AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

Essential Director Update:18

Your duties. Your update.

Welcome

The Essential Director Update is one of the Australian Institute of Company Directors' most valued member services. Our largest event series, it is a core member benefit designed to provide you with valuable insights and the latest developments in the governance, business and regulatory landscapes that impact director duties and responsibilities.

This year, Graham Bradley AM FAICD returns and has aptly themed his presentation "Corporate Governance in Overdrive".

This *Essential Director Update Handbook* builds on the topics covered in the event series, with articles contributed by your peers from their areas of expertise. In this year's handbook the international environment has been added to our governance, business and regulatory environment coverage, in recognition of the global governance trends that increasingly impact our growing membership.

Graham is presenting in capital cities and for members based in other metropolitan and regional centres, the event will be brought to you by our team of experienced directors and esteemed past contributors: Peter Emery FAICD, Marion Macleod FAICD and David Shortland MAICD.

If you are attending an Essential Director Update event for the first time, you will discover a session that is both informative and thought-provoking in its coverage of contemporary practice issues that impact your director journey.

I hope you enjoy the 2018 Essential Director Update and obtain insights that can be practically applied to your governance role.

Angus Armour FAICD

Managing Director and Chief Executive Officer
Australian Institute of Company Directors

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1.1 Governance and culture

1.1.1 Hayne Royal Commission, as at 31 August 2018

Christian Gergis
Head of Policy
AICD

The Hayne Royal Commission has seen an intense spotlight shone on the corporate governance practices within the largest sector of the Australian economy.

Thus far, the Royal Commission has already led to the resignation of the CEO, chair and three other non-executive directors of one of Australia's largest and oldest institutions, AMP, while Counsel Assisting the Royal Commission has levelled accusations of criminal conduct. Other banks have also faced stinging criticism for failures in their businesses.

Meanwhile, the Prime Minister has emphasised that boards are ultimately accountable for what goes on in their companies, while the Treasurer has made similar comments and stated his expectation that the Royal Commission will focus on the role and conduct of boards in the coming months.

Emerging themes

Some of the governance-related issues emerging from the Royal Commission hearings and broader public commentary to date include:

- community expectations on companies and boards to be transparent in balancing the interests of stakeholders while acting in the interests of the company as a whole;
- remuneration policies and incentives and links to sales practices and culture, including the adequacy of boards' oversight of remuneration structures;
- board visibility of corporate engagement with regulatory authorities, particularly ASIC;
- the degree of accountability that boards and individual directors are expected, or will be expected, to own for corporate misconduct or perceived poor practice;
- challenges for non-executive directors governing large and complex corporates, including some debate about the scope for directors to hold multiple board roles; and
- board composition and the mix of sectoral and executive experience that is required.

Clearly, these are all important issues for directors to consider, whether in the financial services sector or beyond.

A view from government

On the regulatory front, in July, Treasury put forward a wide-ranging submission highlighting some of the key policy issues arising from the Royal Commission hearings to date. Specifically in relation to governance, Treasury observed the following:

- High profitability has meant shareholders (both retail and institutional) can remain "largely complacent about governance and culture, and consequently poor conduct can persist".
- There have been significant corporate governance failings, with boards of some financial services firms having not:
  - o always sufficiently prioritised oversight of the conduct of their employees to ensure it is lawful;
  - o ensured their risk management systems are effectively identifying when this conduct causes harm or risk;
  - o sufficiently challenged management about inadequate addressing of issues; and
  - o always ensured that they have the information they need to discharge their duties.
- In light of the extent of corporate governance, accountability and remuneration-driven failings, "it is clear that the current regulatory framework and its enforcement are not delivering satisfactory outcomes".
- Corporate governance provisions are primarily designed to empower shareholders to hold boards to account, however shareholder interests do not necessarily align with those of customers, particularly in the short term.

- Particular corporate governance rules are either non-binding or sufficiently general that they "appear to be ineffective in countering the desire for short-term financial gain when it is at the expense of consumer outcomes and consequent risks to shareholder value if of significant magnitude".
- The Australian Securities Exchange (ASX) Corporate Governance Council's Principles are non-binding, and the governance and remuneration requirements introduced under Australian Prudential Regulation Authority (APRA) standards have "not yet been sufficiently effective in ensuring boards are properly identifying and managing non-compliance with the law, and non-financial risks".

Possible policy responses

Consequently, Treasury suggested that potential policy options might include:

- Direct regulation (for example, around the competency, capacity and composition of boards): issues flagged include limits on numbers of directorships, tenure limits for NEDs and limits on maximum terms without re-election;
- Extension of the Banking Executive Accountability Regime (BEAR): to cover all prudentially regulated firms *or* all financial services firms *and/or* to cover systemic conduct beyond that which impacts prudential reputation or standing;
- Enhanced remuneration disclosure: improved disclosure and/or disclosure of the remuneration practices of the whole firm (not just Key Management Personnel) could provide greater insights for shareholders and stakeholders.

Commissioner Hayne has indicated that he will submit an interim report covering hearings to date (excluding superannuation and insurance) by 30 September 2018. There will be an opportunity for public submissions on the policy issues raised in the interim report thereafter. At the conclusion of the superannuation and insurance hearings (through August and September), there will be a similar opportunity to comment.

The final report is scheduled to be submitted by 1 February 2019.

> "Commissioner Hayne has indicated that he will submit an interim report covering hearings to date (excluding superannuation and insurance) by 30 September 2018."

The Australian Institute of Company Directors' role

The Australian Institute of Company Directors (AICD) will keep members updated on the key implications arising from the Royal Commission, and is closely monitoring, and will engage on, possible policy responses.

There will be important common learnings to be taken from the Royal Commission and we will be formally incorporating these lessons into AICD's policies, educational programs and resources for members.

1.1.2 The Australian Prudential Regulation Authority's Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia

Matthew McGirr
Policy Adviser
AICD

On 28 August 2017, the Australian Prudential Regulation Authority (APRA) announced a prudential inquiry into the governance, culture and accountability of the Commonwealth Bank of Australia (CBA) group.

The inquiry was conducted by a panel comprised of Dr John Laker AO (Chairman of the Banking and Finance Oath), Jillian Broadbent AO (company director) and Professor Graeme Samuel AC (Professorial Fellow in the Monash Business School).

On 1 May 2018 the panel released its final report. The panel found that "CBA's continued financial success" had "dulled the sense on management of non-financial risk." Governance "lacked rigour and a sense of urgency", and a lack of benchmarking added to the issue as "rigorous benchmarking would have indicated that aspects of CBA's governance practices were, in fact, below mature practice".

