the COVID-19 pandemic'.

- amend the relief to update and clarify that the design and distribution obligations apply to business introduction services

- require persons who rely or cease to rely on the relief from 1 April 2022 to provide notice to ASIC
- allow the relief for Ch 6D securities to expire. ASIC considers this is appropriate 'because of the overlap with the crowd-sourced funding (CSF) regime, which came into effect in September 2017 for eligible public companies and October 2018 for eligible proprietary companies. The CSF regime also facilitates flexible and low-cost access to capital for small to medium sized unlisted companies and provides adequate protections for retail investors'.

ASIC is seeking feedback on CP 357 from all interested stakeholders including industry and consumers. The due date for submissions is 15 February 2022.

> [Sources: ASIC media release 25/01/2022; Consultation Paper 357 Remaking relief for business introduction services: ASIC Instrument 2017/186 (CP 357)]

Big four bank rolls out ESG training for bankers

- Westpac has announced that commencing in February 2022, 800 employees working in its business banking, institutional banking and risk business will receive ESG training.
- Chief Executive of Westpac Institutional Bank, Anthony Miller said that the training is aimed at equipping bankers to better support customers in their own net zero transition pathway.

  > 'Investing in education, so our bankers have a deeper knowledge of risks and opportunities in different industries, ensures our customers get the best support as the economy transitions to net zero. Our Australian corporate and SME customers have told us they value the help we can provide in this space, particularly small to medium enterprises and those at the start of their transition journeys'

- The training program has been designed in partnership with Monash Sustainable Development Institute and ClimateWorks Australia.

> [Source: Westpac media release 25/01/2022]

AFCA confirms pause on progressing complaints brought against Dixon Advisory and Superannuation Services

- The Australian Financial Complaints Authority (AFCA) has confirmed that as a result of Dixon Advisory and Superannuation Services Pty Limited (Dixon) having been placed into Voluntary Administration, AFCA has paused progress on all complaints against Dixon.
- AFCA states that it will review the pause on complaints against Dixon when the outcome of the administration process is known.
- AFCA explained that this is in line with AFCA's policy for handling of complaints involving insolvent firms, the rationale being that 'we don't wish to put people through the complaints process when there may be no prospect of compensation being paid by the firm because of insolvency'.

> [Source: AFCA media release 21/01/2022]

Risk Management

Rio Tinto releases external review into workplace culture, commits to implement all recommendations

Rio Tinto has released in full, an external review into its workplace culture – Everyday Respect at Work Report - which was commissioned by the company 'as part of its commitment to ensure sustained cultural change across its global operations'. The review was led by former Australian sex discrimination commissioner Elizabeth Broderick.

Some key findings

- Key findings include the following:
  - Bullying and sexism are 'systemic' across Rio Tinto worksites with bullying experienced by almost half of survey respondents
  - 28.2% of women and 6.7% of men have experienced sexual harassment at work
  - 21 women reported actual or attempted rape or sexual assault
  - 39.8% of men and 31.8% of women who identify as Aboriginal or Torres Strait Islander in Australia experienced racism
- The report also identified that there is a perception among employees that everyday harmful behaviours (eg racism and sexism) are 'tolerated or normalised'. For example:
  - 'Employees do not believe that the organisation is psychologically safe which impacts on their trust in the reporting systems'.
  - 'Employees believe that there is little accountability, particularly for senior leaders and so called "high performers", who are perceived to avoid significant consequences for harmful behaviour'.
  - 'Harmful behaviour by serial perpetrators is often an open secret'.

For context, the findings in the report are based on a voluntary global online employee survey, a series of group and one-on-one listening sessions, written submissions from individual employees, as well as a review of Rio Tinto documents and group leadership team briefings and meetings. Participation was voluntary and confidential.

