Governance News

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

26 July 2023

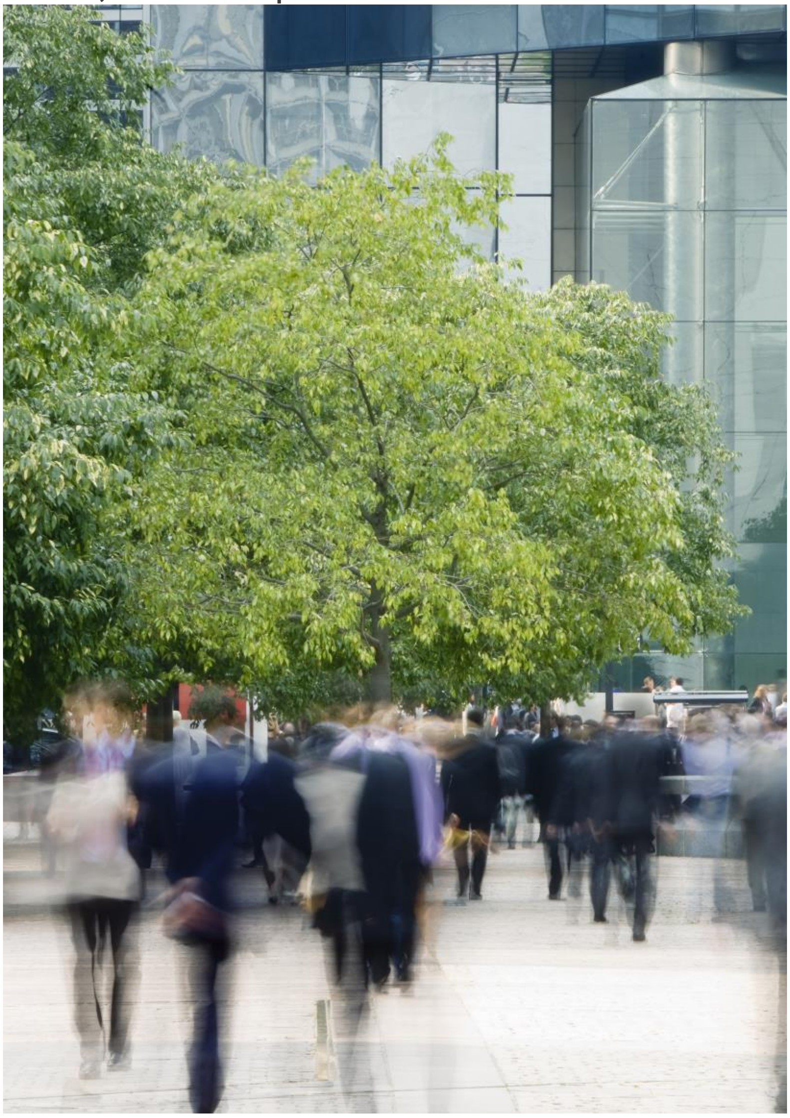
Contents

Diversity

How to do better: CEW offers practical insights into how corporate Australia can harness the leadership potential of culturally/racially diverse women

Chief Executive Women (CEW) has released a report - Unlocking Leadership: Conversations on Gender and Race in Corporate Australia – highlighting the lack of progress towards increasing representation of culturally and racially diverse women in senior leadership roles and putting forward some practical actions to start to 'unlock the potential of culturally diverse women leaders'.

Progress towards gender equality has in the main, increased representation of white women in leadership



The starting point for the report is that though some progress has been made towards increasing gender diversity in leadership roles in Australian companies, progress has been both slow and ultimately unequal. CEW observes that 'treating women as a uniform cohort' without applying a intersectional lens has meant that the 'benefits' of increased representation have flowed more readily to the 'dominate White population'.

The report states:

> 'There are still several challenges we need to address to achieve equal representation in all parts of society. Importantly, we know that a discussion on how to deliver gender equality without applying an intersectional lens can limit our ability to harness the full potential that exists today to increase the representation of women in leadership. There are culturally and racially diverse women, First Nations women, women with a disability, people of marginalised genders and sexualities, and women with low socio-economic status who experience multiple, diverse, and intersecting forms of discrimination and disadvantage. Treating women as a uniform cohort often comes at the expense of these women'.
>
> [Note: This lack of progress has been highlighted in a number of other reports tracking board composition. For example: a standout finding from the 2023 Board Diversity Index (from the Governance Institute and Watermark) is the lack of progress on this issue – the report found that 90% of board members are from an Anglo-Celtic background (consistent with the 2021 and 2022 reports). For more see: Still 'too male, too pale and too stale': Report finds ASX 300 boards are still lagging on diversity - POST - MinterEllison]

How leaders can take action

To start to address this challenge, CEW puts forward several suggested actions, informed by discussions with/insights from culturally and racially diverse women leaders. The table below provides a high level summary.

SUGGESTED ACTION	WHY AND WHAT THIS LOOKS LIKE
1. 'Lead a conversation about cultural and racial diversity' 2. 'Role model curiosity and engage in self-reflection'	▪ Though Australian leaders have become more comfortable/experienced in discussing gender equality, CEW found that 'talking about race remains largely taboo in corporate Australia'. One result of this 'silence' on the issue is that it 'can make it difficult for culturally and racially diverse women to reckon with the intersectional barriers they faced'. ▪ To start to address this, CEW calls for organisations to both: – make intersectional diversity a whole of organisation priority and challenges leaders to 'develop their understanding of intersectionality and create the space for new conversations about cultural and racial diversity' – 'role model curiosity and a learning mindset, in consultation with the workforce, while acknowledging any mistakes and committing to self-improvement'. On this point, the report underlines that leaders should be cautious of placing the burden of cultural responsibility on culturally/racially diverse people
3. 'Gather data, set goals, measure progress, and hold leaders to account' 4. 'Actively invest in sponsorship' 5. 'Build culturally safe workplaces and break down systemic barriers'	▪ In addition to drawing on the full talent pool available (an imperative in the current tight labour market), the report gives a number of examples of other benefits of culturally/racially diverse leadership from an organisational perspective. For example the report flags that increased representation has been found to support more respectful/inclusive and productive organisation culture. ▪ To realise these benefits, the report suggests leaders: – Expand their existing approach to increasing gender diversity in leadership (which has proven to be effective in driving continued, if slow, improvement over time) to driving improvements in the representation of culturally/racially diverse women leaders. That is, leaders are encouraged to gather data, set targets and report and communicate progress against them. – Embrace 'sponsorship' – ie 'the act of advocating and creating opportunities for people who may not otherwise have access to career advancement, such as through nominating them for promotions, making key introductions, and including them in leadership networks' – (as opposed to 'mentorship'), to build a talent pipeline of diverse future leaders. – 'Use their leadership shadow to set expectations and demonstrate how to be an ally for culturally and racially diverse women, while recognising and rewarding others who do the same' – Acknowledge their influence on organisational culture, and: – 'assess the organisation's culture of safety in discussing gender and race, and take action in response' – 'engage in deliberate self-reflection about cultural assumptions and biases, acknowledge any mistakes, and commit to self-improvement' – reorganise social and networking events to ensure inclusion and create opportunities for cultural exchanges.

