Governance News

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

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Contents

Remuneration

'Everyone wins a prize': Key takeaways from ACSI's latest CEO pay report

ACSI's latest annual report into ASX 200 CEO pay trends flags that while companies are exercising more restraint, there is 'still an everyone wins a prize' attitude to awarding bonuses in some parts of the market.

Key Takeouts

- ACSI found that average realised pay (ie take home pay) for ASX 100 CEOs has fallen to its lowest level ($5.5 million) since ACSI has been collecting data. To put this in context, this is 55 times more than what the typical worker earns
- The report highlights a considerable gap between what CEOs of US headquartered companies are paid vs Australia-based CEOs - $11.1 million vs $4.2 million.
- ACSI considers bonuses have 'normalised' following what it terms 'the catch up period' after the pandemic, with the median bonus outcome for ASX 100 CEOs falling from 76.7% to 71% of the potential maximum (which is in line with pre-pandemic levels).
- ACSI raises concerns about what it terms the 'everyone wins a prize' mentality in boardrooms when it comes to awarding bonuses. The report flags that only one CEO in the sample did not receive a bonus (and in that case, the CEO received a retention equity allocation which (if it vests) will be worth approximately $4.45m).
- ACSI has cautioned it will be looking closely at bonuses this year stating that it is unlikely to support bonuses where performance hurdles have been lowered to reflect more challenging conditions.

The Australian Council of Superannuation Investors (ACSI) has released its latest annual report into CEO pay trends at ASX 200 companies.

Overall, ASX 100 CEO pay is down

According to the report:

- Average realised pay for ASX100 CEOs fell to a nine year low of $5,266,905 (down from $9,148,961 in 2021).
- Median realised pay for the ASX100 CEO in 2022 fell to a ten year low of $3,931,362

ACSI observes that this 'follows the trend of new CEOs coming in at lower pay levels than their predecessors'. ACSI CEO Louise Davidson suggests that it also 'shows that boards, and their investors, are applying greater scrutiny to CEO pay in Australian companies'.

ASX 101-200 pay increased on last year

The report also found that realised pay in smaller companies (ASX 101-200) increased on last year – average realised pay in 2022 was $2,700,961 (up from $2,450,609 in 2021)

Cash payments

- Across the ASX 100, median cash pay for ASX 100 CEOs was $2.77m (down 1.1% on the previous period).
- For context, according to ACSI CEO cash pay median for the ASX100 has been between $2.5mn and $3mn over the past 15 years. The only exception to this was during the pandemic when it fell to $1.98m (the lowest level since FY 03).

'Restraint' on bonuses

Bonuses continue to be awarded more often than not:

- ACSI found that the median bonus awarded as a proportion of maximum fell from the 2021 'record' of 76.7% to 71% (which ACSI observes is more in line with pre-pandemic years)
- Only one ASX 100 CEO did not receive a bonus though the CEO in question did receive a retention equity allocation in FY22 which (at current share prices) is estimated to be worth $4.45m (if it vests).

- ACSI has flagged concerns about what it terms an 'everyone get a prize' mentality in some boardrooms when it comes to awarding bonuses. ACSI's Executive Manager, Stewardship Ed John commented:

> 'It is good to see more restraint on executive pay in Australian companies over the past year but there is still an "everyone wins a prize" attitude in some parts of the market. Investors look for any bonuses paid to executives to be linked to the delivery of value to shareholders over the long-term…Investors will be watching closely as reporting season gets under way and we see the numbers for 2023. It has been a choppy year for investors in many companies – boards will need to consider performance carefully when deciding on remuneration this year. If performance is down in 2023, we expect to see bonuses follow. We don't want to see companies changing the goalposts when they have a bad year'.

Pay gap between US-based vs Australian CEOs

The report highlights that the CEOs of US based companies are paid considerably more than the CEOs of Australia-based companies. According to the report, the average realised pay for the 11 foreign domiciled company CEOs in the ASX200 was $11.1 million vs an average of $4.17m for the 159 local CEOs.

ACSI attributes this to 'the positive influence' of Australian investors:

> 'The positive influence of Australian investors is illustrated by the fact boards have applied greater restraint compared to companies based in the US and other markets'.

[Sources: ACSI media release 13/07/2023; Full text report: CEO pay in ASX 200 companies]

Markets and Exchanges

CHESS update: ASIC to host industry roundtable, directs ASX to establish industry advisory group

To help address 'longstanding industry concerns over the adequacy of ASX's stakeholder engagement and governance' with respect to the CHESS replacement project, and to help get the project 'back on track', the Australian Securities and Investment Commission (ASIC) has:

- requested that ASX establish an independently chaired, industry advisory group to advise on 'significant strategic clearing and settlement issues relating to cash equities trading in Australian markets with a focus on CHESS replacement'
- announced it will hold an industry roundtable, to be Chaired by ASIC Chair Joe Longo, on 2 August 2023. ASIC has said that 'more than twelve industry leaders' from different stakeholder sectors and fields of expertise have been invited to attend.

Announcing this, Mr Longo commented:

> 'ASX's effective engagement with industry is an urgent issue that must be resolved in order for the overall project to get back on track…The establishment of an appropriate stakeholder advisory group for cash equity clearing and settlement matters is critical to the restoration of confidence in ASX's decision-making and culture…It is vital that ASX gets its stakeholder engagement on the CHESS replacement right. Ultimately all parties, including ASX, will need to be committed to genuine collaboration and consultation and to the success of an advisory body. The industry now has the opportunity to be part of that solution, and it is in the national interest to do so.'

[Source: ASIC media release 14/07/2023]

ESG

Top Story | ACCC outlines what businesses need to do to avoid greenwashing in new draft guidance

The ACCC has released updated and more detailed draft guidance for business on what it considers they need to do to avoid greenwashing, in line with existing legal requirements. Here's what you need to know.

Key Takeouts

- Greenwashing occurs when an organisation misrepresents (either expressly or impliedly) its sustainability related risks, business credentials, strategies or those of its products or services. Greenwashing distorts information that consumers need in order to make informed decisions.
- Tackling the issue has been identified as a key priority by both the Australian Competition and Consumer Commission (ACCC) and the Australian Securities and Investments Commission (ASIC). The issue is also the focus of a current senate inquiry.
- Ahead of the expected introduction of mandatory ISSB-aligned climate disclosure requirements next year, and ahead of the release of the Senate greenwashing inquiry's final report, the ACCC is seeking feedback on updated and more detailed draft guidance on what it considers businesses need to do to avoid making unintentionally misleading or deceptive sustainability-related claims.
- The draft guidance is structured around eight principles, supported by illustrative examples and commentary from the regulator around what it considers to be 'good practice'. The guidance is informed by the findings of the recent greenwashing internet sweep which revealed widespread greenwashing concerns (see: ACCC internet sweep reveals 'widespread' greenwashing concerns - Insight - MinterEllison)
- Various industry groups have been calling for additional guidance to provide increased certainty for business. For example several submissions to the current senate greenwashing inquiry (eg submissions from the AICD, APPEA, BCA) have called for additional guidance.
- Consultation on the draft guidance is now open and will close on 15 September 2023.
- The ACCC plans to consult separately on sector-specific guidance 'soon'.

ACCC consults on updated draft guidance

Following the ACCC's recent greenwashing internet sweep (summarised) which revealed that a significant proportion of businesses – 57% of businesses reviewed - had made concerning claims about their environmental credentials, the ACCC is seeking feedback on updated (draft) guidance on how businesses can avoid making unintentionally misleading or deceptive sustainability-related claims.

Broadly, the updated draft guidance sets out the ACCC's view of what businesses need to do when making sustainability-related claims, including eight principles it suggests adopting to help businesses comply with obligations under the Australian Consumer Law (ACL) (contained in Schedule 2 of the Competition and Consumer Act 2010 (Cth)) as well as its expectations for good practice when making these claims.

The aim is to clarify regulatory expectations and in doing so, increase business confidence in making legitimate environmental and sustainability claims.

The draft guidance, which appears to take a similar approach to the guidance from the UK Competition and Markets Authority (CMA), is a significant update to the ACCC's existing (less detailed) 2011 guide. Consultation on the draft guidance is now open and closes on 15 September 2023.

What's in the guide: Eight principles for business to apply in order to avoid greenwashing

As flagged, the guidance is structured around the following eight principles, supported by illustrative examples and commentary from the ACCC around what it considers to be 'good practice'.