The report has provided an opportunity for all directors to reflect on the way in which their boards and committees deal with non-financial risks.

The final report makes 35 recommendations which the CBA has accepted in full. The five broad areas identified for action are:

1. more rigorous board and executive governance of non-financial risks;
2. exacting accountability standards reinforced by remuneration practices;
3. a substantial upgrading of the authority and capability of the operational risk management and compliance functions (including board oversight of appointments);
4. the injection into CBA's DNA of the "should we" question in relation to all dealings with and decisions on customers; and
5. cultural change that moves the dial from reactive and complacent to empowered, challenging and striving for best practice in risk identification and remediation.

The panel's findings appear to signal expectations of directors that include:

- a higher expectation of challenge to management and supporting processes to combat management's bias towards optimism in reporting, with committees and frameworks that encourage (and demonstrate through appropriate documentation) questioning;
- greater visibility of boards in setting, demonstrating and monitoring culture, including increased visibility in relation to operational risk and compliance;
- highly engaged oversight of operational risk, compliance and management of compliance breaches, and customer complaints (as lead indicators of risk issues);
- increasing the level of detail in reporting and papers (in particular at committee level) on review of controls, internal audit, compliance actions and regulator contact).

1.1.3 Proposed changes to the Australian Securities Exchange Corporate Governance Council's Principles and Recommendations

Christian Gergis
Head of Policy
AICD

In May 2018, the Australian Securities Exchange (ASX) Corporate Governance Council issued a consultation draft of a proposed fourth edition of the *Principles & Recommendations* (Principles). The draft attempts to address a range of topical governance issues including social licence to operate, corporate values and culture, diversity initiatives and climate risk disclosure.

The Australian Institute of Company Directors (AICD) has been an active and engaged member of the ASX Corporate Governance Council (Council) since its inception in 2002, contributing to and supporting the development of the Principles under the 'if not, why not' reporting model.

As an overarching comment, the AICD is concerned with elements of the proposed fourth edition of the Principles, especially the move towards greater prescription. In our view, it is critical that the guidance remains principles-based, with sufficient clarity and flexibility for listed entities to apply the recommendations to their own governance needs and circumstances. By increasing the number of recommendations (growing from 29 in the current edition to 38 in the proposed) and more detailed commentary, there is a risk of less meaningful engagement with the Principles, and a 'check-box' attitude being adopted.

The AICD has raised these concerns as part of its submission to the consultation process. Some of the most substantive proposed changes to the Principles are outlined below.

Board role, composition and operation

The draft proposes a number of changes including requirement for boards to have and disclose processes for annual review of the board, board committees, individual directors (Recommendation 1.6) and senior executives (Recommendation 1.7), as well as extending commentary under 'independence' (Recommendation 2.3) to broaden personal ties to 'family, friendship or other social or business connections'.

The AICD has queried mandating the timeframes for those reviews (that is, annually), as this should remain at the entity's discretion.

Recommendation 1.1 has also mandated board charters and provided additional commentary on management and board responsibilities.

Principle 3 - the social licence to operate and social responsibility

The draft proposes to change Principle 3 from (currently) "[a] listed entity should act ethically and responsibly" to "[a] listed entity should instil and continually reinforce a culture across the organisation of acting lawfully, ethically and in a socially responsible manner".

The draft notes the importance of an entity's social licence to operate and the need to act to preserve it. To maintain that license, an entity must have regard to the views and interests of a broader range of stakeholders than just its security holders, including "employees, customers, suppliers, creditors, regulators, consumers, taxpayers and local communities". Social licence to operate is also explicitly referenced in the commentary to Recommendation 7.4 (sustainability disclosures), and Principle 8 (remunerate fairly and responsibly).

The AICD has questioned the introduction of fluid, subjective concepts such as 'social licence to operate' and 'social responsibility' into the document, noting that they could confuse directors as to their legal duties, and create unnecessary complexity and uncertainty.

Recommendation 7.4 – environmental and social risks

The draft proposes to amend 7.4 (sustainability disclosures) to refer to "environmental and social risks" rather than (currently) "economic, environmental and social sustainability risks". Social risks are defined as "the negative consequences to a listed entity arising from its impact or perceived impact on social groups (including employees, customers, suppliers and local communities) or from being seen to operate outside accepted community standards..."

The draft also provide guidance on disclosure of climate change risk and suggests that entities that believe they do not have any material exposure carefully consider the basis for that belief and undertake peer benchmarking.

Further, the Council encourages "listed entities with material exposure to climate change risk to consider implementing the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD)".

Overall, the AICD has supported the proposed changes, noting that guidance on climate issues should not be prescriptive, and that there is growing investor appetite for greater disclosure on such matters. However we have questioned the definition of social risks, including its reference to 'social licence' concepts.

Recommendation 1.5 – diversity on boards

In a welcome move, the draft proposes to extend the existing recommendation on diversity disclosures, so that the measurable objectives for achieving gender diversity for listed entities in the ASX 300 would be to have not less than 30 per cent of directors from each gender within a specified period (set by the entity itself). If introduced, the recommendation would help ensure that the momentum towards more gender balanced boards is maintained.

The document however contains extensive commentary, some of which details further actions which entities may wish to take in furtherance of diversity objectives. We have recommended a significant editing of such commentary.

Next steps

Over the coming months, the Council will consider stakeholder feedback on the consultation draft with a view to finalising the fourth edition in early 2019. At this stage, it is expected that the Principles will become operative for financial years commencing on or after 1 July 2019 , with the first corporate governance reporting on the revised principles taking place in 2020.

1.1.4 NFP Governance and Performance Study

Phil Butler GAICD
NFP Sector Leader
AICD

The 2018 *NFP Governance and Performance Study* was released in late July and again highlighted some of the key issues facing leaders of the NFP sector. Following the 2017 Royal Commission into Institutional Responses to Child Sexual Abuse and this year's Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industries, the role of boards and the expectations of directors of all sectors are under heightened scrutiny. In addition, the 2018 Edelman Trust Barometer saw trust in Australian NFPs fall below 50 per cent.

Against this backdrop, the study noted that over 80 per cent of respondents believed the governance of their organisation was improving which continues a trend over a number of years. Also on a positive note, the board's role in culture was seen as being more important. In 2017, the study found that only 45 per cent of respondents believed that their NFP monitored culture well. For the 2018 study, 75 per cent of directors (and 97 per cent of organisations with more than 100 employees) reported that their NFP uses one or more instruments to produce metrics on culture. Despite this, it was recognised by over 50 per cent of directors that measurement and monitoring of culture was difficult.