Next steps

CEW makes clear that the report (and the suggested actions included in it) are a starting point. Rather than an entire solution to the issue. Moreover, the CEW also makes clear that it has improvements to make in its own approach. On this point, CEW comments that it is:

> 'committed to living our stated value of having diverse women leaders at every decision-making table and will adopt this report's recommendations in full. We have started gathering data across our membership, and will work towards setting meaningful targets to drive greater diversity within our organisation. We invite business leaders to join us on this journey towards genuinely diverse gender equality in Australia'.
>
> [Sources: CEW media release 20/07/2023; Full text report: Unlocking Leadership: Conversations on Gender and Race in Corporate Australia]

Shareholder Activism

Top Story | Global report confirms overall slowdown in activist activity

Insightia has released its latest statistical analysis of global trends in shareholder activist activity for H1 2023. Our key takeaways are below.

Key Takeouts

- The global report found that the overall level of activist activity for H1 2023 was down on the same period last year (though some regions defied the overall slowdown)
- Activist activity continues to be highest (by far) in the US, followed by Japan. Australia ranks sixth overall in terms of activist activity
- Globally, the number of companies publicly subjected to environmental and social demands remained high. In the US, the number of companies publicly subjected to specifically 'climate change & GHG emissions' demands increased 22% on H1 2022
- In Australia, fewer companies were publicly subjected to activist demands in H1 2022 compared with the same period last year. The number of Australian companies targeted with environmental demands was slightly up on last year.

Overview

Below is a short overview of some of the key findings in the report, the full text of which is here.

Global trends

The overall level of activist activity is down on last year

- According to the report, 721 companies globally were publicly subjected to activist demands in H1 2023 (down from 730 in H1 2022). For context, this is well down on pre-pandemic levels – in H1 2019, 768 companies globally were publicly subjected to activist demands.
- However, the report also reveals that the H1 2023 slowdown was not even across regions. For example, while activity dropped to a recent low in Europe (with just 85 companies targeted down from 102 in H1 2022), activity remained steady in Japan, increased slightly in Canada and spiked in the Republic of Korea.

Most active (and least active) regions

- According to the report, levels of activity continue to be highest in the US where 403 companies were targeted in H1 2023 (vs 406 in H1 2022).
- The next most active regions were:
  - Japan (89 companies targeted – consistent with H1 2022)
  - Republic of Korea (60 companies targeted, up from 41 in H1 2022)
  - Canada (40 companies targeted, up from 37 companies in H1 2022)
  - the UK (25 companies targeted, down from 28 in H1 2022)
  - Australia (23 companies targeted, down from 27 in H1 2022).
- Activity was found to be lowest in Brazil, India, Hong Kong, Puerto Rico, Norway, Taiwan, Austria, Bermuda, Belgium, Russian Federation and Luxembourg (all had only two companies targeted during the H1 2023 period)

Sectors most targeted

- Globally, and consistent with H1 2022, more companies in the industrials sector were targeted than any other (16% of the total number of companies publicly subjected to activist demands were companies in this sector).
- The next most targeted sectors were: consumer cyclical (15%) and financial services (13%).
- The report also there was a sharp fall in the number of technology companies targeted: 97 companies in H2 2022 vs 82 companies in H1 2023.

Most targeted companies by size

- Consistent with previous years, large cap companies continue to be the most targeted (accounting for 40% of the total number of companies publicly subjected to activist demands during the H1 2023 period).

More companies faced E&S demands

- According to the report, during H1 2023, the number of companies publicly subjected to activist E&S demands increased substantially:
  - 115 companies were publicly subjected to 'environmental' demands (up from 129 in H1 2022 and 93 in H1 2021)
  - 144 companies were publicly subjected to 'social' demands (up from 129 in H1 2022)
- Fewer companies were targeted with 'governance' demands - 327 companies were publicly subjected to 'governance' demands (down from 334 in H1 2022)
- The number of companies publicly subjected to activist M&A demands fell from 46 in H1 2022 to 38 in H1 2023

US-specific findings

- Fewer US-based companies were publicly subjected to activist demands in H1 2023 than in the same period last year – according to the report 403 companies were publicly subjected to activist demands in H1 2023 vs 406 in H1 2022. For context, this is still down on the level of activity for any year in the 2017-2019 period.
- The consumer cyclical and industrials sectors were the most targeted.

More companies faced E&S-related demands

- According to the report, 394 US-based companies were publicly targeted by ESG-related demands in H1 2023 (up from 382 in H1 2022).
- Notably, the report reveals that this increase was driven by an uptick in the environmental and social demands (and a corresponding drop in governance demands):
  - 73 US-based companies were targeted with environmental demands in H1 2023 (vs 64 in H1 2022)
  - 120 US-based companies were targeted with social demands in H1 2023 (vs 96 in H1 2022)
  - 201 companies were targeted with governance demands in H1 2023 (vs 222 in H1 2022)

Demand type:

- In the 'environmental' category, greenhouse gas (GHG) emissions reduction/climate-related demands were the most common
- In the 'social' category, diversity/equality related demands were the most common
- In the 'governance' category, calls to amend company policy were the most common, followed by board-independence demands

Australia-specific findings

- Fewer Australia-based companies were publicly subjected to activist demands in H1 2023 compared with the same period last year - 23 Australia based companies in H1 2023 vs 27 in H1 2022. For context, this is substantially down on 2019 levels (40 companies were targeted during H1 2019).
- Consistent with previous years, the basic materials sector continues to be the most targeted sector (accounting for 35% of the total number of companies targeted during the period)
- The next most targeted sector (accounting for 30% of Australia-based companies targeted in the period) was financial services – double the number targeted in the same period in 2022.
- Consistent with previous years, the most common demand type in H1 2023 were demands to appoint or remove personnel
- The number of Australia-based companies targeted with environmental demands remained steady:
  - Six companies faced environmental demands in H1 2023 (consistent with H1 2022)
  - Interestingly, the report found that unlike last year, not all demands concerned GHG emissions/climate change - this year, the majority of demands (five of seven) concern waste and pollution.

- Activists have so far secured 12 board seats (down from a record 18 in H1 2021). Interestingly, 11 of 12 were secured through a contested vote (rather than settlements) - last year, seven of 11 seats were secured through settlements.