1. 'Make accurate and truthful claims'

Sustainability claims should be 'accurate, true and factually correct'. That is, claims must:

- **be accurate and truthful overall.** The draft guidance makes clear that it is not enough for claims to be only 'partially' true: For example, the guidance suggests that a claim that paper is 'made of recycled materials' when it only contains 20% recycled material is likely to contravene the ACL.
- **not overstate/exaggerate the extent to which the claim is supported by credible, scientific research/evidence.** For example a claim that plastic boxes 'biodegrade faster than the leaves in your backyard' (without qualification or explanation) is likely to be misleading because the rate at which plastic biodegrades is not well-established or 'universally accepted' scientific fact. Rather the claim is based on the findings of a single, limited study. The ACCC suggests that in order to avoid contravening the ACL in this case, the business 'could instead advertise that the boxes biodegrade and specify the circumstances where this will happen'
- **'exaggerate an environmental benefit or understate an environmental harm'.** The draft guidance suggests that to reduce the risk of misleading consumers businesses should be specific about the environmental benefit of the product or service being offered. For example, businesses should explain whether the benefit applies to the whole product/service or only part of it and quantify the benefit achieved. The draft guidance also encourages businesses to avoid both:
  - stating that the product/service has an overall 'positive' effect; and/or
  - 'making claims about your product or service that are based on broad scientific opinion if you are unsure whether there is evidence that this applies to your situation'.
- **be 'meaningful':** The draft guidance advises against making claims that a product/service has a specific environmental benefit where either: all similar products or businesses have the same feature; or the claimed environmental benefit is not because of 'something special' the business is doing but a legal requirement (and this is not made clear). The ACCC comments that 'while these claims may be literally true, they are likely to mislead consumers into believing that what is being advertised is special, when it is a necessary or ordinary feature'.
- **use 'fair and transparent' comparisons (where comparisons are used):** Where comparisons between products/services are used, the draft guidance advises businesses to ensure that they are 'transparent and fair, and are a true reflection of the impact of the products, services, or businesses being compared'. For example, the draft guidance suggests that where used, comparisons should:
  - make it clear to consumers what is being compared
  - be 'like for like'
  - use up to date information
  - 'compare features that are verifiable and significant' and compare features using the same method/standard
  - explain how the comparison has been made and ensure this is easy for consumers to understand
  - not omit relevant information.
- **third party products:** The ACCC expects that businesses take reasonable steps to ensure any environmental claims made when supplying products from a third party are accurate and truthful.

Forward looking statements

The draft guidance also emphasises that statements about the future – eg net zero targets and transition plans– will be deemed to be misleading, unless the business making the claim has reasonable grounds at the time of making the claim.

The ACCC considers that before setting and publicly announcing environmental goals it is 'good practice' for business to (among other things):

- ensure the goals set are clear and achievable, and that 'realistic and verifiable steps' have been put in place to achieve them
- ensure targets/goals set are based on 'accepted methodologies, and resources and technologies that are effective and are available to you now (or there is a reasonable basis to consider they will be available to you in the near future)'
- provide consumers with regular progress updates including 'disclosing if you are not on track to achieve them and what steps you are taking to address any setbacks so as to meet your goals'
- revise goals if they cannot be met.

2. ‘Have evidence to back up your claims’

Businesses are expected to be able to back up their claims with research, data or other evidence. Summing up this principle, ACCC Chair Gina Cass-Gottlieb cautioned: ‘If you don’t have the evidence to back up your claims, you are likely to mislead consumers and contravene the ACL’.

The ACCC considers it is ‘good practice’ for business to be able to substantiate any environmental claims with ‘clear evidence’. Independent scientific evidence is considered to be the most credible.

Where a third party certification scheme is used to back up a claim, businesses are advised to ensure that:

- the certification scheme is ‘independent, transparent, reputable, and robust’; and
- the certification ‘adequately reflects the characteristics of your product, service, or business’
- ‘your claims accurately reflect what you have been certified for, and the scope of certification’.

It’s also suggested that businesses offer consumers details of further information on the scheme or direct them to where they can access this information.

3. ‘Don’t leave out or hide important information’

The draft guidance makes clear that omitting relevant information may also be misleading because only including positive information can ‘give consumers the impression that your business, product, or service has a lower environmental impact overall than it really does’.

Don’t rely on disclaimers/qualifications in ‘small print’

The ACCC notes any information in ‘small print’ must ‘not conflict with the overall message’ of the claim being made. As such, the draft guidance cautions businesses against relying on ‘disclaimers, disclosures or clarifications buried in small print’ to mitigate the risk of potential greenwashing, suggesting instead that small print should only be used to provide supporting information.

The ACCC suggests that where there is need to provide a disclaimer/qualification, businesses can reduce their risk of unintentionally misleading consumers by displaying it ‘near the headline statement’.

Whole of product lifecycle

The ACCC also considers it is important for businesses to take into account the effect of the environmental impact of the product/service over its lifecycle, before making an environmental claim.

The draft guidance clarifies that:

> ‘You do not necessarily need to conduct a life cycle assessment or provide information about the full product life cycle in every claim. However, you should consider which impacts are relevant to the claims you want to make and ensure that the overall impression conveyed is not misleading’.

In addition, its suggested that it a claim only relates to part of the life cycle of a product/service, businesses should make clear what part.

4. ‘Explain any conditions or qualifications on your claims’

The draft guidance underlines the need to ensure that where an environmental benefit will only be realised in certain conditions/if certain steps are followed, this should be made clear to consumers. For example, it’s suggested that a claim that coffee pods are ‘recyclable’ (without further information/qualifications) could be misleading, because coffee pods are not widely accepted for recycling and extra steps are required before they can be recycled.

The ACCC considers it is ‘good practice’ to:

> ‘clearly explain any limitations on the product’s ability to be recycled and any additional or unusual steps that need to be taken. If it is not practicable for the majority of consumers to recycle the product, the claim should not be made’.

5. ‘Avoid broad and unqualified claims’

The ACCC advises that businesses should avoid using ‘broad, vague terms’ such as ‘green’, ‘environmentally friendly’, ‘eco friendly’ or ‘sustainable’ because they:

> 'convey sweeping benefits that can mean different things to different consumers. Without further qualification or clarification, consumers can easily be misled that the product, service or business is better for the environment than is actually the case'.

As flagged previously, the draft guidance also suggests that certain other 'commonly used' terms eg 'recyclable', 'recycled' should be qualified to ensure consumers have an accurate picture of the product/service. For example, the draft guidance suggests that products should not be labelled as 'recyclable' unless they can be recycled through a household/local council waste collection program or consumers are given an explanation as to how the product can be recycled or the statement is appropriately qualified.

Emissions-related claims

The draft guidance calls on all businesses to:

> 'exercise particular caution when making representations to consumers about the greenhouse emissions associated with their products, services or business and their overall impact on climate change, given the complexities involved in quantifying these impacts'.

In setting out what it considers to be good practice in this context, the ACCC (among other things) suggests that businesses should explain how their Scope 2 (operational) emissions have been accounted for, including the extent of their reliance on carbon offsets (or carbon credits) (where these are used).

The draft guidance also underlines the need to ensure any claims made make clear 'what emissions have been accounted for and avoid using headline claims which create a misleading impression'.

Emissions-intense businesses

The draft guidance underlines that businesses that 'rely on or sell fossil fuels' should be 'particularly careful not to understate the overall environmental impact of their business when making environmental claims'. This is because:

> 'the overall environmental detriment of these industries is likely to overshadow any environmental improvements made by a business. Broad or unqualified environmental claims made by businesses in these industries have a higher chance of misleading consumers'.

Principle 6: Use clear and easy to understand language

The ACCC Chair comments:

> 'It is important to remember that an ordinary consumer generally does not have specialist knowledge, instead they understand words to have their ordinary meaning'.

The draft guidance advises businesses to both:

- avoid using scientific or technical language as far as possible. Where scientific or technical terms are needed, the guidance states that it is 'good practice' to 'clearly define the words if there is the potential for confusion'.
- use words to convey their common meaning eg if a product is described as 'reusable' then the assumption attaching will be that the product can be reused multiple times. If a product could only be used a limited number of times, then use of the term could be misleading (unless qualified/an explanation were given).

Principle 7: 'Visual elements should not give the wrong impression'

The draft guidance cautions that certain imagery, colours and symbols 'may be interpreted by consumers to be making a broad claim of an environmental benefit' and therefore should be used with care.

This includes, for example, use of:

- Images of plants, animals, the earth, or the colours green and blue which may suggest environmental benefits
- Symbols that are widely recognised as having a particular meaning (eg the mobius loop which is generally understood as the symbol for recycling)
- Custom-designed symbols that resemble 'trust marks' or words that give the impression that a service/product has been certified by a third party (eg 'biodegradable approved') if this is not the case

Use of third party logos/certifications

In each case, the ACCC emphasises the need for businesses to consider the overall impression created before using the imagery/symbol.