The study delved into the role of the board in driving innovation and managing cybersecurity and reported different perspectives on these. The study noted that more than 50 per cent of directors did not have cybersecurity as a regular part of the board agenda, with close to 20 per cent believing it was an operational matter.

And with regard to innovation, about half of respondents believe that it is the responsibility of the CEO, who they expect to drive innovation and report back to the board. The other half see innovation as a responsibility of the board. This group believes the board should take an active role in the planning and oversight of innovation and, in some cases, be even more involved than the CEO. While recognising the importance of innovation, it was also noted that the rapidly changing environment for many organisations made this difficult.

More than 80 per cent of respondents undertake their governance role for no financial reward and many offer financial and other donations to their organisation to support its mission, in addition to serving on boards.

Our findings show that the directors of NFPs are engaged and committed, with over 80 per cent spending more than one day per month on their organisation, including a quarter who are spending more than five days per month.

The AICD recognises that our society cannot function properly without a strong, well-governed NFP sector and thanks all of those who are leading these organisations.

1.1.5 Lessons from the Royal Commission into Institutional Responses to Child Sexual Abuse

Robert Fitzgerald AM
Former Commissioner

Institutions from a diverse array of sectors failed to protect the children in their care. Over 3,500 institutions were named by over 8,000 survivors in private sessions. The types of institutions examined included government, not-for-profit and private enterprises. Victims included young apprentices, trainees and workers, as well as students, patients, sports players, parishioners, children in care and many others.

Information gathered showed that child sexual abuse in institutions continues today. Institutional cultures and practices that allowed abuse to occur and inhibited detection and response continue to exist in contemporary institutions. Commission case studies showed that some leaders:

- did not take responsibility for their institution's failure to protect children against sexual abuse; and,
- preferenced their own and their institution's reputation over victims and the truth.

There continues to be a lack of understanding of child sexual abuse in institutional settings. This lack of understanding, including at board level, often relates to:

- misperceptions about offenders;
- grooming behaviours;

- tendencies for people to believe adults over children and young people;
- fears of falsely accusing someone of child sexual abuse and consequential retaliation.

Boards are often ill informed, do not have line of sight over safety policies and practices and do not have adequate feedback loops to know what is happening.

Poor practices such as inadequate governance structures and failing to record and report complaints, or understating the seriousness of complaints, were evident. Some work places even tolerated hazing and initiation rituals that were sexual in nature and abusive at law, failing to act in the interests of their own young workers.

All institutions have a legal and moral responsibility to protect children from potential abuse by preventing, identifying and mitigating risks and responding appropriately when abuse occurs. Child safety must be embedded in institutional leadership, governance and culture at every level of the organisation. This includes all organisations that deal with children and young people or who employ young workers, trainees or apprentices. Providers of health, education, childcare, disability and community services, and sporting or recreation activities are obviously affected. But so too are organisations that employ young staff including retailers, hospitality services, construction and manufacturing businesses.

Institutional culture consists of the collective values and practices that guide the attitudes and behaviour of directors, staff and volunteers in institutions. It guides 'the way things are done' and the way issues are managed, dealt with and responded to. A positive child-focused culture can help to protect children and young people from abuse and facilitate the identification and proper response to abuse.

As leaders, directors play a pivotal role in influencing governance frameworks and setting an institution's culture. Integrity, transparency and accountability, risk management and ethics are important elements of good governance and can help an institution to meet its duty of care. More simply, directors should ask themselves regularly: Are we acting in the best interest of children?

> "As leaders, directors play a pivotal role in influencing governance frameworks and setting an institution's culture."

Practically, boards must ensure that the safety of children and young people is embedded into the governance structures and practices of their organisations by ensuring that:

- there are contemporary standards and policies governing child safety which are understood by board members, staff and other stakeholders (for example, parents and volunteers);
- child safety is a standing item for risk committees, just as it is for workplace safety;
- there is regular reporting to the board of serious incidents or complaints and that these complaints are dealt with promptly, honestly, fairly and those involved are adequately supported;
- regular evaluations of the effectiveness of policies and practices and especially complaint handling processes are conducted; and
- there is continuous education of staff, board members and other stakeholders.

Resources are available to assist organisations through Children's Commissioners in each state and territory and numerous consulting organisations now specialising in these issues.

The safety of children and young people is everybody's business. It is core business for organisations that deal with or employ young people, and, accordingly, it must be core business for all directors of these organisations.

1.2 Reporting, disclosures and risks

1.2.1 Environmental, Social and Governance reporting trends

Kerry Hicks GAICD
Senior Policy Advisor
AICD

Environmental, Social and Governance (ESG) oversight, reporting and disclosure are vital board tasks – a hallmark of good governance being the ability of boards to consider all material risks facing their organisation, including ESG risks.

Investors are increasingly paying greater attention to these issues. Globally, Blackrock has indicated that stakeholders are demanding that companies exercise leadership on a broader range of matters. Larry Fink, CEO of Blackrock, states "a company's ability to manage environmental, social and governance matters demonstrates the leadership and good governance that is so essential to sustainable growth…"[1], with such factors increasingly being integrated into investment processes.

In Australia, the Australian Council of Superannuation Investors (ACSI) considers that transparent disclosure of ESG governance, management and performance, leads to better decision making and long-term value creation, and helps to establish and maintain trust between a company, its shareholders and other stakeholders. In its latest governance guidelines, it has added a new chapter on board ESG oversight and disclosure practices, and practical guidance under four key ESG themes: climate change, labour and human rights, corporate culture, and tax transparency.

Numerous academic and financial studies show ESG leaders outperform ESG laggards over time. Macquarie Group research in December 2017 found companies with top ESG scores in its dataset had outperformed low-ESG companies by 2.7 per cent annually since 2011.

To gauge how companies are performing in regards to ESG disclosures, ACSI produce annually a report analysing disclosures made in the ASX 200. Their latest report, *Corporate Sustainability Reporting in Australia: An analysis of ASX200 disclosure*[2], was issued in June 2018 and delivers the following key findings:

- The number of ASX200 companies with 'leading' or 'detailed' disclosures on sustainability (104 companies) has increased compared to 2017 and the trend has been increasing over the last decade.
- 35 'leaders' that have consistently outperformed others in their sustainability disclosures were identified.
- Nine 'laggards' that have not reported sustainability risks and management for two or more successive years were identified.
- There has been a step up in 2017 of climate-related disclosures, with 95 companies disclosing a climate-related policy statement.
- The most commonly identified key performance indicators in the form of targets were in respect to diversity (69 companies), safety (52 companies) and climate change (53 companies).
- The Global Reporting Initiative framework is the most commonly adopted international framework (72 companies).
- 22 companies reported against the international recommendations from the Task Force of Climate-related Financial Disclosures (TCFD) or have committed to do so.