  [Source: Insightia report: Shareholder Activism in H1 2023]

Further confirmation: Record number of E&S shareholder proposals appeared on ballots this US proxy season, but support was down

A number of recent reports into the trends to emerge this US proxy season have flagged an uptick in the volume of shareholder environmental and social (E&S) proposals and a drop in the level of support they are securing. See for example this report from Semler Brossy, and this report from Georgeson.

Analysis from Institutional Shareholder Services' (ISS) to mid-June 2023, appears to further confirm these trends.

According to ISS' analysis as at mid-June 2023:

- More Environmental and Social shareholder proposals appeared on ballots than any other category of proposal (340 E&S vs 224 Governance proposals which were the next highest category of shareholder proposal).
- Support for shareholder E&S proposals continued to drop: support dropped from 26% in 2022 to approximately 19% in 2023
- There were fewer majority supported proposals: Eight proposals secured majority support during the period (vs 37 majority-supported proposals in full year 2022).
- The most common categories of shareholder E&S proposals this year were:
  - climate change (typically calling on companies to report/adopt Paris-aligned greenhouse gas targets) were the most common
  - political spending/lobbying
  - human rights
  - diversity, equity and inclusion (DEI)
  - health and safety.

- ISS found that the level of support has fallen across all E&S shareholder proposal categories. For example:
  - Support for climate-related shareholder proposals fell with the average level of support falling from 35% in 2022 to around 23% 2023, with two majority supported shareholder climate proposals.
  - Support for political spending and lobbying proposals received less than 7% support on average. Only one proposal in this sub-category has received majority support so far.
  - Support for DEI shareholder proposals is down on last year.
- ISS attributes the drop in support to a range of factors including:
  - that more proposals made it onto company ballots that are either more 'prescriptive' than was previously the case and/or less likely to lead to long-term shareholder value. ISS considers this is a reflection (at least in part) of the fact that companies are having a harder time persuading the Securities and Exchange Commission to approve their proposal omission requests
  - the growing politicisation and polarisation on ESG issues in the US
- Governance-related shareholder proposals:
  - Governance-related proposals requesting an independent board chair were the most prevalent in this category (79 proposals).
  - The average level of support was 29.6%.
  - There have been no majority supported shareholder governance proposals in 2023.
- The number of 'anti-ESG' proposals – eg proposals asking for companies to do cost/benefit analyses on targets to reduce carbon emissions with the aim of proving they are not – going to a vote increased to 40 proposals (almost double the number last year). The level of support for these proposals has remained low (typically less than 5% support). ISS suggests that the risk in anti-ESG proposals signals 'a larger trend of politicisation and polarisation of corporate E&S issues in the US'.

  [Source: ISS media release 20/07/2023]

Vote no: ShareAction urges investors to vote against EMS-Chemie Chair on climate grounds

- ShareAction has urged investors in Swiss chemical company EMS-Chemie Holding AG (EMS Chemie) to vote against the Chair's reelection at the 12 August 2023 meeting to signal concern over (what ShareAction considers to be): a) the lack of rigour in the company's existing climate plan/targets; and b) the lack of effective oversight of climate risk/opportunities.
- Broadly, ShareAction considers the company's plan for meeting its net zero target lacks credibility because: a) the net zero target covers less than 1% of the company's emissions; b) the company plans to increase its absolute Scope 3 (supply chain) emissions over the next 12 years; and c) the company has not produced a 'meaningful emissions reduction strategy' in that it lacks detail/interim targets are heavily reliant on offsetting.
- In addition, ShareAction considers the company's climate governance and risk management arrangements under the existing Chair are inadequate. For example ShareAction raises concerns about (what it views as) a lack of clarity around how the board provides effective oversight of climate-related risks/opportunities or management's strategy for addressing them. ShareAction comments:

  > 'EMS-Chemie provides no evidence of Mr Merki, other board members or management having expertise, or receiving training, on climate change or sustainability issues. Vague descriptions of risks, opportunities and efforts to respond to them, without comment on their probability and potential impact, provide little reassurance of how risks are being assessed and managed. Further, the company describes the climate scenarios used to assess these risks in scant detail, with no disclosure of underlying assumptions or whether they are informed by qualitative or quantitative elements.13 This raises concerns about their sufficiency to identify and evaluate risks….
  >
  > Under Mr Merki's oversight clear gaps have developed in the company's governance and risk management. This raises important questions about Mr Merki's competence as chair, at a time when EMS-Chemie must urgently adapt to new realities in Switzerland'.

- Finally, ShareAction considers a vote against the Chair's reelection is justified because the company has consistently opted not to engage with shareholders on these concerns.

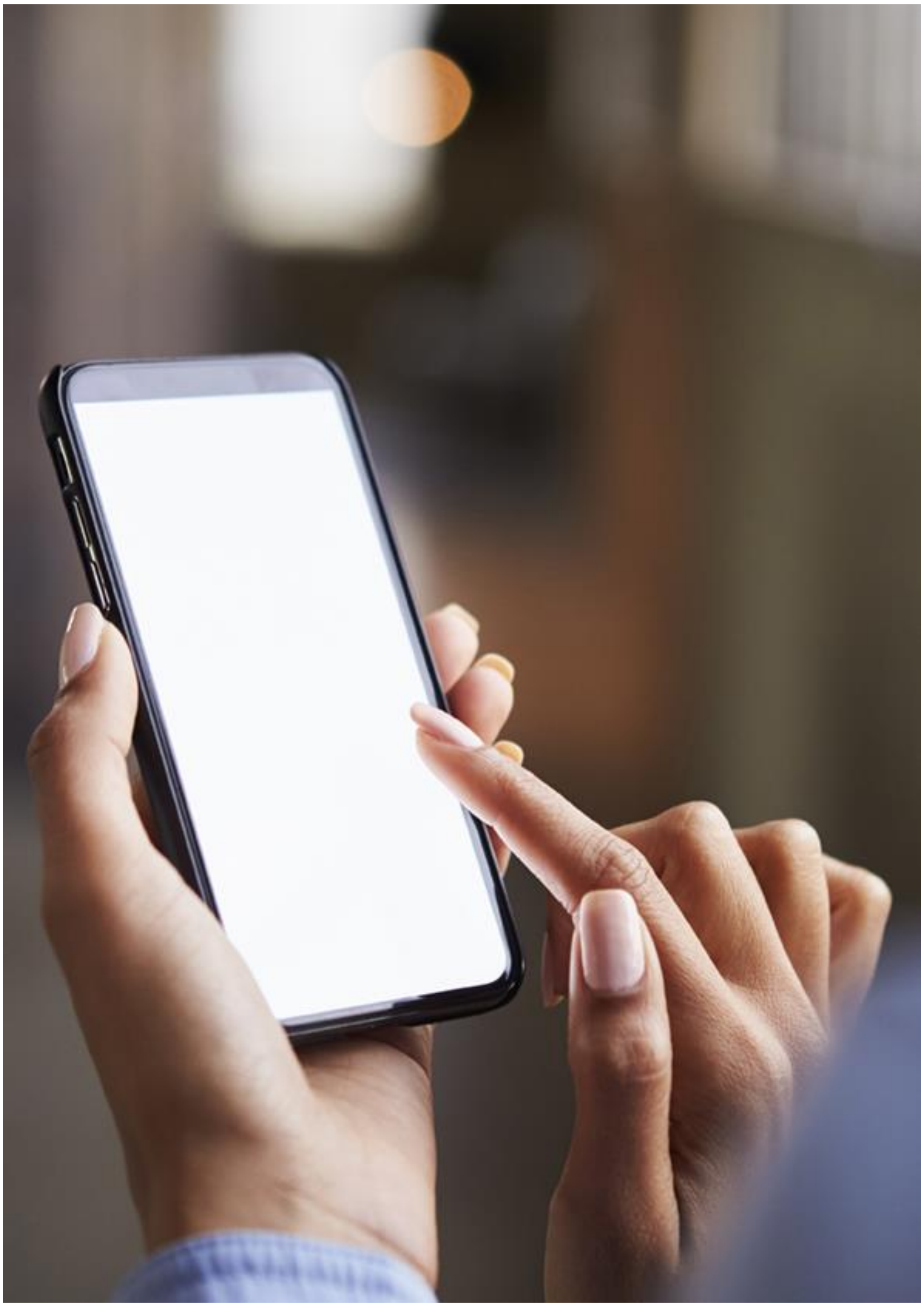
  [Source: ShareAction media release 21/07/2023]