Principle 8: 'Be direct and open about your sustainability transition'

The ACCC cautions businesses to be careful not to overstate their progress on this front. The ACCC observes that:

> 'The need to be competitive can incentivise and drive environmental change. However in relation to any sustainability reduction claims, you should ensure genuine progress has been made before making environmental claims. You should also ensure that you have realistically portrayed the environmental harm still associated with your business as you transition to more sustainable operating models, to reduce the risk of misleading consumers'.

Views on how businesses should communicate extra information to consumers

The consultation paper includes a number of specific questions (p3-4) for feedback directed to both industry and consumers/consumer advocates.

Perhaps the key question for industry is whether the draft guidance will instil confidence in terms of knowing feel 'how to express an environmental or sustainability claim clearly and accurately'.

For consumers, the focus of the questions is on what information is needed to enable informed purchase decision-making and the extent to which the guidance is likely to assist. The regulator also seeks consumer views on the best way for businesses to provide information about their sustainability credentials. For example, whether consumers would like to see information provided on product labels, websites or through QR Codes and views on whether certified trademarks/certification schemes assist in understanding businesses' environmental/sustainability credentials.

Regulatory approach

ASIC and the ACCC to work 'closely together' in detecting and investigating potential greenwashing

Tackling greenwashing has been flagged by both the ACCC and ASIC as a key priority and in line with this, both regulators sharpened their focus on enforcement and education.

In addition to setting out the eight principles above, the ACCC's draft guidance explains the ACCC's role and approach to enforcement and how this fits with ASIC's role.

Determining when to take enforcement action

Importantly, the ACCC provides commentary on its compliance and enforcement approach, foreshadowing the potential use of Section 155 notices, substantiation notices, infringement notices and penalty proceedings for false or misleading representations or engaging in misleading or deceptive conduct.

The ACCC states that:

> 'In determining whether to take enforcement action in respect of environmental claims, ACCC will consider whether genuine efforts and appropriate steps were taken by the business to verify the accuracy of any information that they relied on. The scope and extent of due diligence undertaken will vary depending on the size of the business. The ACCC recognises that small businesses generally will not have access to the same resources as larger businesses and this will be taken into account when assessing the steps taken to verify environmental claims. The ACCC is more likely to take enforcement action in respect of representations about future matters regarding environmental claims where a business did not have reasonable grounds for making the representation, does not have an intention or plan to implement initiatives, or knew or was reckless about whether the claim was untrue or incorrect'.

Regulators will work closely together where there is overlap

In essence, the ACCC will focus primarily on claims about consumer facing products and services, while ASIC will focus on financial products and services. However, where there is crossover, ie where claims fall within the jurisdiction of both regulators, the regulators will 'work closely together to address any misconduct'.

> [Sources: ACCC media release 14/07/2023; Environmental and sustainability claims - Draft guidance for business; ACCC Chair Gina Cass-Gottlieb, address at the Breakfast Matters event at the Law Institute of Victoria 14/07/2023]

Top Story | Australian renewables investment breaking records as optimism surges

MinterEllison (together with Mergermarket) has released the results of a survey of 100 active domestic and international renewable energy investors gauging their views on the investment opportunities, trends and challenges in Australia. The standout finding is that confidence in the Australian renewable energy story has never been higher.

For more see: Australian renewables investment breaking records as optimism surges - Report - MinterEllison

NZ is considering the introduction of a national biodiversity credit system

The New Zealand Ministry for the Environment and Department of Conversation has opened a consultation on the potential introduction, design and operation of a biodiversity credit system (BDS) to help incentivise the protection/restoration of wildlife. It's envisioned that the BDS would do this by mobilising investment to support landholders to protect/maintain and restore indigenous diversity, supplementing other 'traditional ways' of financing projects that support/conserve nature.

It's suggested that the BDS could potentially follow the approach in Australia's Nature Repair Market Bill 2023 (Cth) in various respects including that the NZ scheme could potentially:

- recognising projects on land as well as in freshwater, coastal and marine environments (as opposed to being limited to projects on land only).
- adopt a 'project' based approach (again similar to that put forward in the Australian Bill).

The due date for submissions is 3 November 2023.

Australia

In Australia, the Nature Repair Market Bill 2023 (Cth) (discussion and summary) would (if legislated) create a national framework for a voluntary national biodiversity market.

The Bill has passed the House of Representatives (with amendments) and is yet to pass the Senate. The Bill has been referred to the Senate Environment and Communications Legislation Committee for report by 1 August 2023.

[Source: Ministry for the Environment and Department of Conservation Consultation: Helping nature and people thrive – Exploring a biodiversity credit system for Aotearoa New Zealand 07/07/2023]

IOSCO report includes 12 recommendations aimed at supporting implementation of well-functioning/efficient carbon credit markets across IOSCO's member jurisdictions

- The Board of the International Organization of Securities Commissions (IOSCO) has released a report setting out 12 recommendations to support regulators/relevant authorities to implement well-functioning/efficient carbon credit markets (CCMs) across IOSCO's member jurisdictions. IOSCO states:

  > 'The aim of these recommendations is to support jurisdictions seeking to establish new or to enhance their existing compliance carbon markets to do so in the most effective way possible, learning from the experience of others.'

- The recommendations (included in Chapter 6 of the report) are focused on issues around integrity and the 'orderly functioning' of CCMs including:
  - primary market functioning
  - transparency and predictability of primary market decisions
  - market structures for primary markets
  - covering allowance allocation mechanisms
  - market stability mechanisms and primary market access
  - secondary market functioning
- The report also includes a section on potential mechanisms that could over time lead to a consistent price for carbon globally.

  [Source: IOSCO media release 17/07/2023]

ICAPs Expectations Ladder updated to include deforestation actions for the first time

- The founding partners of the Investor Agenda have released an updated ICAPs Expectations Ladder. The updates incorporate deforestation actions for the first time and also ensure currency (ie alignment with the latest approaches, existing frameworks and ICAPs guidance).
- For clarity the ICAPs Expectations Ladder is a comprehensive framework for investors to guide them in their transition planning/actions. It

  > 'summarises key actions investors can take to tackle the climate crisis in the four focus areas of the Investor Agenda: investment, corporate engagement, policy advocacy, and investor disclosure, with governance as a cross-cutting theme'.

- Announcing the release of the updated ladder, Asia Investor Group on Climate Change (AIGCC) and Investor Group on Climate Change (IGCC) CEO and Investor Agenda Steering Committee member, Rebecca Mikula-Wright, said:

  > 'Institutional investors know that climate risks and opportunities are financial risks and opportunities. The updated Expectations Ladder is an actionable, user-friendly and useful compendium of steps that all investors can take to make sure their climate action plan matches best practice and evolving expectations, whether they are starting out or are market leaders. The ICAPs Expectations Ladder supports investors in their critical role to deploy capital to support real-world emission reductions and climate solutions.'

  [Source: The Investor Agenda media release 11/07/2023]

Greenwashing | The UK has pushed back the planned publication of the Sustainability Disclosure Requirements policy statement

Following the passage of the Financial Services and Markets Act 2023 (UK), the UK Financial Services Regulatory Initiatives Forum (Forum) - Bank of England (BoE), Financial Conduct Authority (FCA), Prudential Regulation Authority (PRA), Payment Systems Regulator (PSR), the Competition and Markets Authority (CMA), the Information Commissioner's Office, The Pensions Regulator (TPR) and the Financial Reporting Council (FRC) – have released a short update on planned financial services regulatory initiatives for the next 24 months ahead of releasing a fuller/more comprehensive update later in the year.

Among other things, the update flags that the planned Q3 2023 release of the FCA's sustainability disclosure requirements has been pushed back to Q4 2023. The update states:

> 'The Treasury has published the updated Green Finance Strategy 2023 in March, with the aim of ensuring the UK market is well positioned to support the transition to net zero. Following the FCA's Sustainability Disclosure Requirements and investment labels consultation and the range of comments, we have decided to publish the Policy Statement in Q4 2023, having been previously planned for Q3 2023. These policy changes will help the UK's asset management sector thrive by setting standards that improve the sustainability information consumers have access to'.

For context, the FCA consulted earlier in the year on a proposed package of measures aimed at tackling greenwashing including sustainable investment labels, sustainability disclosure requirements and restrictions on the use of sustainability-related terms in product naming and marketing. At the end of March 2023, the regulator indicated it would release the policy statement in Q3 with adjusted effective dates. This further delay appears likely to further push back implementation.

[Source: July 2023 Regulatory Initiatives Grid – Summer Update]

Regulators

Top Story | 'Helpful guidance and reinforcement' of APRA's existing priorities: FRAA capability review of APRA released

The Financial Regulation Assessment Authority (FRAA) latest capability review focused on the effectiveness and capability of APRA's supervision and resolution work in superannuation. Here's what you need to know.