Louise Davidson, CEO of ACSI, states in the report's foreword:

> *Corporate reporting is an important opportunity to build trust with investors and the community. Done well, it enables shareholders to make informed investment decisions and the community to judge whether its confidence is well-placed or misplaced.*

[1] L Fink, 2018, *Annual Letter to CEOs*, Blackrock, **https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter** (accessed 9 July 2018).

[2] Australian Council of Superannuation Investors, 2018, *Corporate Sustainability Reporting in Australia: An analysis of ASX200 disclosure*, ACSI, June, **https://www.acsi.org.au/images/stories/ACSIDocuments/generalresearchpublic/2018-Sustainability-Report-FINAL-June-2018.pdf** (accessed 9 July 2018).

1.2.2 Integrated reporting

Kerry Hicks GAICD
Senior Policy Advisor
AICD

Globally, more and more organisations are changing their reporting to stakeholders – producing reports that show how the organisation creates value, and linking this to the company's strategy, business model, governance, risks, performance and outlook. This is occurring not just in the listed sector but in the not-for-profit, superannuation and public sectors as well.

Integrated reporting aims to enhance accountability and stewardship for all sources of capital (financial, manufactured, intellectual, human, social and relationship and natural) to support integrated thinking, decision making and actions that focus on value creation for the short, medium and long term. It seeks to improve investor disclosure by including both financial and non-financial data in an integrated way within the annual report.

"Integrated reporting is occurring not just in the listed sector but in the not-for-profit, superannuation and public sectors as well."

In 2018, the International Integrated Reporting Council (IIRC) reported that over 1,600 companies used some form of integrated reporting globally. Australia has been a laggard in this regard, with only 4 companies in the ASX 200 specifically referring to the IIRC's Integrated Reporting Framework (IRF) in the last two financial years – National Australia Bank, Lendlease, the GPT Group and Stockland.[3] However, a 2017 analysis of the ASX 200 by KPMG[4] identified that 25 per cent of ASX200 companies focused on reporting of value creation in 2017, not just financial earnings. KPMG suggests this is a stepping stone towards integrated reporting. Not-for-profit, superannuation and public sector organisations, such as CPA Australia, CBUS, VicSuper, Camp Quality, Australia Post and NRMA, have also started to embrace this style of reporting.

In October 2017, the AICD released an updated policy position on the IRF, recognising that integrated reporting can offer useful principles for communicating strategy, business model and governance, risks, performance and outlook. This position was communicated in the October 2017 edition of the *Company Director* magazine as follows:

> *The AICD encourages directors to consider the aims and principles of the Integrated Reporting Framework (IRF) in corporate reporting as relevant to their organisation and stakeholder needs.*
>
> *Flexible, voluntary adoption of relevant content elements of integrated reporting may help directors seeking to improve the quality and usefulness of information reported to stakeholders.*
>
> *The IRF suggests content elements that companies could adopt in reporting, as relevant. Many of these content elements are similar to guidance produced by ASIC for the Operating and Financial Review (OFR) [a requirement for listed companies] or can be effectively adopted with the OFR framework.*
>
> *The AICD does not recommend adoption of the full framework due to directors' liability concerns with forward-looking statements and the need for a directors' compliance statement under this formal framework.*

The reason the AICD does not recommend adoption of the full framework is because the disclosures that would be required are not subject to the business judgement rule in Australia and could expose the directors to personal liability, particularly in regards to forward-looking statements.

[3] Ibid, p 22.

[4] KPMG, 2017, Corporate Reporting: A significant shift towards adoption of the principles of integrated reporting, **https://assets.kpmg.com/content/dam/kpmg/au/pdf/2017/asx-200-corporate-reporting-integrated-reporting-principles.pdf** (accessed 9 July 2018).

1.2.3 Climate change

Sarah Barker MAICD
Special Counsel
Minter Ellison

In October 2016, the Centre for Policy Development and Future Business Council published an opinion by Australian Bar Association President Noel Hutley SC. Mr Hutley concluded that, as a matter of Australian law, directors must actively engage with the impacts of climate change related risks on their operations and strategy in order to satisfy their duty of due care and diligence under s 180 of the *Corporations Act 2001*.[5]

In the last twelve months, corporate regulators from the Australian Securities Exchange (ASX)[6] to the Australian Prudential Regulation Authority (APRA)[7] [8] and the Australian Securities and Investments Commission (ASIC)[9] have echoed Mr Hutley's conclusion that climate change should be integrated into Australian directors' governance and disclosure agendas. It has evolved from an 'ethical', 'environmental' and 'non-financial' issue to one that presents foreseeable financial risks (and opportunities) over mainstream investment and planning horizons.

Financial risks and opportunities

The clear shift in Australian regulatory emphasis reflects a clear international trend. Significantly, in June 2017 the G20 Financial Stability Board released the recommendations of its Taskforce on Climate-related Financial Disclosures (TCFD). The TCFD provides a framework for companies to disclose the material impacts of climate change on their financial performance and prospects, in a form that is decision-useful for investors, lenders and insurance underwriters. The TCFD identifies 16 'high-risk' industries (from banking and insurance, to mining, transport and agriculture) – many of which feature prominently within the Australian economy. Whilst 'voluntary', the TCFD is emerging as the key benchmark against which to assess a company's strategic approach to climate change in the 2018 annual reporting season, with heavyweight investor advocates from Blackrock to the Climate Action 100+ (representing investors with over US$30 trillion under management).

> “The clear shift in Australian regulatory emphasis reflects a clear international trend.”

Consistent with existing duties

APRA and ASIC have put directors of entities under their regulatory oversight on notice that they should approach climate change through a financial risk (and opportunity) lens. The duty of due care and diligence requires a proactive and robust approach to interrogation of potential material impacts for corporate strategy and risk management, with independent judgment brought to bear in a process of critical evaluation of contemporary climate change information (including advice from management and/or independent experts as required). Directors of listed corporations should consider how climate change should be integrated into reporting of corporate performance, position and prospects. In all cases, directors would be well-advised to have regard to the TCFD recommendations to guide their journey on climate risk governance and disclosure.