Institutional Investors and Stewardship

New investor coalition set to tackle digital harm

Twenty-seven global institutional investors representing $2,117 bn in assets under management, led by AXA IM and Sycomore AM, have launched a new engagement initiative (coordinated through the PRI platform) with the aim of 'helping' technology companies to:

> 'define policies and implement measures to mitigate the potential negative impact of technology on their end consumers' mental health and well-being'.



This harm includes for example behavioural issues associated with excessive screen use (especially when screens are introduced too early).

As an initial step, investors plan to engage with 15 companies in the hardware, media, internet, gaming, edtech and telecommunications sectors with a view to raising awareness of the issue and encouraging companies to develop and implement concrete action plans to mitigate potential consumer harms.

For example, initiative members will seek to encourage companies to:

- Have a policy and implement measures to 'mitigate risks of addiction and potential adversary effects on end-consumer mental health and well-being'
- Include a high level commitment in business codes, human rights policies or risk assessment frameworks; to keep children safe online
- Set and report on progress towards achieving specific goals

If this approach is unsuccessful in driving the look-for changes, individual coalition members 'may' consider initiating their own escalation tactics including for example voting against management or filing shareholder resolutions.

You can find the initiative's full statement here

[Sources: AXA investment managers media release 11/07/2023]

ESG

How do the ISSB standards differ from the TCFD recommendations?

Context: What are the ISSB standards?

The International Sustainability Standards Board (ISSB) launched its initial two global sustainability reporting standards in final form on 26 June 2023, together with accompanying guidance:

- General Requirements for Disclosure of Sustainability-related financial information (IFRS S1) sets out the requirements for disclosure of 'information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term'
- Climate-related Disclosures (IFRS S2) sets out the requirements for disclosure of 'climate-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term'.

While the IFRS are not binding on Australian reporting entities the new standards are expected to form the core of emerging (and mandatory) sustainability-related financial disclosure requirements globally, including in Australia. For more on the ISSB standards see: Step change in sustainability reporting: First two ISSB standards released - Why the release of the first two global sustainability standards is such a big deal.

Comparison of TCFD recommendations and IFRS S2 Climate-related Disclosures released

The IFRS Foundation released a comparison of the requirements in the IFRS S2 Climate-related Disclosures and the Financial Stability Board's Taskforce on Climate-related Disclosure (TCFD) recommendations.

Importantly, the IFRS considers that (as illustrated by the comparison):

- There is no need for companies to apply the TCFD recommendations in addition to the ISSB standards fully incorporate the TCFD recommendations. (Having said this, IFRS notes that the TCFD recommendations remain available for companies to use should they wish to do so/may be a helpful starting point for preparing to report under the ISSB standards).
- Though the ISSB standards are consistent with the TCFD recommendations, they build on/go further than the TCFD recommendations in a number of respects, in that the ISSB standards both require more detailed/granular disclosure and include number of additional requirements. For example, IFRS S 2 contains additional requirements for companies to (among other things):
  - Disclose more detailed information on greenhouse gas (GHG) emissions targets including additional information about their planned use of/extent of their reliance on carbon credits (or offsets) to achieve the targets set
  - Disclose additional information about their approach to setting and reviewing each GHG target and how progress is monitored
  - Disclose additional and more detailed information about their GHG emissions (including Scope 3 or supply chain GHG emissions) eg new requirements to disclose information about the measurement approach, inputs and assumptions used in measuring Scope 3 emissions

  [Source: IFRS Sustainability: Comparison IFRS S2 Climate-related Disclosures with the TCFD Recommendations July 2023]

ISSB standards | IOSCO endorses the IFRS S1 and IFRS S2, calls on its 130 member jurisdictions to incorporate them

- Following its review of the International Sustainability Standards Board's (ISSB) initial two global sustainability standards, the International Organization of Securities Commissions (IOSCO) formally endorsed IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (IFRS S1) and the IFRS S2 Climate-related Disclosures (IFRS S2). IOSCO Chair Jean-Paul Servais commented:

  > 'Investors are demanding better information about sustainability risks and opportunities, and the G20, the G7, and the FSB rely on IOSCO to assess whether the ISSB Standards are fit for purpose for capital markets. Our members, working together, have carefully analysed the ISSB's standards against IOSCO's endorsement criteria. IOSCO has found that the ISSB conducted a robust process and have concluded that

these standards serve as an effective and proportionate global framework of investor-focused disclosures on sustainability- and climate-related risks and opportunities'.

- You can access IOSCO's report of its technical assessment of IFRS S1 and IFRS S2 here.
- IOSCO has called on its 130 member jurisdictions – which together regulate more than 95% of the world's securities markets – to consider how they might implement IFRS S1 and IFRS S2.
- Commenting on this, IFRS Chair Erkki Liikanen said that IOSCO's endorsement of the standards

'is a resounding validation of the ISSB's work to develop robust, proportionate sustainability disclosure standards fit for capital market use at global level.