Key Takeouts

- The FRAA's overall assessment is that APRA's supervision function within superannuation is generally effective, while its resolution function is less mature (though there is scope for the regulator to improve its approach in both areas). This accords with APRA's own assessment.
- The report makes five recommendations to strengthen APRA's supervision and resolution functions, all of which APRA has accepted and said it will act on/is already acting on.
- The bulk of the recommendations are focused on strengthening APRA's supervision function through: increased focus on emerging/systemic risks (Recommendation 1); lifting internal staff capability (Recommendation 2); continued investment in data and technology capabilities (Recommendation 4); and increased transparency around APRA's supervisory work/expectations of industry.
- Recommendation 5 recommends the regulator 'prioritise developing its resolution capability' (to ensure it is 'equipped to resolve more complex or large trustees, or simultaneous failures in the event of a systemic superannuation crisis')
- The next FRAA review will focus on the effectiveness and capability of the Australian Securities and Investments Commission (ASIC) and will commence in 2026. The next review of APRA will commence in 2027.

Overview

The Financial Regulation Assessment Authority (FRAA) has released its report into the effectiveness and capability of the Australian Prudential Regulation Authority's (APRA) supervision and resolution of the superannuation industry.

Broadly, FRAA concludes (in line with APRA's own self-assessment) that APRA's supervision function within superannuation is generally effective, and that its resolution function is less mature.

Having said this, the FRAA considers there is scope for improvement in both areas.

Accordingly, the five recommendations in the report are focussed on improving both APRA's effectiveness and capability in both its supervision and resolution functions (with the bulk of the recommendations focussed on supervision). A key aim is to 'make APRA's regulation of the superannuation industry more forward looking' in order to ensure it is resilient to future shocks.

APRA has indicated its support for all five recommendations, and confirmed it will act on all five (noting that the recommendations reinforce and 'build on' many of the initiatives already on foot).

Five Recommendations

Improving APRA's approach to supervision

Recommendations 1-4 focus on strengthening APRA's approach to supervision through increasing its focus on emerging/systemic risks; lifting internal staff capability; continuing to invest in data and technology capabilities; and increase transparency around its supervisory work.

Increase focus on identifying and understanding emerging/systemic risks

The report expresses concerns that APRA has:

> 'at times, been reactive and focused on a limited number of risks facing the sector, which may have significant implications for how trustees are delivering outcomes for members and the broader financial system'.

To address this, Recommendation 1 recommends that:

> ‘APRA should increase its efforts to identify risks in superannuation, including emerging and systemic risks, and their potential consequences’

More specifically, FRAA suggests that APRA should ‘direct greater attention to proactively identifying and comprehensively understanding’ risks such as:

– ‘conversion of unlisted or illiquid assets to cash
– unlisted asset valuation practices
– more members moving to the retirement phase
– increasingly complex investment strategies undertaken by trustees (who are increasingly sourcing investment strategies in-house), and the development of complex income-stream products
– severe market downturn, exacerbation by financial instability and member switching requests
– failure or industry exit of administration service providers’.

In its response to the report, APRA states that it is already strengthening its approach in this area including through sharpening its focus on

> ‘risks that have particular application within superannuation – such as valuation of unlisted and illiquid asset classes; movement of members to the retirement phase; and evolving investment strategies and product complexity. And more broadly, those risks relevant on a cross-industry basis including market downturn scenarios; availability of service providers; and cyber-risks’.

Lift internal capability

Recommendation 2 recommends that APRA

> ‘should prioritise and invest in initiatives to recruit, train, retain and develop its staff to build appropriate skills and industry knowledge, to drive deeper understanding and build stronger capability to manage and respond to emerging and systemic risks’.

Again, APRA has indicated it is already acting on the recommendation including through conducting a review into its supervisory training program and more broadly through ‘strengthening workforce planning’ to ensure staff have the skills, capability and experience needed to both deliver on APRA’s Corporate Plan and respond to emerging and systemic risks.

Continued investment in data and technology

Recommendation 3 recommends that APRA should:

> ‘continue to invest in its data and technology capabilities and processes to provide timely insights, allow effective internal collaboration, and to the extent appropriate, minimise regulatory burden associated with data and information requests’.

APRA has indicated that it already acting on the recommendation, in line with its corporate plan. For example through the establishment of APRA’s new Technology and Data Division and the continued data and technology investment (including the delivery of the Superannuation Data Transformation program).

Increased transparency around supervisory activity/expectations

Recommendation 4 recommends that APRA should:

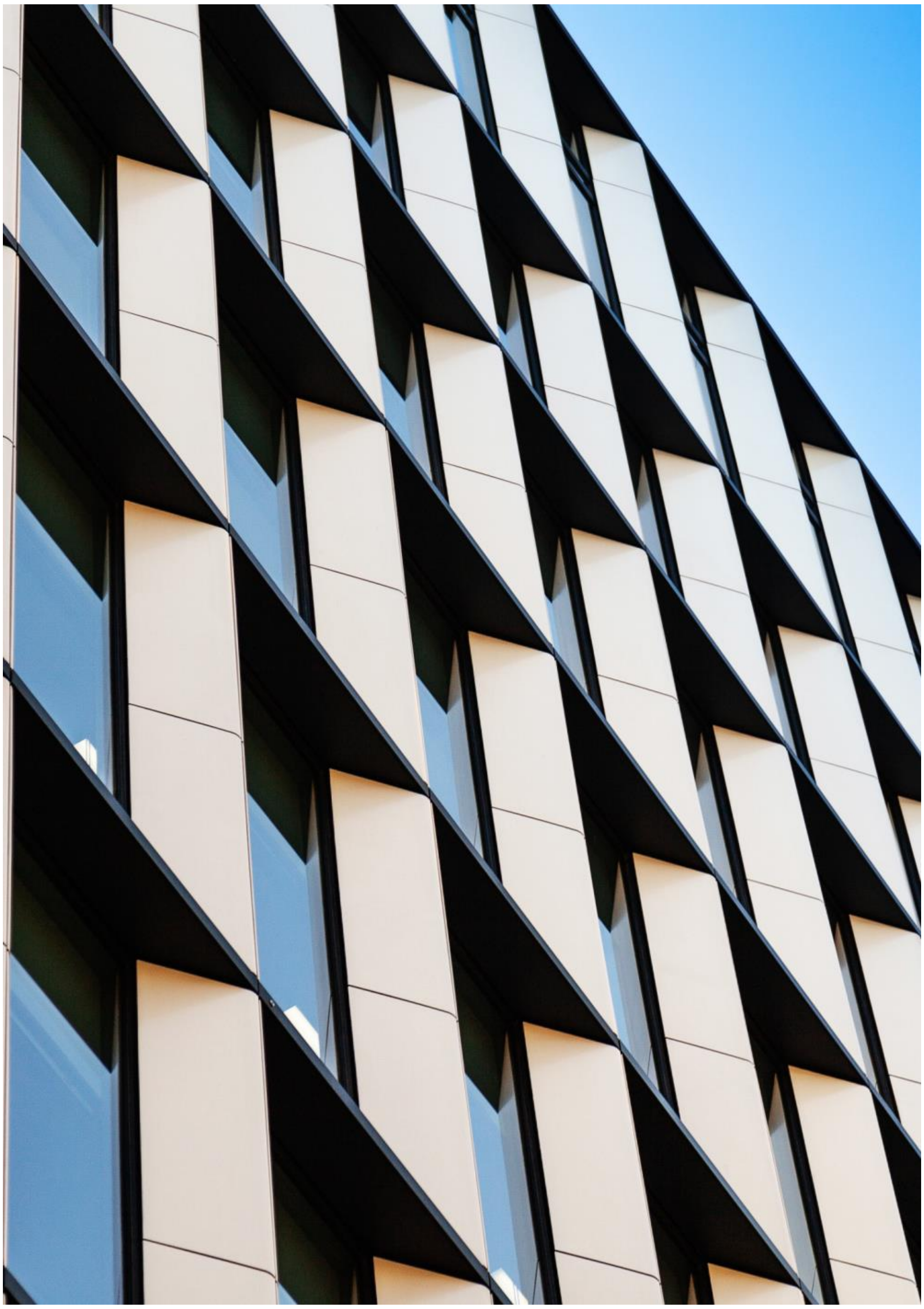
– ‘provide trustees with annual plans of proposed supervisory activity. APRA should keep trustees informed of the status of reviews, information requests and other supervisory activities’.
– ‘consider publishing its methodologies’ for thematic reviews and provide ‘more detailed insights to build public awareness and enable interested parties to comment’.
– ‘consider communicating more timely and detailed insights across industry to increase awareness of risks and promote better practices’.
– APRA has indicated that its 2023-224 Corporate Plan (set to be released next month) will ‘provide enhanced visibility regarding APRA’s strategic priorities and key supervisory and policy activities’.