A 'strong desire' for change

Importantly, the report also commends the company for the steps toward cultural change that have occurred over the last twelve months and for its commitment (including at senior leadership levels) to change. The report comments that:

> 'While Rio Tinto has begun a reform journey…it is only at an early stage along this path. Though confronting, these findings are not exclusive to Rio Tinto, nor reason for reduced confidence in the organisation. Rather, the findings provide a foundation for a stronger organisation in which all employees feel safe and able to thrive'.

Commenting on the report, Ms Broderick appeared to underline these points stating:

> 'This report is not a reason for reduced confidence in Rio Tinto. By proactively commissioning this study, one of the largest of its kind within the resources industry, it demonstrates a very clear commitment to increased transparency, accountability and action. The high levels of confidence among employees that a significant impact can be made in the next two years are an encouraging sign that change can happen. In my interactions with the Rio Tinto leadership team, I have observed a strong desire for transformational change, as well as to make positive contributions to the societal shifts that we need to see. There is clear recognition, however, that new approaches are needed to solve these issues.'

Recommendations

The report recommends the adoption of a principle-based 'framework for action' to address the issues identified, backed by 26 specific recommendations for change, all of which the company has committed to implement.

This framework is based on five 'principles' including both: a) 'caring courageous and curious leadership'; b) a commitment to 'creating a positive onus to prevent bullying, sexual harassment, racism and all forms of discrimination'; and b) 'embedding, sustaining, monitoring and evaluating progress of cultural reform'.

A table summarising the recommendations and the rationale behind them can be found at p77 of the report here.

Key recommendations include the following.

'Caring, courageous and curious leadership'

From a leadership perspective, the report recommends, among other things that:

- The Rio Tinto Board, CEO and ExCo oversee and monitor progress toward implementation of the recommendations (Recommendation A1)
- CEO and ExCo provide to employees a signed statement that: 'commits to a safe and inclusive workplace, including addressing sexual harassment, bullying, racism and other forms of discrimination in the workplace; outlines the case for change and their commitment to implement the recommendations in this report; and includes their personal reflections on stories contained in this report' (Recommendation A2)
- Leaders at all levels are aware of their responsibility to prevent and manage harmful workplace behaviours and that they are held to account should they 'fail to take appropriate action in relation to reported harmful behaviour' (A3)

A focus on prevention

In terms of 'creating a positive onus to prevent bullying, sexual harassment, racism and all forms of discrimination' the report recommends (among other actions) that the company:

- develop an make readily available to all employees, an 'everyday respect global policy and principles' including 'practical guides contextualised to local requirements and assistance available', and based on best practice aligned with Rio's values and code of conduct (Recommendation B1)
- extending the company's existing strong focus on safety and risk minimisation to include the prevention of harmful behaviours by using the company's risk assessment, management and controls processes to capture hazards and risks associated with harmful behaviour as safety risks, including risks to psychological safety (B2)
- roll out training to: a) raise awareness of the nature and impacts of harmful behaviours eg bullying, sexual harassment, racism and other forms of discrimination; b) 'focus on prevention, responses and the role of the active bystander/upstander'; and c) encourage the reporting of harmful behaviour and reinforce options available for support (B3)
- Establish a 'panel of mentors from diverse backgrounds' to support trainees, apprentices and graduates (B6)
- 'Conduct probity checks on candidates for prior harmful behaviour who are seeking re-employment. Where a candidate has been found to have previously been exited for harmful behaviour an assessment of their capacity to return to the organisation should be conducted' (B7).

Support for those who report harmful behaviours

A number of recommendations focus on improving the company's response to reports of harmful behaviours. For example, the report recommends that:

- A 'discrete unit' should be established to provide 'support and guidance to people experiencing harmful behaviour' and to offer 'early intervention strategies and guidance' (Recommendation C1)
- Any investigation into 'harmful behaviour' would be undertaken through a trauma informed approach and conducted 'in partnership' with this unit's case managers (C2)

'Embedding reform'

The report also includes a number of recommendations around monitoring progress towards implementing the recommendations and 'embedding reform'. These include:

- That the existing Everyday Respect Taskforce should drive and design the implementation of the recommendations in partnership with the Product Groups and Functions (Recommendation E1) as well as track and report quarterly to the board and ExCo on progress against key indicators (Recommendation E2)
- That the online survey should be re-administered to employees every two to three years, through an independent provider, to track progress (Recommendation E3)
- That an independent review of progress towards implementation of the recommendation should be undertaken within two years.