[5] The Hutley Opinion is available at **http://cpd.org.au/wp-content/uploads/2016/10/Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf**, (accessed 16 July 2018).

[6] ASX Corporate Governance Council, 2018, *Review of the ASX Corporate Governance Council's Principles and Recommendations: Public consultation*, 2 May, **https://www.asx.com.au/documents/asx-compliance/consultation-paper-cgc-4th-edition.pdf**, (accessed 16 July 2018).

[7] Australian Prudential Regulation Authority, 2017, *16/17 Annual Report*, 16 October, pp 12, 50, **https://www.apra.gov.au/sites/default/files/Documents/apra-ar-2017-full.pdf**, (accessed 16 July 2018).

[8] G Summerhayes, 2017, *The weight of money: A business case for climate risk resilience*, [speech], 29 November, Australian Prudential Regulation Authority, **https://www.apra.gov.au/media-centre/speeches/weight-money-business-case-climate-risk-resilience**, (accessed 16 July 2018).

[9] J Price, 2018, *Climate change*, [keynote address], 18 June, Australian Securities and Investments Commission, Centre for Policy Development: Financing a Sustainable Economy, **https://static1.squarespace.com/static/569da6479cadb6436a8fecc8/t/5b32df6e70a6adcbb7267c19/1530060657862/Climate+change+%7C+ASIC+-+Australian+Securities+and+Investments+Commission.pdf**, (accessed 16 July 2018).

1.2.4 Managing reputational risk

Sally Linwood
Senior Policy Advisor
AICD

Directors have long understood the value of reputation and consequently the importance of managing reputational risk.

However, a confluence of rapid social, technological and governance developments are now combining to focus directors' minds on the issue, possibly more than ever before.

In today's digital world, reputation can be ruined by a few strokes of a keyboard on social media. Bad news can be disseminated globally in minutes. Moreover, the traditional trust that investors, consumers and other stakeholders used to place in institutions and print media (which was more easily managed) has eroded and is now just as likely to be placed in views expressed online.

This can mean that despite careful and successful cultivation of reputation over many years, it can be effectively undermined (if not destroyed) in a matter of minutes, particularly when a crisis hits.

At the same time, changes in the regulatory landscape are demanding a greater focus at the board level on culture and accountability and demonstrate that regulator expectations are shifting in line with community expectations (as illustrated by the findings in the Australian Prudential Regulation Authority's (APRA) report on the Commonwealth Bank of Australia (CBA) (see 1.1.2 above) and the Australian Securities and Investments Commission's (ASIC) ongoing focus on corporate culture). The correlation between an organisation's culture and an organisation's reputational risk is clear.

The issues that can damage reputation are many, and often hard to predict, but can include:

- society's perception of a company's practices;
- poor handling of customer complaints;
- regulatory action against a company;
- misconduct of employees, especially the leadership team;
- responses to major privacy or data breaches; and
- death or serious injury caused by the business.

Facebook's attempt to manage the fall-out from Cambridge Analytica is a good example of how even one of the world's biggest brands and most media-savvy organisations can suffer.

Against this background, key takeaways for directors include the following:

- Boards have an important role to play in monitoring strategic risk management frameworks, policies and processes and in "setting the tone from the top". As part of this role, boards should consider whether non-financial risks including reputational risks are being adequately considered and discussed at board level.
- While there should be an expectation that management, and the CEO in particular, should continue to assume responsibility and accountability for an organisation's culture, boards – led by the chair – should effectively hold management to account and adopt the "don't tell me, show me" philosophy.
- It would be prudent for boards and management to proactively consider their approach to crisis management – there will be no luxury of time when a crisis hits. Companies may find it helpful to play out corporate crisis scenarios and engage external experts to facilitate this. The chair may wish to be involved in this process, recognising that in the case of a reputational crisis that is linked to culture or governance (as opposed to an operational issue), the chair will often be the appropriate spokesperson for the company.

1.3 Director liability

1.3.1 Insolvency safe harbour reform

Matthew McGirr
Policy Advisor
AICD

Since amendments to the *Corporations Act 2001* (Cth) (the Act) became law on 18 September 2017, a "safe harbour" has been available to company directors from personal civil liability for insolvent trading.

The AICD has published a Director Tool[10] which provides directors with a comprehensive outline of the operation of the safe harbour.

The safe harbour excludes liability for insolvent trading under s 588G of the Act if, at a particular time after the person starts to suspect a company may become or be insolvent, he or she starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company, and the debt is incurred directly or indirectly in connection with that course of action and during a specified time period.

A better outcome is defined as "a better outcome for the company than the immediate appointment of an administrator or liquidator".

Some key factors for directors to consider if they are considering the safe harbour defence are as follows:

a. Whether a course of action is "reasonably likely" to lead to a better outcome for the company will vary on a case-by-case basis depending on the individual company and its circumstances at the time the decision is made. However, in making a determination, the Court will take into account whether proper financial records were being kept by the company, whether the directors were receiving appropriate advice, and whether there was a restructure plan to improve the company's position.

a. To rely on the safe harbour, directors must be able to provide evidence to a Court which supports the defence. For this reason, directors should ensure any turnaround or restructure plans are comprehensively documented, particularly around the time the directors are considering whether to proceed with a course of action or place the company into voluntary administration.

a. The safe harbour will not apply where a company fails to pay employee entitlements as they fall due, comply with taxation reporting requirements, or fulfil existing statutory obligations to provide assistance in the event of administration or liquidation.

Directors of listed companies should be aware that the Australian Securities Exchange (ASX) has published additional guidance in relation to disclosure in the context of an entity in financial difficulty.

The ASX has clarified that the fact that an entity's directors are relying on the insolvent trading safe harbour, in of itself, "is not something that ASX would generally require an entity to disclose under Listing Rule 3.1". However, directors should be aware that adverse developments affecting the financial condition or prospects of an entity will need to be disclosed, even if the directors are hoping to rely on s 588GA(1).

1.3.2 Fair Entitlements Guarantee and illegal phoenixing activity

Matthew McGirr
Policy Advisor
AICD

Fair Entitlements Guarantee recovery

The Australian Government is currently looking to introduce new laws to address corporate misuse of the Fair Entitlements Guarantee (FEG) scheme.

The FEG scheme provides financial assistance to eligible employees who have lost their jobs due to the insolvency of their employer. The FEG enables employees to claim unpaid wages, unpaid annual leave, and other employee entitlements.