IOSCO has a crucial role in shaping global financial regulation. Securities regulators are central to setting corporate reporting and disclosure requirements in capital markets. IOSCO's endorsement sends a powerful signal to jurisdictions worldwide, providing them with the confidence they need to implement the ISSB Standards in their regulatory frameworks'.

Supporting implementation

Separately, the IFRS Foundation has released a document outlining how the ISSB and the IFRS (working closely with IOSCO) plan to support implementation of the standards, and the steps already taken. IFRS comments:

'Our strategy to support jurisdictions in their journeys towards adoption focuses on four strategic pillars: proportionality, transitional reliefs, consistency in approaches on the phasing-in and scaling of requirements, and capacity building that supports implementation'.

Key measures flagged in the document include:

- the planned release of an 'Adoption Guide' which will

'set expectations regarding the scope of application of ISSB requirements, the targeted entities within the scope of the regulatory adoption assessment and the pace for the introduction of ISSB requirements for different types of entities'.

- establishing a Transition Implementation Group (TIG) to support the implementation of IFRS S1 and IFRS S2, similar to the transition resource groups (TRGs) established to support implementation of new IFRS Accounting Standards. The ISSB plans to establish the TIG in the Q3 2023.

IOSCO has welcomed the release of the document, stating that it is

'committed to working closely with the ISSB, other relevant bodies, and IOSCO members to promote consistent and comparable climate-related and other sustainability related disclosures for investors through the roll out of a comprehensive capacity building program'.

[Source: IOSCO media release 25/07/2023]

In Brief | ISSB implementation: The Financial Reporting Council (FRC has issued a call for evidence to inform the proposed endorsement of the ISSB Sustainability Disclosure Standards in the UK. The due date for submissions is 11 October 2023

[Source: FRC media release 11/10/2023]

NBIM joins PCAF, commits to reporting portfolio emissions

- The largest single owner in the world's stock markets, Norges Bank Investment Management (NBIM) has joined the Partnership for Carbon Accounting Financials (PCAF) initiative.
- In line with NBIM's 2025 Climate action plan, NBIM has committed to:
  - 'push' companies in its portfolio to align their activities with the goals of the Paris Agreement
  - expand its climate risk reporting at the portfolio level, continuing to bring it into full alignment with the PCAF Standard

- For context, PCAF is an financial industry led global initiative that aims to make reporting of greenhouse gas (GHG) emissions associated with loan/investment portfolios a baseline for financial institutions. In line with this aim, PCAF members commit to assess and disclose the greenhouse (GHG) gas emissions associated with their loan/investment portfolios within a period of three years, using the PCAF Accounting and Reporting Standard for the Financial Industry. To date, more than 400 financial institutions globally have joined the initiative.
- Announcing this, NBIM Head of ESG Risk Monitoring Christopher Wright commented:

> 'As financial institutions around the world continue to build an understanding of and report on their climate risk and opportunities, the standardisation of climate risk accounting methodologies will prove invaluable. We look forward to collaborating with PCAF to further develop standards in this area over the coming years.'
>
> [Source: PCAF media release 20/07/2023]

Reducing supply chain emissions: Amazon to require suppliers to set and report against emissions targets

As part of its broader plan to meet its net zero by 2040 goal, Amazon Inc has said it will update its Supply Chain Standards next year to require its suppliers to set emissions reduction goals and share updates with Amazon on their progress toward achieving them. To support this, Amazon has said it plans to provide suppliers products and 'tools' to support their transition. Commenting on this, Amazon, Vice President and Head of Worldwide Sustainability Kara Hurst said:

> 'We know that to decrease our carbon footprint, we must work with our supply chain partners to help them decarbonize their own operations. Beginning in 2024, we're updating our Supply Chain Standards to require suppliers to share their carbon emissions data with us and set carbon goals. We'll use our scale, investment, and innovation to provide tools and resources to help them reach their goals - whether that's transitioning to renewable energy or accessing more sustainable material'.

Amazon has also reiterated its commitment to improving the environmental impact of its packaging, including efforts to minimise excess waste/single use packaging. Ms Hurst notes that in 2022 the company decreased its single-use plastic usage by 11.6% across its global operations (through expanding paper-based packaging, and continuing to use lighter and more-flexible packaging).

Amazon faced a record 18 shareholder ESG proposals on a range of issues at its 24 May 2023 AGM, including a plastic packaging proposal. Though none of the proposals secured majority support, As You Sow's plastic reduction proposal (Item 22 in the Notice) secured over 30% support. proposal calling on the company to report on:

> [Sources: Amazon 2022 Sustainability Report; Amazon media release 18/07/2023]

Tying executive pay to ESG metrics: Use of environmental metrics is now a majority practice among S&P 500 utilities and energy companies

Analysis of S&P 500 companies' executive compensation plans has identified that:

- Almost three quarters (73%) of companies now link a portion of incentive compensation to the achievement of ESG metrics
- ESG metrics are most commonly included in Short Term Incentive Plans (STIPs) (77% of cases), with the weighting given typically between 5% and 15%
- Only 9% of S&P 500 companies include ESG metrics in Long-term Incentive Plans (LTIPs)
- The three most commonly used ESG metrics are: Diversity and Inclusion related (51% of companies), Carbon footprint and emissions reduction related (23%), and Employee health and safety related (also 23% of companies).
- There is variation across sectors. The only sectors where inclusion of environmental metrics is a majority practice are the Energy and Utilities sectors (100% and 83% respectively)
- Interestingly, relatively few companies (26% of companies that use ESG metrics) use standalone, individual ESG metrics. The most common approach is for companies to include ESG metrics as part of a business strategy scorecard. That is, ESG metrics are rarely individually measured or weighted.

[Source: Harvard Law School Forum on Corporate Governance 20/07/2023]

Australia to launch decarbonisation plans for key sectors

- In his 18 July 2023 address to the Clean Energy Council Minister for Climate Change and Energy Chris Bowen announced plans to develop (working closely with industry, climate groups, unions and the community) sector-specific decarbonisation plans for the following six sectors:
  - Electricity and Energy,
  - Industry (including the waste sector),
  - the Built Environment,
  - Agriculture and Land,
  - Transport and
  - Resources.
- Mr Bowen said that the circular economy would be a 'cross-cutting issue' across all plans will focus on the circular economy would be a focus across all sectoral plans.
- The new sector plans are expected to 'feed in to both' the government's Net Zero by 2050 plan and the 2035 targets already set.
- The Climate Change Authority will be tasked with developing sector pathways to help inform the plans. The government has requested advice from the Climate Change Authority on the 2035 target. This advice is expected to be delivered to the Minister in 'late 2024'.