APRA has also said it will ‘review and increase the visibility provided to entities on planned and ongoing supervisory activity and thematic insights’.

Delivery of recovery and resolution plans

FRAA recommends (Recommendation 5) that APRA:

> 'should prioritise developing its resolution capability and work closely with industry to lift awareness of recovery and resolution planning requirements, to ensure APRA is able to support recovery and exit, and resolve failing superannuation trustees'.



This recommendation aims to ensure the regulator is 'equipped to resolve more complex or large trustees, or simultaneous failures in the event of a systemic superannuation crisis'.

Responding to the report, APRA said it intends to:

> 'drive a step-change in superannuation industry recovery and resolution planning, consistent with APRA's new prudential standards'.

APRA also flagged its intention to:

- 'communicate better practices to industry following pilot reviews of selected superannuation trustee recovery and exit plans;
- progress superannuation pilot resolution planning, including to enhance APRA's resolution capability in superannuation; and
- engage with Treasury and provide advice to government on options to enhance APRA's statutory crisis response toolkit in superannuation'.

Looking ahead: Moving to five year review cycle

In the 2023/4 Federal budget, the government announced it would reduce the frequency of the FRAA review cycle to five years (with the FRAA secretariat function continuing to operate within Treasury between reviews).

The next FRAA review will focus on the effectiveness and capability of the Australian Securities and Investments Commission (ASIC) and will commence in 2026. The next review of APRA will commence in 2027.

FRAA panel changes

The Assistant Treasurer has announced that in light of the longer review cycles, the three current members of the FRAA panel Nicolas Moore (Chair), Fiona Crosbie and Craig Drummond have tendered their resignation.

[Sources: Assistant Treasurer Stephen Jones media release 13/06/2023; 2023 Report: Effectiveness and Capability Reviews of the Australian Prudential Regulation Authority; APRA media release (including APRA's response) 13/07/2023]

Outgoing RBA Governor Phillip Lowe outlines some (initial) changes being made in response to the Independent Review of the RBA

In his 12 July 2023 address to the Economic Society of Australia, outgoing Reserve Bank of Australia (RBA) Governor Phillip Lowe outlined the (initial) planned changes set to be made in response to the recommendations of the Independent RBA Review. It's envisioned that further changes will be implemented over time as the RBA works through the recommendations.

We've summarised the key initial changes below.

Initial planned changes: Monetary policy processes and Communication

- Fewer, longer meetings from 2024:
  - From 2024, the Board will meet eight (not eleven) times a year. Four of the meetings will be on the first Tuesday of February, May, August and November. The other four meetings will be held midway between these meetings (exact dates for 2024 are planned to be communicated 'soon')
  - Board meetings will commence on Monday afternoon and continue into Tuesday morning
- Communication of meeting outcomes
  - Meeting outcomes will be announced following the Tuesday board meeting, The quarterly Statement on Monetary Policy will be released at the same time.
  - The post-meeting statement announcing the decision will be issued by the board (rather than by the Governor)
  - The Governor will hold a press conference after each board meeting to explain the decision
- Board oversight
  - All Board members will have the opportunity to attend an internal staff meeting some time before the Board meeting to give them an opportunity to hear directly from/ask questions of a broader range of staff
  - The Board (rather than the Governor) will be the signatory to the Statement on the Conduct of Monetary Policy (ie the document that records the common understanding on monetary policy between the RBA and the Australian Government). The new Statement is expected to be finalised later this year.
  - The Board will oversee the Bank's research agenda as it relates to monetary policy and aspects of financial stability.
  - There will be no change to the board's current approach to climate change analysis
  - The Board will work with the Treasury to undertake five-yearly reviews of the monetary policy framework.

It's envisioned that further changes will be made in response to other Review recommendations focused on these areas over time.

Initial changes to internal operations

- The RBA will also create a new Chief Operating Officer role. The search process is planned to commence later in 2023.
- The RBA will seek to 'embed the three lines of accountability model more thoroughly across the organisation'.
- A new Communications Department will be established within the RBA to centralise the bank's communications activities and 'provide strategic communications advice to the Governor and the Board'. The search process for an executive to lead this function is planned to commence 'soon'.

[Source: RBA Governor Philip Lowe, Address at the Economic Society of Australia (Qld) Business Lunch Brisbane 12/07/2023]

Financial Services

Top Story | APRA's new operational risk standard finalised

The Australian Prudential Regulation Authority (APRA) has released its long-awaited new cross industry prudential standard - CPS 230 Operational Risk Management (CPS 230) – to 'strengthen the management of operational risk across APRA's regulated population'. APRA has also opened consultation on draft guidance to support implementation. Here's what you need to know.

Key Takeouts

- Following consultation, APRA has released a new prudential standard - Prudential Standard CPS 230 Operational Risk Management (CPS 230) – to replace five existing outsourcing and business continuity standards and apply to all APRA-regulated entities.
- Commencement deferred:
  - CPS 230 will apply from **1 July 2025** (rather than from 1 January 2024 as originally proposed).
  - Transition arrangements (to enable entities to make changes to existing contractual arrangements with service providers): APRA-regulated entities will have until the earlier of **1 July 2026** or the **next renewal date** of an existing agreement to ensure the agreement complies with CPS 230.
- All regulated entities are expected to 'be proactive in preparing for the new requirements in 2023-2024'. For example, 'APRA expects that senior management would have identified their critical operations and material service providers by mid-2024 and be well positioned to set tolerance levels by the end of 2024'. APRA has flagged that supervisors will 'engage with entities during the implementation period to assess progress'.
- APRA has also released draft Prudential Practice Guide CPG 230 Operational Risk Management (draft CPG 230) to support entities in implementation of CPS 230. The due date for submissions on the draft guidance is 13 October 2023. Following this, APRA expects to finalise the guidance later this year.

The new standard has been developed as part of APRA's multi-year project to modernise the prudential architecture. The new standard - Prudential Standard CPS 230 Operational Risk Management (CPS 230) – will apply to all APRA-regulated entities and will replace the following five existing standards:

- Prudential Standard CPS 231 Outsourcing (CPS 231);
- Prudential Standard CPS 232 Business Continuity Management (CPS 232);
- Prudential Standard SPS 231 Outsourcing (SPS 231);
- Prudential Standard SPS 232 Business Continuity Management (SPS 232); and
- Prudential Standard HPS 231 Outsourcing (HPS 231).

Broadly, the standard has three key aims.

- 'Strengthen operational risk management through new requirements to address identified weaknesses in existing controls';
- improve business continuity planning to ensure they are positioned to respond to severe disruptions; and
- enhance third-party risk management by ensuring risks from material service providers are appropriately' managed'.

How does the final standard differ from the consultation draft?

The final standard is broadly similar to the consultation draft. For a detailed overview and analysis of the consultation draft see: CPS 230 | Consultation on strengthening operational risk management begins.

We've highlighted some key differences below.

Deferred commencement

As flagged, the commencement date has been deferred to 1 July 2025 in line with industry feedback, and transition arrangements have also been included for existing service provider arrangements.

Under the final standard, APRA-regulated entities will have until the earlier of 1 July 2026 or the next renewal date of an existing agreement to ensure the agreement complies with CPS 230. However, APRA's underlines that

> 'contracts with material service providers should be updated as soon as possible given their importance to critical operations and operational risk'.

Less rigid approach on prescribed critical operations and service providers

'Critical operations' are defined in the final guidance as:

> 'processes undertaken by an APRA-regulated entity or its service provider which, if disrupted beyond tolerance levels, would have a material adverse impact on its depositors, policyholders, beneficiaries or other customers, or its role in the financial system'.

These include (but are not necessarily limited to):

- 'for an ADI: payments, deposit-taking and management, custody, settlements and clearing;
- for an insurer (general, life, private health): claims processing
- for an RSE licensee: investment management and fund administration; and
- for all APRA-regulated entities: customer enquiries and the systems and infrastructure needed to support critical operations'.

The draft guidance (on which APRA is currently consulting) states that:

> 'APRA expects "critical functions" defined for resolution planning would be classified as critical operations'.

In response to industry feedback, the final CPS 230 introduces a measure of flexibility for entities not to classify operations as critical, provided that they 'can provide satisfactory justification for the decision' (though APRA may override the decision if it disagrees with an entity's assessment).

The draft guidance provides further guidance around what APRA considers to be 'better practice' in this context. The draft guidance states that:

> 'APRA expects that any justification by an entity that a business operation prescribed in paragraph 36 of CPS 230 is not a critical operation would be documented, approved by an Accountable Person or the equivalent at a senior management level and reviewed on at least an annual basis'.

APRA underlines that it expects instances like this to be 'exceptional'.