[10] Australian Institute of Company Directors, 2018, "The insolvency safe harbour", *Director Tools: Duties of Directors*, **http://aicd.companydirectors.com.au/-/media/cd2/resources/director-resources/director-tools/pdf/06547-1-director-tools-insolvency-safe-harbour-a4-9pp-web.ashx**, (accessed 16 July 2018).

The government is concerned that sharp corporate practices and particularly illegal phoenixing have contributed to a dramatic increase in the cost of the FEG scheme. Average annual costs under the FEG scheme have more than tripled from $70.7 million in the four year period between 1 July 2005 and 30 June 2009, to $243.6 million in the four year period between 1 July 2013 and 30 July 2017.

On 12 June 2018 the government released an Exposure Draft Bill which, if passed in its current form, would:

- strengthen civil recovery action, plus criminal and civil penalties available against company directors who engage in transactions that are directed at preventing, avoiding or reducing employer liability for employee entitlements;
- enable liquidators and other persons with standing to recover outstanding employee entitlements from an insolvent corporate group member where it would be just and equitable to do so, and where the other entities in the group have benefited from the work done by the insolvent entity's employees; and
- introduce a new ground of disqualification for directors who repeatedly rely on FEG over a period of time.

Illegal phoenixing activity

Illegal phoenixing continues to be a focus of the government, with the government announcing a package of reforms in the 2018 Federal Budget. While the government is yet to legislate these reforms, the AICD expects that draft legislation will be released for public consultation in the second half of 2018.

Illegal phoenixing involves the deliberate misuse of the corporate form. Phoenix companies "rise from the ashes" with a new corporate structure that derives its assets and directors from an old entity, but in some cases improperly leave behind its debt.

The package announced in the Budget[11] includes the following measures to:

- create a new phoenixing offence, which will strengthen the regulator's ability to target those who conduct or facilitate illegal phoenixing;
- prevent directors from improperly backdating resignations to avoid liability or prosecution;
- limit the ability of directors to resign when this would leave a company with no directors;
- restrict the ability of related creditors to vote on the appointment, removal or replacement of an external administrator;
- extend the Director Penalty Regime to GST, luxury car tax, and wine equalisation tax, making directors personally liable for the company's debts; and
- expand the ATO's power to retain refunds where there are outstanding tax lodgements.

In addition, the government has announced plans to introduce a Director Identification Number (DIN), which will identify directors with a unique number, and which will enable government agencies and regulators to map the relationships between individuals and entities, and individuals and other people.

> "The AICD supports the government's focus on illegal phoenixing activity and has for some time advocated for the introduction of a DIN."

The AICD supports the government's focus on illegal phoenixing activity and has for some time advocated for the introduction of a DIN, along with the removal of personal information of directors from public records. However, the AICD will carefully examine the details of the proposals to ensure they are appropriately targeted.

[11] See the exposure draft legislation at **https://treasury.gov.au/consultation/c2018-t313204**, (accessed 20 August 2018).

1.3.3 Penalties

Matthew McGirr
Policy Advisor
AICD

On 20 April 2018, the government has announced that it intends to significantly increase maximum civil and criminal penalties for individuals and corporations under the *Corporations Act 2001* (Cth) (the Act). The changes were announced as part of the government's response to the Australian Securities and Investments Commission (ASIC) Enforcement Review Taskforce Report, which followed a period of public consultation.

Maximum civil penalties for individuals are set to increase more than fivefold. The current penalty of $200,000 per contravention will be increased to the greater of $1.05 million, or three times the benefit obtained or loss avoided.

Corporations currently face a maximum civil penalty of $1 million per contravention under the Act. This maximum penalty is set to significantly increase to the greater of $10.5 million, three times the benefit obtained or loss avoided, or 10 per cent of the company's annual turnover. The maximum fine will be capped at $210 million.

Criminal fines and penalties are also set to increase for individuals, with the government proposing to increase imprisonment terms for a range of offences from five to ten years, and increasing maximum fines to the greater of $945,000, or three times the benefit gained or loss avoided.

Corporations will face the larger of $9.45 million, three times the benefit gained or loss avoided, or 10 per cent of the company's annual turnover.

The government also proposes to expand ASIC's enforcement powers, including proving greater scope for ASIC to ban individuals from performing any role in financial services when they are found to be unfit, improper, or incompetent, and strengthening ASIC's investigation tools.

The government has also agreed to remove imprisonment as a possible sanction for strict liability and absolute liability offences.

The AICD supports increased penalties under the Act. While they are significant increases, it is essential that penalties act as an adequate deterrent for misconduct in order to promote community trust in Australia's corporate governance framework.

> "…it is essential that penalties act as an adequate deterrent for misconduct in order to promote community trust in Australia's corporate governance framework."

As these proposed changes move towards legislation, the AICD will endeavour to engage with the government to ensure these laws are designed appropriately and continue to keep members updated on how matters progress.

1.4 Shareholder engagement and the AGM season

1.4.1 Shareholder activism

Christian Gergis
Head of Policy
AICD

In line with global trends, shareholder activism is an increasingly important issue for Australian listed companies to grapple.

In March 2018, proxy adviser CGI Glass Lewis released its review of the 2017 annual general meeting (AGM) season. Overall, AGMs were less contentious than in previous years with only 11 strikes on remuneration reports by ASX 300 companies – the lowest level since the 'two-strikes' rule was introduced. There has been an average of 17 strikes annually since 2011.

However, 2017 also saw the highest recorded number of shareholder proposals (couched as constitutional reform given the *Corporations Act 2001* limitations on shareholder advisory votes) with seven in total (only three were lodged in 2016). All of the resolutions were put forward by activist groups and all were defeated or withdrawn. Five of the seven resolutions related to climate change.

Asset Owner Stewardship Code

More broadly, institutional investors are increasingly flexing their muscles as asset owners. On 17 May 2018, the Australian Council of Superannuation Investors (ACSI) released its Asset Owner Stewardship Code (the Code). The first of its kind in Australia, the Code is a voluntary set of principles aimed at assisting asset owners to exercise their ownership rights in a manner that protects and enhances long-term value, including through consideration of environmental, social and governance (ESG) matters.

The Code, developed by a working group of nine major investors, is directed at Australian asset owners that have equity in Australian listed companies, regardless of whether the holding is passively or actively held. ACSI members include 38 Australian and international asset owners and institutional investors, which collectively manage over $2.2 trillion in assets. Australian Super and HESTA have already committed to the Code as signatories.