Initial response to the announcement

- ClimateWorks has welcomed the announcement on the basis that:

  'Decarbonisation pathways are crucial for laying the pathway for emission reductions in other sectors too, particularly ahead of Australia increasing its national emissions reduction targets for 2035'.

- The Property Council of Australia has also welcomed the announcement. Property Council CEO Mike Zorbas commented:

  'The Property Council has long advocated for a sector specific plan to guide that effort and today's announcement is a welcome one. Buildings account for 50 per cent of Australia's electricity use and 23 per cent of all emissions through their operations. The technology already exists today to decarbonise buildings – but we must do this as a priority and at scale. The shift to low carbon and resilient buildings needs a clear plan and steady trajectory that encourages market confidence. We look forward to working with Ministers Bowen, Husic and McAllister to provide certainty to industry and benefits to communities'.

[Source: Minister for Climate Change and Energy Chris Bowen, Address to the Clean Energy Council 18/07/2023]

SPG 530 finalised: APRA clarifies how super funds are expected to factor ESG into their overall risk management approach

The Australian Prudential Regulation Authority's (APRA) Prudential Standard for superannuation trustees SPS 530 Investment Governance came into force on 1 January 2023. Following consultation, APRA has released guidance (SPG 530) to support compliance with the standard.

Among other things, SPG 530 includes guidance around how APRA 'expects trustees will consider environmental, social and governance risk factors as part of their overall investment risk management'.

For example, SPG 530:

- States that the task of determining the appropriate level of diversification for each investment strategy is expected to entail consideration of the potential impact of climate risk (among other risks) on outcomes for beneficiaries. RSE licensees are also expected to be able to demonstrate how this informed their investment strategy. Specifically APRA states that RSE licensees are expected to be able to:

  > 'demonstrate an understanding of the risk and opportunities present in a range of ESG factors, and the extent to which they may have an impact on the financial risk-return profile of the RSE licensee's investment portfolio, including an assessment of climate risk exposures'.

- Provides insight into APRA's expectations around 'stewardship activities': SPG 530 makes clear that:

  > 'APRA expects an RSE licensee would consider how it uses its influence or investment market presence, including engaging with investees, making public statements, undertaking policy advocacy and voting, to generate value in investments. Where an RSE licensee engages in such stewardship activities as part of its prudent management of investments, APRA expects an RSE licensee would be able to demonstrate how these activities:
  >
  > a) contribute to value creation/preservation over different time horizons and support delivering financial returns to beneficiaries;
  >
  > b) are appropriate in the context of the RSE licensee's business operations, resources and investment mix and complexity;
  >
  > c) are undertaken on a cost-effective basis, including where undertaken by way of a collective approach; and
  >
  > d) are aligned with publicly disclosed statements on stewardship'.

In a letter to industry, APRA states that the final guidance responds to industry's calls for 'for further clarity and consistency in the language relating to ESG risks and having an appropriate emphasis on ESG from a risk perspective'.

[Source: Prudential Standard SPS 530 Investment Governance in Superannuation]

Greenwashing | ASIC has launched civil penalty proceedings against a fund manager over allegedly misleading investors about the sustainability of an ethical bond product

The Australian Securities and Investments Commission (ASIC) has commenced civil penalty proceedings against a fund manager, over the fund manager's (alleged) failure to ensure that ESG screening criteria were applied - as claimed - to exclude bond issuers with significant business activities in certain industries (eg fossil fuels) from an 'ethically conscious' bond product. The product is alleged to have 'exposed investor funds to investments which had ties to fossil fuels, including those with activities linked to oil and gas exploration'.

Summing up ASIC's case, ASIC Deputy Chair Sarah Court said:

> '[the fund manager] promised its investors and potential investors that the product would be screened to exclude bond issuers with significant business activities in certain industries, including fossil fuels. We consider that the screening and research undertaken on behalf of…[the fund] was far more limited than that being promised to investors, and we consider this constitutes another example of greenwashing.'

Ms Court also emphasised ASIC's expectation that 'if exclusions in investments are promised…[they] need to be applied and promises upheld'.

The date for the first case management hearing is yet to be scheduled by the court.

[Source: ASIC media release 25/07/2023]

Financial Services

Top Story | FAR status update: Regulators consult on FAR implementation

The Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) have opened a four week consultation on draft rules to support the transition from the existing BEAR to the Financial Accountability Regime (FAR) and implementation of the FAR. Here's what you need to know.

Key Takeouts

- Legislation to introduce the long-awaited FAR - the Financial Accountability Regime (Consequential Amendments) Bill 2023 and Financial Accountability Regime Bill 2023 – is currently before the Senate.
- If the Bills are passed by the Senate during the 31 July - 10 August sittings (and receive Assent in August), the earliest possible date from which the FAR would apply (for the banking sector) is February 2024 (and for the insurance and superannuation sectors) February 2025. You can read more about the FAR here: FAR status update: FAR Bills delayed (again).
- Ahead of the expected passage of the Bills, APRA and ASIC (which will jointly administer the FAR) have opened a four week consultation on draft Rules. The draft Rules prescribe information for inclusion in the register of Accountable Persons (APs) under the FAR, including the 'key functions' that have been assigned to the AP. The 'key functions' for ADIs are prescribed by the draft Rules and each must be assigned to at least one AP. This differs from the approach under BEAR, where APRA has provided 'guidance' as to the key functions for ADIs to consider when developing accountability statements. The list of 'key functions' under FAR is also considerably broader than under the BEAR.
- Though the focus of the consultation is on ADIs, the regulators suggest that superannuation funds and insurers 'may wish to consider' the draft Regulator Rules in particular (which include the information that every responsible entity would need to submit for inclusion in the register of accountable persons).
- The due date for submissions is 17 August 2023.

What is the FAR?

The Financial Accountability Regime (FAR) would replace and expand on the existing Banking Executive Accountability Regime or BEAR.

Broadly, the FAR would extend strengthened, but BEAR-like accountability requirements, to other APRA-regulated entities and to the directors/senior executives of those entities in accordance with the government's response to several Hayne Commission recommendations (Hayne Recommendations 3.9, 4.12, 6.6, 6.7 and 6.8).

The aim of the FAR is ultimately to strengthen and increase individual and entity level accountability across the financial services sector, including for non-financial conduct risk.

As flagged, legislation to establish the proposed FAR is currently before the Senate.

The FAR will (if legislated in its current form) apply to ADIs six months after Assent and to insurers and superannuation funds 18 months after Assent.

Unlike the BEAR (which is administered by the Australian Prudential Regulation Authority (APRA) only), FAR will be jointly administered by APRA and the Australian Securities and Investments Commission (ASIC) (the regulators).

For more on the FAR see: FAR status update: FAR Bills delayed (again).