Similarly, Draft CPS 230 prescribed certain services as being material. The final standard retains a list of prescribed material service providers, but introduces scope for entities not to do so, provided they can justify their decision (again APRA expects cases like this to be exception rather than the rule.).

The draft guidance provides further guidance around what APRA considers to be 'better practice' in this context. The draft guidance states that:

> 'APRA expects that any justification by an entity not to classify a service provider prescribed by APRA as material would be documented, approved by an Accountable Person or the equivalent at a senior management level, and reviewed on at least an annual basis'.

Also, in response to feedback from the CPS 230 consultation, the list of prescribed material service providers in final CPS 230 does not include all service providers that manage information assets classified as critical or sensitive. APRA comments that despite this,

> 'Such providers would, however, still be captured where they meet the broad definition of material service provider set out in the final CPS 230'.

Unfortunately for the insurance industry, 'insurance brokerage' remains on the prescribed list despite industry submissions identifying concerns in relation to the appropriateness of this classification. However, in response to feedback, APRA notes its clarification that it may be open to an entity to form the view that an arrangement with a prescribed service provider is not a 'material arrangement' (see further discussion in the next section).

Clarification around 'material arrangements'

Broadly, the final version of CPS 230 has been amended to reflect that:

> 'Not all arrangements with a material service provider will be material to the entity. "Material arrangements" are those on which a regulated entity relies to undertake a critical operation or that expose the entity to material operational risk.'

Fourth parties remain in scope with some clarification

Despite submissions on the point, the final version of CPS 230 has retained the requirements for service provider management policies to address the APRA-regulated entity's approach to managing risks associated with fourth parties, i.e. parties that service providers rely on to deliver their own services.

However, amendments have been made since consultation draft to clarify that the requirement only applies to fourth parties that are relied upon to deliver critical operations to the APRA-regulated entity.

Draft CPG 230 also suggests that APRA does not necessarily expect entities to directly enter into an agreement with fourth parties, instead stating minimum risk management measures would typically include due diligence to identify fourth parties, contractual provisions requiring service providers to inform the entity of their involvement and assurance that the service provider can manage material fourth parties.

Removal of the requirement to assess systemic importance to Australia

The final version of CPS 230 removes the requirement for APRA-regulated entities to assess whether a material service provider is systemically important to Australia as part of its assessment before entering into an agreement with the service provider.

This is a welcome change, as submissions in response to the consultation indicated this was likely to be difficult for APRA-regulated entities.

Notification requirements: proposed timelines are unchanged

The timelines for notifying APRA of certain incidents are unchanged from the consultation. Under final CPS 230 APRA regulated entities are required to notify the regulator of:

- an 'operational risk incident that it determines to be likely to have a material financial impact or a material impact on the ability of the entity to maintain its critical operations' within 72 hours after becoming aware of it (or earlier);
- changes to service provider arrangements within 20 business days (or sooner) of 'entering into or materially changing an agreement for the provision of a service on which the entity relies to undertake a critical operation'.

  Entities are also 'required to notify APRA prior to entering into any offshoring agreement with a material service provider, or when there is a significant change proposed to the agreement, including in circumstances where data or personnel relevant to the service being provided will be located offshore'.
- the activation of its business continuity plan (BHP) within 24 hours (or sooner) – though the final standard clarifies that this is only necessary 'if the activation of the entity's BCP relates to a disruption to a critical operation outside tolerance'. The notification would need to include: 'the nature of the disruption; the action being taken; the likely impact on the entity's business operations; and the timeframe for returning to normal operations'.

In response to feedback, APRA states that it has sought to 'simplify' the notification process with the draft guidance (draft CPG 230) providing more guidance around APRA's expectations when making notifications.

APRA has clarified that a notification of an information security incident reported under Prudential Standard CPS 234 Information Security (CPS 234) is not required to be separately reported under CPS 230.

Draft CPG 230

Broadly, the draft guidance aims to aid compliance with CPS 230 by:

- clarifying that while all requirements of CPS 230 apply to all APRA-regulated entities, APRA intends the requirements to be applied proportionately – ie APRA's expects 'an entity's approach to operational risk to be proportionate to its size, business mix and complexity'.
- providing guidance in response to key issues/concerns raised in the CPS 230 consultation with respect to implementation of requirements around operational risk management, business continuity and service provider management
- providing guidance on APRA's expectations around the responsibilities of the board and senior management in this context

- providing guidance on the extent of monitoring of operational risk management expected and guidance on the assessment of the entity's operational risk profile eg for new products
- providing guidance on identifying critical operations, setting tolerance levels and business continuing planning including APRA's expectations around systematic testing
- providing guidance on what would be addressed by an entity's service provider management policy
- providing guidance on the type of information a regulated entity would 'typically' be expected to provide and how the information can be provided to APRA.

Next steps

As flagged, the due date for submissions of the draft guidance is 13 October 2023. Following this, APRA expects to finalise the guidance later this year.

APRA's expectation is that all entities adopt a 'proactive' approach to preparing for the new requirements 'in 2023-2024', flagging that supervisors will expect to engage with entities during the implementation period to 'assess progress'.

[Sources: APRA media release 17/07/2023; Response paper - Operational Risk Management; Prudential Standard CPS 230 Operational Risk Management; Draft Prudential Practice Guide CPG 230 Operational Risk Management - Integrated version]

Should banks pay for scam losses?

Writing in The Conversation, La Trobe University academic Muhammad Al Mamun suggests that Australia (and New Zealand) should follow the UK in introducing mandatory requirements for banks to reimburse victims of authorised push payment fraud (ie where a scammer masquerades as a legitimate business/person in order to convince their victim to authorise a payment).

Why a mandatory reimbursement requirement is considered necessary

Professor Al Mamun argues that there is a 'strong case' for the introduction of UK-style mandatory requirements in Australia because:

- the scale of the losses is significant, and looks set to continue to increase – according to the ACCC, Australians lost (at least) $3.1 bn to scams, up 80% on 2021, with actual losses likely to be higher.
- banks are 'falling short of detecting, stopping and recovering losses'. Professor Al Mamun points to the findings of ASIC's report into the big four banks' approach to scam activity in the banking sector (ASIC REP 761, summarised) in support of this. Report 761 found for example that:
  - banks are detecting and stopping a low proportion of scam payments (13%)
  - few banks (between 2-5%) have reimbursement policies/practices in place (and when they are in place, ASIC considers they are 'inconsistent and generally very narrow'.
- the UK experience demonstrates that compliance with a voluntary Code to help ensure victims of push payment fraud are reimbursed did not (wholly) achieve its object in that less than half of reported scam losses were reimbursed between 2020 and 2022
- expecting consumers to assume personal responsibility for preventing losses to scams is not realistic/fair. Professor Al Mamun writes:

  > 'such an argument ignores the effects of the digitisation push by financial service providers, which has made scamming so much easier. Scammers are also becoming more sophisticated. The statistics speak for themselves. Scamming losses are increasing. Recovery rates are meagre. A more pragmatic approach based on this reality and banks' fiduciary responsibilities is needed.'

CALC reiterates calls for the introduction of stronger safeguards

The Consumer Action Law Centre (CALC) has similarly called for the introduction of 'new laws that mandate industry action on scam prevention and impose liability for losses when they fail'.

In a recent opinion piece, CALC Acting CEO Tania Clarke opines that the 'Australian market has failed to introduce the safeguards needed to protect our money online' and calls on the government to step in.

Strengthening consumer protections is stated to be a government, regulatory (and industry) priority

- The 2023 Federal Budget includes a number of measures focused on addressing online fraud, including the establishment of a new a new National Anti-Scam Centre (NASC) within the ACCC which officially launched on 1 July 2023. For more on this see: First anti-scam centre 'hit squad' to target online investment scams - Post - MinterEllison.
- The Assistant Treasurer has also flagged plans to introduce 'over the next few months' new industry Codes of Practice for 'banks and other financial institutions', telecommunications companies and social media platforms to push industry to lift standards.
- Financial regulators have also stepped up their focus on the issue. See: Regulatory focus on combatting scams and strengthening cyber resilience continues - POST - MinterEllison and Banks and 'corporate Australia' on notice: ASIC calls on banks (and encourages other organisations) to improve their approach to scams - POST - MinterEllison
- The banking sector is also taking steps to respond. For example, the Australian Banking Association (ABA) has announced a number of industry-led anti-scam measures including:
  - the launch of a new Fraud Reporting Exchange digital platform (FRX platform) which aims to help banks to respond more quickly and effectively to scams, including through streamlining communication between banks, enabling them to move more quickly to block the movement of money en route or transferred to another bank.
  - the implementation by one telecommunications company (leveraging intelligence provided through a bank-funded body) of an automated 'Call Stop' technology to help protect its customers from SMS scams.