Rio Tinto has committed to implement all report recommendations

In a statement, Rio Tinto CEO Jakon Stausholm expressed regret at the extent of the issues identified in the report, thanked employees for their participation and apologised to those impacted by the harmful behaviours identified. He stated:

> 'The findings of this report are deeply disturbing to me and should be to everyone who reads them. I offer my heartfelt apology to every team member, past or present, who has suffered as a result of these behaviours. This is not the kind of company we want to be. I feel shame and enormous regret to have learned the extent to which bullying, sexual harassment and racism are happening at Rio Tinto'.

Mr Stausholm also emphasised the company's commitment to change. He states:

> 'I am determined that by implementing appropriate actions to address the recommendations, and with the management team's commitment to a safe, respectful and inclusive Rio Tinto in all areas, we will make positive and lasting change and strengthen our workplace culture for the long term'.

The statement makes clear that Rio Tinto will implement all recommendations from the report, with particular focus on the following three key areas:

- 'commitment from the company's leadership to create safe, respectful and inclusive working environments to prevent harmful behaviours and better support people in vulnerable situations. This includes increasing diversity within the company.
- Ensuring the company's camp and village facilities are safe and inclusive. This includes making sure the company is applying the same safety and risk processes that it uses to prevent harm in operations to create a safe environment for all employees and contractors.
- Making it as easy and as safe as possible for all people to call out unacceptable behaviours, highlight issues when they happen and receive support. This includes introducing early intervention options and improving how the company responds to formal complaints in the workplace'.

The ACCR has welcomed the release of the full report

In a statement, the Australasian Centre for Corporate Responsibility (ACCR) commended the company for its decision to release the report in full. ACCR Executive Director Brynn O'Brien stated:

> 'ACCR welcomes Rio Tinto's transparency through the publication of this report in full. Leadership and accountability at all levels is required to eliminate unacceptable cultures of racism, sexism and bullying from our workplaces. Rio has taken the first step and is leading the mining industry with this report. We welcome that'.

[Sources: Rio Tinto: Everyday Respect at Work Report 01/02/2022; ACCR media release 01/02/2022]

In Brief | In Brief | Governance Review: ASIC has released a slide pack highlighting the key findings from a review of specific aspects of the governance practices of 10 large responsible entities. This includes (among other things) insights into board composition, director tenure, board performance reviews and skills assessments and board oversight practices. The report also includes a number of questions 'for consideration' on each of the governance topics discussed

[Source: Governance of responsible entities January 2022]

Other News

Treasurer welcomes BHP's decision to consolidate the company's dual-listed company structure into a single entity listed on the ASX

- Treasurer Josh Frydenberg has released a statement welcoming BHP's decision to consolidate the company's dual-listed company structure into a single entity listed on the Australian Securities Exchange (ASX) on the basis that it will 'enable BHP to continue to make a significant contribution to Australia's economy while operating in a number of other jurisdictions'.
- Mr Frydenberg observed that as part of the regulatory approval, enforceable conditions have been imposed on the company 'to ensure BHP's unification would not be contrary to Australia's national interest'. These conditions include that:
  - BHP remains an Australian resident company, incorporated under the Corporations Act 2001 and listed on the Australian Securities Exchange;
  - the company is headquartered in Australia and this is 'publicly acknowledged…in significant public announcements'
  - the CEO has their principal place of residence and principal office in Australia
  - the majority of board meetings are held in Australia
- Mr Frydenberg commented that the conditions are consistent with those imposed by former Treasurer Peter Costello in 2001, when the merger of BHP Limited and Billiton Plc was approved.

[Source: Treasurer Josh Frydenberg media release 27/01/2022]

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