Regulators open consultation on important aspects of FAR implementation

In jointly administering the FAR, the Regulators will be required to establish and maintain a register of APs. FAR contemplates that the content of this register can include additional relevant information prescribed by the Regulator rules.

The draft Regulator rules are divided into two parts:

- a list of data items that all ADIs, superannuation and insurance entities would need to provide to the regulators about their APs; and

- a list of key functions, relevant to accountable entities that are ADIs or authorised non-operating holding companies (NOHCs) of an ADI.

The regulators have also released a document (that is not part of the draft Rules) providing further context around these proposed 'key functions', and plan to consult separately on 'key functions' for insurers and superannuation funds. We've summarised the key points below.

Information proposed to be included in the AP Register (for all Responsible Entities)

The draft Regulator Rules include a list of 'prescribed information' for inclusion in the AP Register which the regulators have indicated is 'relevant to all accountable entities'. This information is proposed to include:

- personal identification details
- details of employment status
- 'key functions' information (ie the 'key function' or 'key functions' they have been assigned and the date they assumed responsibility for that function/s)
- reporting lines
- requirement to notify the regulators of suspension of the AP in certain circumstances.

Under proposed transitional rules to apply to ADIs, this information would be required to be submitted in electronic form via APRA Connect within 30 days of the FAR applying to ADIs.

'Key functions'

In a departure from the existing BEAR, the draft Regulator Rules include a prescribed list of 'key functions' that ADIs (and their authorised NOHCs) would need to assign at least one AP against (though ADIs would have discretion to assign more than one AP 'if this reflects different responsibilities in relation to that function').

The list of 'key functions' included is both much broader than under the existing BEAR and, as flagged, is not proposed to be an indicative/non-exhaustive source of guidance, but rather a requirement. The list includes for example:

- data management
- product design and distribution obligations
- recovery and exit planning and resolution planning
- scam management
- technology management and risk culture
- whistleblower policy and process

A full list (together with additional guidance around the application of each) is included in a separate document (which is not part of the draft Regulator Rules) read ADI key functions descriptions.

The list of 'key functions' in the draft Regulator Rules is proposed to apply to ADIs only. The regulators plan to consult separately on a list of specific key functions for insurers and superannuation funds 'in due course' but in the meantime insurance and superannuation entities are encouraged to consider the concept of 'key functions' and review the draft Regulator rules.

Timing

- Consultation on the draft Rules closes on 17 August 2023.
- It is not clear how quickly the legislation to establish the FAR will be enacted.
- The Senate is not due to sit again until 31 July 2023. Even though the FAR Bills are listed on the latest Senate Notice Paper, it is not certain that the Bills will be considered or passed during the 31 July - 10 August sittings.
- If the Bills are passed and Assent is given in August 2023, the earliest possible date from which the FAR would apply (for the banking sector) is February 2024 (and February 2025 for the insurance and superannuation sectors).

[Source: Financial Accountability Regime - Proposed Regulator rules and Transitional rules]

CHOICE again calls for tougher scam prevention rules for banks

Consumer group CHOICE has released research into scam activity. Among other things, CHOICE found that:

- **Scam activity is perceived to be widespread**
  - 9 in 10 people suspect they have encountered at least one scam in the past 12 months
  - Over 50% think they have encounter a potential scam on a weekly basis
- **There's a high level of concern about the risk of financial loss:** 64% of people worry they could lose money to a scam
- **People say they are exercising more caution online:** CHOICE found that 84% of people are being more cautious financially online due to scams
- **People think scams are getting harder to spot:** CHOICE found that 88% of people surveyed think scams are becoming more sophisticated and therefore more difficult to identify
- **There's strong public support for the introduction of tougher rules:**
  - 80% of people agreed that the government should legally force businesses to do more to stop scams
  - 64% of people agree banks should reimburse people who lose money to scams.

Mandatory Code for banks

CHOICE has called for the introduction of a mandatory Code requiring banks to reimburse customers for scam losses (where the bank has not taken reasonable steps to prevent the money being stolen). The introduction of stronger requirements, CHOICE Considers would both reduce distress for scam victims and 'create the right incentives for banks to invest in scam prevention'.

For context, the government has 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. It is not clear whether this will include imposing any requirements on banks to reimburse scam victims. The AFR reported in March that the government had ruled out introducing blanket requirements for banks to compensate scam victims.

[Source: CHOICE media release 25/07/2023]

CDR | New regulations aim to boost business consumer participation

Following consultation, new Regulations - Competition and Consumer (Consumer Data Right) Amendment Rules (No. 1) 2023 – have been registered which aim to both:

> 'support business consumer participation in the CDR and introduce a number of other operational enhancements to the CDR Rules'.

Key changes include:

- Enabling businesses to consent to accredited data recipients (ADRs) sharing their CDR data with a broader range of (unaccredited) third parties eg 'bookkeepers, consultants and other advisers who are not classified as trusted advisers under the current CDR Rules'. The changes also enable 'disclosures to the wide range of software providers that offer important services to small businesses in Australia'.
- Extending the length of certain business consumer use and disclosure consents from one year to (up to) seven years
- Delaying reciprocal data sharing obligations for newly accredited entities holding banking data sets until 12 months after they become an ADR
- Enabling data holders in the banking sector to publicly offer small scale pilot products (for up to 1,000 customers and for a 6-month maximum duration) without being subject to data sharing obligations
- Making changes around CDR representative arrangements and CDR outsourcing arrangements

[Source: Competition and Consumer (Consumer Data Right) Amendment Rules (No. 1) 2023]

Parliamentary Inquiry to inquire into insurers' response to the 2022 floods

Assistant Treasurer and Minister for Financial Services Stephen Jones has announced a new parliamentary inquiry into insurers' response to the 2022 floods in South-East Queensland and NSW.

The inquiry is set to investigate:

- the preparedness of insurers to respond to the frequency of flood events
- supply chain issues
- skills, and labour shortages
- claims handling
- insurers' communication with policy holders before, during and after flood events

Flood mitigation efforts

Mr Jones reiterated that the government has committed significant funding to mitigation efforts, noting that the government has committed:

- up to $1 billion over five years from 2023-24 (up to $200 million per year) to 'measures that better protect homes and communities from extreme weather through the flagship Disaster Ready Fund'.

- $22.6 million towards initiatives aimed at 'helping reduce the cost of insurance in communities at risk of natural disasters' through the establishment of the 'Hazards Insurance Partnership' - 'a formal arrangement between the Federal Government and insurance industry to engage on issues of disaster risk reduction'.

ICA welcomes the announcement, calls for inquiry to also consider impact of 'past decisions' on last use planning/disaster mitigation

In a statement, the Insurance Council of Australia (ICA) welcomed government's announcement and in particular, confirmation that the inquiry will consider the impact of 'worsening extreme weather events, supply chain issues and skills and labour shortages'.