[Source: The Conversation 12/07/2023]

The FSB has finalised the global regulatory framework for crypto-asset activities

The G20 tasked the Financial Stability Board (FSB) with coordinating the delivery of a global regulatory oversight/supervision framework for cryptoassets. The FSB has now released its finalised framework.

The framework consists of two sets of recommendations:

- High-level recommendations for the regulation, supervision and oversight of crypto-asset activities and markets. The recommendations aim to:

  > 'establish a global regulatory baseline…Their aim is to promote a regulatory, supervisory and oversight framework that is technology-neutral and focuses on underlying activities and risks'.

- Revised high-level recommendations for the regulation, supervision, and oversight of "global stablecoin" arrangements. The recommendations aim to:

  > 'promote consistent and effective regulation, supervision and oversight of global stablecoin arrangements (GSCs) across jurisdictions to address the potential financial stability risks they pose, both at the domestic and international level, while supporting responsible innovation and providing sufficient flexibility for jurisdictions to implement domestic approaches'.

Central Bank Digital Currencies (CBDCs) are not subject to the recommendations.

The FSB emphasises that the focus of the framework is on addressing risks to financial stability. As such the FSB notes that they 'do not comprehensively cover all specific risk categories related to crypto-asset activities'.

The recommendations also 'take account of lessons from events of the past year in crypto-asset markets, as well as feedback received during the public consultation of the FSB's proposals'.

[Source: FSB media release 17/07/2023]

DDO enforcement | ASIC issues first stop order for a life insurance product, cautions insurers it is 'considering' further stop orders for other insurance products

The Australian Securities and Investments Commission (ASIC) has issued an interim stop order prohibiting a life insurer from 'engaging in retail product distribution and providing general advice' about two income protection cover products.

ASIC states that the interim order was issued due to 'deficiencies' in the target market determination (TMD). Specifically was concerned that:

> 'the TMD failed to consider the impact of key eligibility criteria (ie. age and minimum employment criteria) on the suitability of the product for certain classes of consumers. As a result, ASIC was concerned that the target market contained classes of consumers for whom the product was not likely to be appropriate.
>
> ASIC is also concerned that the TMD does not specify any meaningful distribution conditions to ensure that the Income Protection Cover would likely be distributed to consumers in the target market and likely exclude distribution to consumers in the negative target market'.

Insurers on notice

- This latest action by the regulator follows a 'risk based and targeted review of insurance TMDs and ASIC's announcement makes clear that it is 'considering further stop orders for other insurance products'.
- It also follows the release of a report by ASIC (REP 762) (summarised) outlining the findings of ASIC's initial review into how investment product issuers are meeting their DDOs. REP 762 highlights a number of 'key market deficiencies' in the sample TMDs reviewed including: defining target markets too broadly and use of unsuitable risk profiles. From ASIC's latest action, it appears the regulator may have similar concerns about TMDs for certain insurance products.
- DDO enforcement is included in the list of ASIC's top priorities for 2023. These latest interim stop orders bring the total number issued to date to 81 (39 of which relate to insurance products).

[Source: ASIC media release 18/07/2023]

DDO compliance | ASIC has contacted insurance peak bodies outlining the findings of its review of insurance TMDs

Following its review of over 100 Target Market Determinations (TMD) for general and life insurance products, the Australian Securities and Investments Commission (ASIC) has written to the Insurance Council of Australia, outlining the review findings.

ASIC states that having reviewed each TMD against the TMD requirements in the Corporations Act 2001(Cth) and ASIC Regulatory Guide 274 Product design and distribution obligations (RG 274).ASIC 'considered that the products reviewed represent higher risk and/or potential for poor value to consumers'.

The letters also outline how insurers could make improvements to their TMDs.

[Source: ASIC media release 18/07/2023]

Retirement Income Covenant: Implementation review released

The Retirement Income Covenant (which requires RSE licensees to have a strategy to help members in or approaching retirement) was introduced from 1 July last year.

Twelve months on, the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) have issued an information paper - REP 766 Implementation of the retirement income covenant: Findings from the APRA and ASIC thematic review (REP 766) - outlining the findings of their joint thematic review into implementation of the covenant to date, by a sample of 15 Registrable Superannuation Entity (RSE) licensees.

Collectively the RSEs in the sample cover about 50% of the accounts and benefits of members aged 45 or above in APRA-regulated superannuation funds.

For context, the review considered how RSEs:

- 'identify and understand members' needs in retirement;
- assist members with information, financial advice and product offerings; and
- execute and oversee their retirement income strategy, and assess whether the intended outcomes are being achieved'.

The headline conclusion is that:

> 'overall, there was a lack of progress and insufficient urgency from RSE licensees in embracing the retirement income covenant to improve members' retirement incomes'.

Three key improvement areas identified

The regulators have called on RSE licensees to prioritise acting to address the following three issues.

IMPROVEMENT AREA	PRIORITY ACTIONS
▪ **'Understanding member needs'**. The regulators consider that 'all' trustees 'have gaps in the critical information they need about their members to inform the development of an effective retirement income strategy. Very few had plans to address these gaps'.	REP 766 calls on RSE licensees to prioritise: ▪ addressing data gaps to 'support effective strategy formulation and deliver useful assistance to members'. ▪ enhancing their use of modelling/analytics to enable 'understanding of how members' financial position and retirement spending needs could change over time'
▪ **'Designing fit-for-purpose assistance'**. Though some trustees were found to have taken steps toward improving assistance through various measures, some were found not to be using metrics to track how their members are using the assistance measures in place or the effectiveness of these measures (making it difficult for them to determine whether adjustments are required)	REP 766 calls on RSE licensees to prioritise: ▪ tailoring their communications and other assistance 'to cater to diverse member preferences and needs'. ▪ implementing regulator testing/appropriate metrics to track the effectiveness of the assistance being offered and enable any gaps to identified and addressed.
▪ **'Overseeing strategy implementation'**. The regulators consider that 'many trustees have not embedded their retirement income initiatives as concrete actions in their overall business plan. Additionally, a majority of trustees lack quantitative metrics to assess the retirement outcomes resulting from their initiatives'.	REP 766 calls on RSE licensees to prioritise: ▪ Integrating the 'retirement income strategy with the broader business planning cycle'. ▪ Developing 'metrics that focus directly on member outcomes (such as changes in drawdown rates and member confidence in meeting their retirement goals) to measure success of their strategy'

Next steps

The regulators have said they

> 'expect all RSE licensees to consider the findings and examples of better practices outlined in this report. They should address, with urgency, the gaps in their approach'.

The report also flags that APRA plans to update its prudential framework to 'reflect the key findings' of the review. In terms of timing, APRA expects to consult on proposed changes 'later in 2023'.

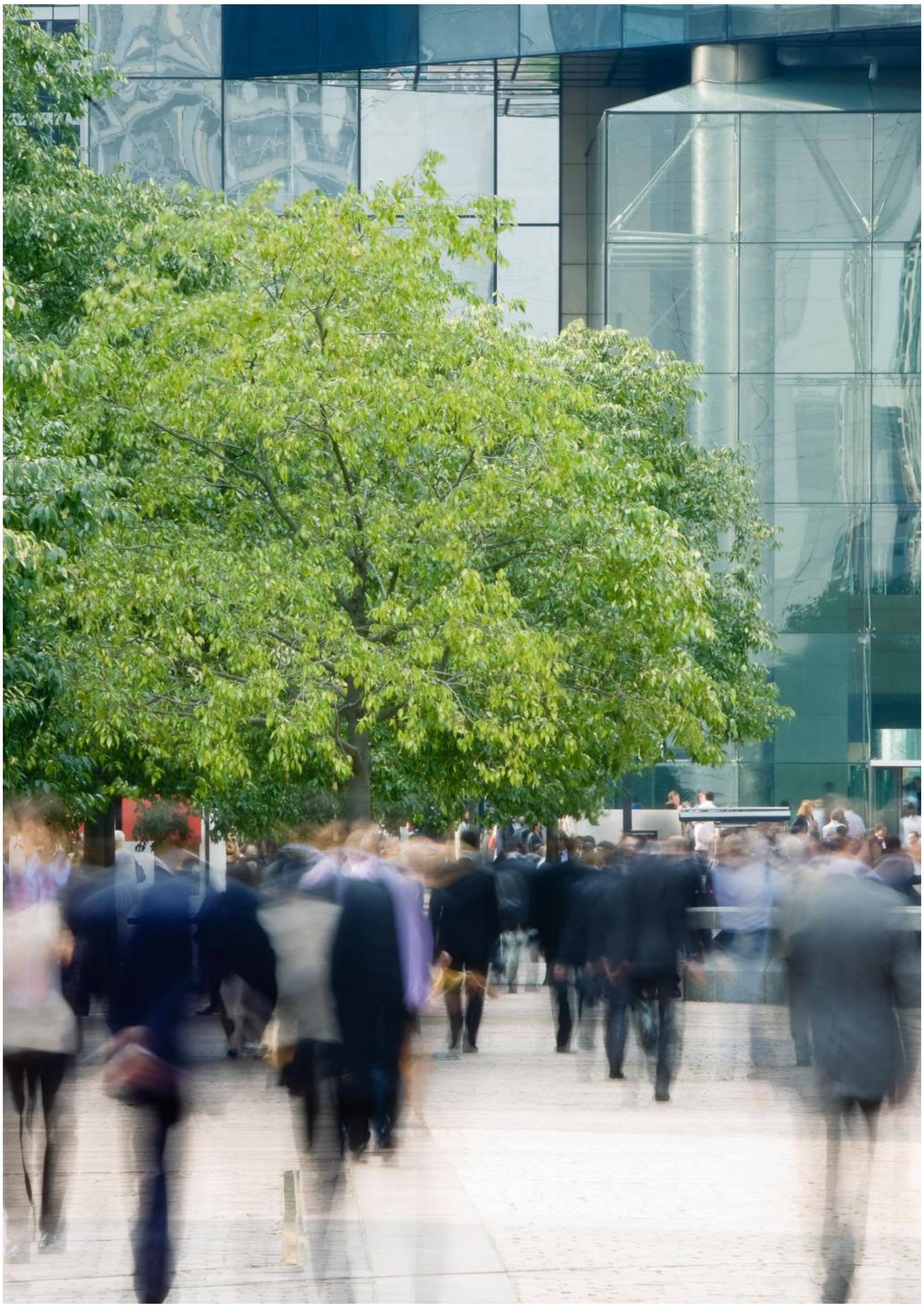
How this fits with planned changes in response to the Quality of Advice Review