ACSI's rationale for the Code is that greater transparency about stewardship practises will increase accountability for asset owners to beneficiaries and other stakeholders, while influencing the behaviour of asset managers and the companies in which they invest.

The Code sets out six principles and then contains guidance by way of example:

1. Asset owners should publicly disclose how they approach their stewardship responsibilities.
2. Asset owners should publicly disclose their policy for voting at company meetings and voting activity.
3. Asset owners should engage with companies (either directly, indirectly or both).
4. Asset owners should monitor asset managers' stewardship activities.
5. Asset owners should encourage better alignment of the operation of the financial system and regulatory policy with interests of long-term investors.
6. Asset owners should report to beneficiaries about their stewardship activities.

Specifically, Principle 3 provides guidance on how to engage with companies on long-term ownership matters such as performance, strategy, ESG issues, leadership, and reporting. It also discusses how such engagement practices, including escalation policies, should be disclosed.

ACSI proposal for non-binding shareholder resolutions

Separately, ACSI has also been campaigning for reform in the area of non-binding shareholder resolutions. Specifically, ACSI released a paper in October 2017[12] advocating for law reform to permit shareholders (either five per cent or 100 members, per s 249N of the *Corporations Act 2001*) to move non-binding resolutions.

[12] J Rennie, 2017, *Reform necessary to give shareholders a greater voice on ESG issues*, [media release], Australian Council of Superannuation Investors, 26 October, **https://www.acsi.org.au/images/stories/ACSIDocuments/MediaReleases/26.10.17-shareholder-res.pdf**, (accessed 17 July 2018).

In ACSI’s view, the introduction of non-binding advisory resolutions could improve engagement on ESG issues and other priorities, providing shareholders with better avenues for raising issues of concern than voting against directors or remuneration reports. ACSI’s model proposes no constraints on the subject matter of resolutions, but does invite review of whether some form of regulatory ‘policing’ of resolutions may be appropriate.

Stakeholder response to the proposal has been mixed with some of the concerns that have been raised including:

- the case for reform is unclear and that existing mechanisms, such as the AGM, provide sufficient scope for shareholders to put views forward and question company direction;
- advisory resolutions at low thresholds would let single-issue activists drive AGM agendas; and
- unlike directors, shareholders are not obliged to act in the best interests of a company and advisory resolutions risk blurring the role of the board and established governance models.

In an environment of declining trust in business and rising community expectations, we will continue to hear calls for shareholders and other stakeholders to have a greater say on how companies are managed.

1.4.2 Executive remuneration

Kerry Hicks GAICD
Senior Policy Advisor
AICD

Executive remuneration continues to be a hot topic in Australia and globally, particularly given the Australian Prudential Regulation Authority's Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia (APRA Report)[13], which highlights the need for pay to be tied to non-financial outcomes.

In terms of shareholder action, the number of strikes on remuneration reports in the S&P/ASX 300 are the lowest since the two-strikes rule first came into effect in 2011 (11 strikes in 2017 versus a high of 23 in 2011), although there was a sharp increase in companies receiving a close call ‘against’ vote of between 20-24 per cent.

Commentary provided in ASIC’s *Report 564: Annual general meeting season 2017*[14] indicates that the decline in the number of second strikes was due to:

- improved active engagement with shareholders; and
- changes made to remuneration structures to reduce complexity and to withhold bonus payments.

The reasons reported for companies receiving ‘against’ votes on their remuneration reports included:

- excessive quantum of pay (particularly having regards to performance);
- pay structure;
- lack of transparency.

ASIC recognises the important role played by incentive structures as a driver of conduct, encouraging all companies to:

- adopt incentive structures designed to achieve long-term company value (which may involve the use of non-financial targets);
- ensure remuneration structures are sufficiently transparent to allow objective measurement of performance; and
- avoid unnecessary complexity in the design of structures and disclosures in remuneration reports.

In the APRA Report, Recommendations 23 to 26 specifically cover the area of remuneration. APRA recommended that the CBA Board exercise stronger governance to ensure the effective application of the remuneration framework. In particular, the CBA Board should assess remuneration outcomes for group

[13] Australian Prudential Regulation Authority, 2018, *Prudential Inquiry into the Commonwealth Bank of Australia*, APRA, April, **https://www.apra.gov.au/sites/default/files/CBA-Prudential-Inquiry_Final-Report_30042018.pdf** (accessed 9 July 2018).

[14] Australian Securities Investment Commission, 2018, *Report 564: Annual general meeting season 2017*, January, **http://download.asic.gov.au/media/4633282/rep-564-published-29-january-2018.pdf** (accessed 9 July 2018).

executives as reflecting individual and collective accountability for material adverse risk management and compliance outcomes. In turn, group executives should cascade accountability throughout the group on a consistent basis. Other specific recommendations were made in order to support the effective oversight and application of the framework. Further recommendations include the need for CBA to update its framework and practices to include the adoption of the Financial Stability Board's (FSB) *Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices*, including the potential for clawback in the case of serious misconduct.

> "The release of the APRA results in April 2018 in relation to executive remuneration practices revealed the need for significant improvement in regulated entities."

The release of the APRA results in April 2018 in relation to executive remuneration practices[15] revealed the need for significant improvement in regulated entities. The review found that remuneration frameworks and practices did not consistently and effectively promote sound risk management and long-term financial soundness, and fell short of the better practices set out in APRA's existing guidance. The review identified the need for improvement in:

- ensuring practices were adopted that were appropriate to the institution's size, complexity and risk profile;
- the extent to which risk outcomes were assessed, and weighted, within performance scorecards;
- enforcement of accountability mechanisms in response to poor risk outcomes; and
- evidence of the rationale for remuneration decisions.

Meanwhile in the UK, the Financial Reporting Council has been consulting on a revision to The UK Corporate Governance Code (published in July 2018) and its supporting guidance. The changes are intended to give remuneration committees greater responsibility for demonstrating how pay and incentives align across the company, and to explain to the workforce each year how decisions on executive pay reflect wider pay policy. They are also consulting on extending the recommended minimum vesting and post-vesting hold periods for executive share awards from three to five years.

Further, the draft Companies (Miscellaneous Reporting) Regulations 2018 have been published in the UK. The regulations introduce additional corporate governance reporting disclosures which include the disclosure of CEO pay ratio. Specifically, quoted companies with more than 250 UK employees will need to disclose and explain annually the ratio of their CEO's total annual remuneration to the median remuneration of their UK employees, as well to the 25th and 75th percentiles of their UK employee population. Additionally, all quoted companies will need to report on the impact of share price growth on share-based executive pay.