The ICA also 'urged' the inquiry to consider:

> 'the impact of state insurance taxes on customers' capacity to appropriately insure, as well as how the impact of past decisions on land use planning and disaster mitigation impact community risk and insurability'.

The statement adds that the ICA-commissioned, independent review into insurers' response to the February-March 2022 floods is due to report its findings in October 2023.

> [Source: Assistant Treasurer Stephen Jones media release 19/07/2023]

APRA seeks injunction against (allegedly) unlicensed banking businesses

The Australian Prudential Regulation Authority (APRA) has sought an injunction in the Federal Court to restrain an individual from running and marketing several 'banking' businesses without the appropriate licence.

APRA observes that:

> 'Under the Banking Act 1959 (Cth), only authorised deposit-taking institutions (ADIs) licensed by APRA permitted to carry on banking business in Australia, including referring to themselves as "banks" or describing their services as banking'.

Announcing this APRA Deputy Chair Margaret Cole urged consumers 'to do their research before handing money over to unfamiliar businesses describing themselves as banks' noting that businesses marketing themselves as 'banks' without meeting APRA's licensing and other requirements, do not offer the same protections to depositors as APRA-licensed banks.

Ms Cole stated that APRA opted to take action in this case to:

> 'help prevent Australians mistakenly believing they are depositing money with an APRA-regulated institution and receiving the same protections'.

Ms Cole advised people who are uncertain about whether a business is a bank to check the register of APRA-regulated ADIs here, or email APRA for confirmation.

> [Source: APRA media release 25/07/2023]

Risk Management

'Responsible' AI development: White House announces (voluntary) commitments from technology companies

The White House has announced that it has secured the following three (voluntary) commitments from seven 'leading AI companies'– Amazon, Anthropic, Google, Inflection, Meta, Microsoft, and OpenAI – around the development of AI technologies.

COMMITMENTS	DETAILS
'Ensuring products are safe before introducing them to the public'	Companies have committed to ▪ undertake independent security testing of their AI systems prior to release; ▪ share information on 'managing AI risks' with their industry counterparts, academic and governments
'Building systems that put security first'	Companies have committed to: ▪ invest in cybersecurity and insider threat safeguards to protect proprietary and unreleased model weights ▪ facilitate third-party discovery and reporting of vulnerabilities in their AI systems.
'Earning the public's trust'	Specifically, companies have committed to ▪ 'developing robust technical mechanisms to ensure that users know when content is AI generated, such as a watermarking system. This action enables creativity with AI to flourish but reduces the dangers of fraud and deception'. ▪ Publicly reporting on their AI systems' 'capabilities, limitations and areas of appropriate and inappropriate use' with this disclosure expected to cover both societal and security risks eg the effects on fairness/bias. ▪ 'prioritising research on the societal risks that AI systems can pose, including on avoiding harmful bias and discrimination, and protecting privacy' ▪ developing and deploying advanced AI systems to 'help address society's greatest challenges' eg mitigating climate change

The White House announcement underlines the administration's continuing focus on this issue, noting that this is one of a raft of measures on foot. For example, the Administration is currently 'developing and executive order' and intends to 'pursue bipartisan legislation to help America lead the way in responsible innovation'.

[Sources: White House Fact Sheet 21/07/2023]

EU and US regulators open dialogue on consumer protection issues associated with the digital transformation of the financial services sector

The European Commission and the United States Consumer Financial Protection Bureau have entered into 'informal dialogue' on a range of financial service-related consumer protection issues, with a view to improving policy and regulatory cooperation.

The regulators identified the following five issues as focus areas:

– 'Automated decision making and processing of data in financial services, including the deployment of AI, and the related opportunities and risks for consumers such as the lack of transparency, misuse of data and violation of financial privacy rights, discrimination, and exclusion.
– New forms of credit such as "Buy Now, Pay Later" products, and the related risks to consumers, including over-consumption and over-indebtedness..
– Strategies to effectively prevent over-indebtedness and to help over-indebted consumers to repay their debt sustainably.

- Digital transformation that ensures fair choice and access to financial services for consumers, including the unbanked, underbanked, and consumers who want to protect their own data.
- Implications for competition, privacy, security and financial stability of Big Tech companies offering financial services, including payment services'

It's envisioned that cooperation/exchanges between the CFPB and the European Commission within the 'informal dialogue' will occur 'in parallel with' other forms of cooperation between the EU and the US on various digital/financial services policies/regulation.

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

National Anti-Scam Centre Advisory Board established

- The 2023-24 Federal Budget ear-marked $86.5 million over three years to combat scam activity and online fraud, including $58 million in funding for the ACCC to move forward with establishing the National Anti-Scam Centre (NASC).
- The new NASC, which officially launched on 1 July 2023, is tasked with coordinating scam disruption/prevention activity across industry sectors, government and digital platforms. A key element of the NASC's approach is the (planned) creation of a series of time-linted taskforces or 'fusion cells' which will coordinate targeted action on specific scam categories, drawing on public and private expertise. The first of these 'fusion cells', led by ASIC and the ACCC, will focus on online investment scams. For more, see: First anti-scam centre 'hit squad' to target online investment scams - Post - MinterEllison
- Separately, the ACCC has announced the establishment of a new13 member advisory board, Chaired by ACCC Deputy Chair Catriona Lowe, 'to support and inform the delivery of the National Anti-Scam Centre's program of work'. The Terms of Reference for the advisory board are here. The board is set to meet monthly for its first six months.
- The twelve other board members are:
  - CEO of the Australian Banking Association Anna Bligh
  - CEO of the Australian Communications Consumer Action Network Andrew Williams
  - Assistant Commissioner of the Australian Federal Police Scott Lee
  - CEO of the Australian Payments Network Andy White
  - CEO of Blockchain Australia Simon Callaghan
  - CEO of CHOICE (representing Consumers' Federation of Australia) Alan Kirkland
  - CEO of Communications Alliance John Stanton
  - CEO of Consumer Action law Centre Stephenie Tonkin
  - CEO of the Customer Owned Banking Association Michael Lawrence
  - Managing Director of Digital Industry Group Inc Sunita Bose
  - National Coordinator of Financial Counselling Australia Peter Garlan
  - Managing Director of IDCARE David Lacey
- At its first meeting, the new advisory board:
  - adopted a number of principles to guide their work including that consumers will be placed in the centre of considerations and that the National Anti-Scam Centre will seek to integrate existing initiatives and avoid duplication
  - acknowledged the need for a consistent approach to defining and naming scams. Members agreed to develop a naming convention for scams to facilitate both reporting and 'seamless data sharing'.
- The next board meeting will be held on 14 August 2023.

[Sources: ACCC media release 21/07/2023]

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