- The government has accepted (in full or in principle) 14 of the 22 Quality of Advice Review (QAR) recommendations for the overhaul of financial advice regulation. See: the government's written response to the QAR.
- The government's immediate priorities for reform include expanding access to retirement income advice (though enabling superannuation funds to provide more information to consumers). The government has said that legislation to implement the recommendations accepted by the government is planned for the second half of 2023 and early 2024'. For more about the planned response to the QAR recommendations see: Government response to the Quality of Advice Review - Insight - MinterEllison

- The regulators make clear in their report that QAR-related reforms should not be reason for RSE licensees to delay acting on REP766. The report states:

  > 'This information report does not address the implications of future advice laws on the assistance that RSE licensees may provide as part of their retirement income strategies. This is a matter that RSE licensees will need to consider as legislative changes are made. Under the existing laws, there are still a number of actions that RSE licensees can take now to better assist members in or approaching retirement, some of which involve the provision of advice'.

  [Sources: REP 766 Implementation of the retirement income covenant: Findings from the APRA and ASIC thematic review; ASIC media release 18/07/2023; APRA media release 18/07/2023]



Assistant Treasurer issues call for funds and insurers to do better for customers

Our key takeaways from Assistant Treasurer and Minister for Financial Services Stephen Jones' 18 July 2023 address to Conexus Group Insurance Dialogue are below.

Consultation on legislation to legislate the objective of superannuation expected to be released in coming months

- Mr Jones said that the government plans to release draft legislation for consultation 'in coming months' proposing to legislate the government's proposed objective for the superannuation system. The objective proposed is that:

  > 'the objective of superannuation is to preserve income for a dignified retirement, alongside government support, in an equitable and sustainable way'.

- This is expected to 'clarify the task of those working in the superannuation system' (including trustees, advisers and insurers)

Insurance in superannuation

- Mr Jones said that for 'insurance in superannuation to achieve its desired benefits, the insurance sector needs to lift its game' (in terms of improving customer experience).
- Mr Jones pointed to the volume of complaints made to the Australian Financial Complaints Authority (AFCA) in support of this. Mr Jones noted that according to the most recent data:
  - three of the top five types of superannuation complaints to AFCA relate to insurance.
  - a third of all superannuation complaints to AFCA concern total and permanent disability (TPD) and income protection products
  - AFCA receives two complaints every day concerning delays in claims handling.

Retirement Income Covenant

- Mr Jones said there is a need for RSE licensees to improve their approach to implementation of the Retirement Income Covenant (Covenant), citing the findings of the joint Australian Prudential Regulation Authority (APRA) and Australian Securities and Investments (ASIC) review (ie REP 766, covered separately above) in support.
- Mr Jones commented that two of the report findings 'stand out'. Namely: the regulators found there has been a 'lack of progress' and a 'lack of urgency'. Mr Jones also pointed to findings in ASIC's December 2022 report into complaints handling (REP 751) as evidence of the need for improvement.
- Mr Jones stated 'service standards in the superannuation system need to improve. Funds have to do better. And now.'

Consumer protection is a key priority for the government

- Mr Jones reiterated that strengthening consumer protections (across all sectors), is a 'top priority' for the government. Mr Jones pointed to the establishment of the new National Anti-Scam Centre within the ACCC, the work on foot to 'fix the mess' in the advice sector, the work on foot to put downward pressure on insurance premiums (eg investment in mitigation projects in disaster prone areas), reforms intended to strengthen the consumer protection framework for consumers of small amount credit contracts and consumer leases (included in the Financial Sector Reform Act 2022 (Cth)) and the planned regulation of the Buy Now, Pay Later (BNPL) sector in support.
- Mr Jones concluded his speech by calling for:
  - the financial sector as a whole to 'unite behind…[the government's proposed] clarified purpose of the superannuation system'
  - superannuation funds (and insurers) to lift expectations, standards and outcomes for members

    [Source: Assistant Treasurer and Minister for Financial Services Stephen Jones speech to Conexus Group Insurance Dialogue 18/07/2023]

In Brief | SEC has called on China-based companies to 'provide more prominent, specific, and tailored disclosures about China-specific matters so that investors have the material information they need to make informed investment and voting decisions'.

[Source: SEC Sample Letter to Companies Regarding China-Specific Disclosures 19/07/2023]

In Brief | Cyclone pool update: All major insurers are required to join the cyclone pool by December 2023. To date, an estimated 65% of home insurance policies are now covered by the cyclone pool and this is expected to reach 95% by the commencement of the 2023-24 cyclone season in November 2023

[Source: Assistant Treasurer and Minister for Financial Services Stephen Jones media release 13/07/2023]

Insolvency and Reconstruction

Top Story | Parliamentary Inquiry recommends comprehensive insolvency review

The Parliamentary Joint Committee on Corporations and Financial Services inquiry into corporate insolvency in Australia tabled its final report to the Australian Parliament on 12 July 2023.

The report includes 28 recommendations to improve Australia's corporate insolvency regime as well as 'further areas of reform which could be addressed in the near term'.

The full list of recommendations is here.

MinterEllison has released an article highlighting the key recommendations and offering insights into the likely next steps. You can access the full text here: Parliamentary Inquiry recommends comprehensive insolvency review - Technical update - MinterEllison

Other News

Consultation launched on modernising execution of Commonwealth statutory declarations

Ahead of the expiry of temporary measures allowing electronic execution of Commonwealth statutory declarations on 31 December 2023, the Commonwealth Attorney General's Department has opened a consultation on a proposal to permanently modernise the execution process.

Broadly, it's proposed that statutory declarations could be executed in any of the following three ways:

- e-execution (ie allowing electronic signatures and witnessing via audio-visual link)
- digital execution (ie 'end-to-end online execution, with digital identity providers to verify identity and satisfy witnessing requirements'. You can find a flow chart showing the proposed process on p4 of the consultation paper)
- traditional paper-based execution (requiring wet-ink signatures and in-person witnessing)

On the second of these options, the consultation papers that

> 'the proposal to facilitate digital execution of Commonwealth statutory declarations prioritises flexibility, adaptability, and is designed to accommodate…[the] future expansion of the AGDIS [Australian Government Digital Identity System] to state and territory and private sector participants, should Government decide to expand the framework'.

The consultation includes a number of specific questions for feedback including any concerns about the proposal to enable wholly digital execution.

The due date for submissions is 28 July 2023.

> [Source: Consultation: Modernising document execution: consultation on proposed reform to the execution of Commonwealth statutory declarations 6 July 2023 – 28 July 2023]

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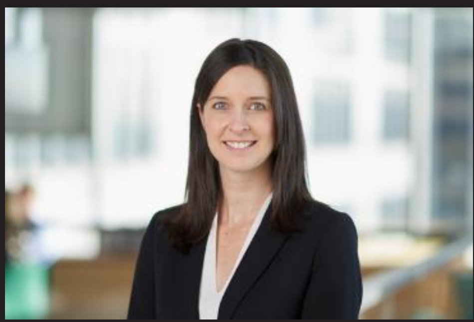

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