[15] Australian Prudential Regulation Authority, 2018, *Information Paper: Remuneration practices at large financial institutions*, April, **https://www.apra.gov.au/sites/default/files/180328-Information-Paper-Remuneration-Practices.pdf**, (accessed 21 August 2018).

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2.1 Changing business environment

2.1.1 AICD Director Sentiment Index

Matt Pritchard
Head of Government Relations and Media
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In April 2018, the AICD released our latest Director Sentiment Index (DSI) results. The DSI is currently the only indicator measuring the opinions and future intentions of directors on a range of issues including the Australian and world economies, government policy and governance regulations.

For the second survey in a row director sentiment had a positive index and reached its highest point ever, largely off the back of increased confidence about the strength of the Australian economy, as well as other major economies around the world including Asia, Europe and particularly the United States. Optimism in the Australian economy was most evident from directors based in New South Wales and Victoria, who were much more confident in the health of their state economy than directors in Queensland, Western Australia and South Australia.

Infrastructure was once again a top long-term priority for directors, followed by issues associated with our ageing population, tackling climate change and reforming the tax system. Directors also continued to rate renewable energy sources as the priority for additional investment, followed by regional infrastructure and telecommunications infrastructure, particularly the National Broadband Network.

Directors remained committed to fostering a good culture in their organisations. The top three elements that directors said they are focused on to change corporate culture were ensuring culture is a regular item on the board and audit committee agendas, capturing data on key cultural indicators and communicating ethical positions of the board and the business generally. When asked about what steps boards' need to take to regain and rebuild public trust directors identified the need to demonstrate respect for their customers/clients/communities they deal with while also improving their corporate culture and the trustworthiness of their leadership.

Once again a majority of directors surveyed (72 per cent) agreed that there is a risk averse decision-making culture on Australian boards. When asked about the main reason for this issue 31 per cent of directors said it was caused by an excessive focus on compliance over performance, 22 per cent believe it comes from shareholder pressure for short-term returns, 16 per cent put it down to a lack of genuine diversity in the boardroom and 14 per cent selected director liability provisions.

> “Sustainability and long-term growth prospects continued to be the main issue keeping directors awake at night.“

Sustainability and long-term growth prospects continued to be the main issue keeping directors awake at night. Structural change/changing business models and issues around corporate culture were also identified as worries by many directors. Data security also recorded a significant increase, even with survey being conducted before the revelations around Cambridge Analytica and Facebook became public.

2.1.2 Trust and business legitimacy

Louise Pocock MAICD
Deputy Executive Director
Governance Leadership Centre, AICD

Australian consumers, shareholders and the broader community have come to expect more of business. No longer can a company focus solely on maximising its profits and returns to shareholders; today it needs a social licence to operate.

Essentially, a company must enjoy sufficient trust and legitimacy from those affected by its activities. For companies to earn and maintain community trust, they increasingly need to engage with environmental, social, community and sustainability issues.

What we are seeing, however, is a growing chasm between community expectations and corporate conduct. This was borne out in the 2018 Edelman Trust Barometer, which identified Australian institutions as among the least trusted in the world. This crisis of trust is likely to increase this year as the Royal Commission scrutinizes misconduct in the banking, superannuation and financial services industries. Some of Australia's largest companies have suffered extensive reputational damage through this process, and changes to legislation and practices in these industries will inevitably follow.

Importantly, the law and industry standards are evolving in response to changing community expectations. For example, the draft revised ASX Corporate Governance Council's *Corporate Governance Principles and Recommendations* (under public consultation as at June 2018) expressly includes the concept of a 'social licence to operate', requiring the board and management of listed companies to have regard to the views and interests of a broad range of stakeholders. This proposed change has been criticised, including by the AICD (see 1.1.3 above); it is potentially inconsistent with directors' statutory and general law duties – to act in good faith in the best interests of the company (s 181 of the *Corporations Act 2001*) – and may create unintended confusion. In contrast, the UK Companies Act requires mandatory consideration of other stakeholders, while acting in a way "most likely to promote the success of the company for the benefit of its members as a whole". The Modern Slavery Act (before Parliament as at June 2018) would require large businesses operating in Australia to report annually on their actions to address modern slavery in their operations and supply chains.

> "Importantly, the law and industry standards are evolving in response to changing community expectations."

Beyond regulatory changes, our business leaders needs to prioritise rebuilding public confidence in business. Globally, 70 per cent of respondents to the 2018 Edelman Trust Barometer see 'building trust' as the biggest priority for CEOs – more important than high-quality products/services, profits and share prices. Boards also have a crucial role to play. They need to hold CEOs to account, oversee organisational culture and ensure a clear alignment between CEO pay and performance. Directors should have a good (and evolving) understanding of stakeholder expectations and ensure that these expectations are consistently being addressed.

Rebuilding trust in business will take time and require commitment and accountability over a long period. On a positive note (and notwithstanding the decrease in trust in our institutions), the 2018 Edelman Trust Barometer shows that community trust in Australian directors and CEOs has increased (trust in directors rose from 24 to 34 per cent and trust in CEOs from 26 to 39 per cent). Though these gains are off low bases, and Australia continues to be below global averages, it is a start.

2.2 Government

2.2.1 Governance of the Nation: A Blueprint for Growth 2018

Stephen Walters GAICD
Former Chief Economist
AICD

Since 2016, the AICD has published a comprehensive document intended to be a national call to arms on the need for broad based reform. The document – *Governance of the Nation: A Blueprint for Growth* – has made recommendations across six main policy areas: reforming national governance, fiscal sustainability, innovation and entrepreneurialism, human capital, the not-for-profit sector, and national infrastructure.

Across these six priority areas, the AICD's dozens of recommendations included calls for longer terms of federal Parliament, reform of the fractured COAG process, broad-based tax reform, including a higher rate for the GST, spending restraint, a push back on populist trade protectionism, simplification of the workplace award system, five year funding cycles for NFPs, and renewed focus on national infrastructure priorities.

The most recent 2018 edition of the Blueprint took a different approach to its predecessors by undertaking a score-check of progress on the main recommendations, in addition to reinforcing the main policy priorities. The results were unflattering, with the only worthy progress so far in the areas of innovation and entrepreneurialism (B+) gaining better than a C+ assessment, based on AICD analysis. The remaining five areas received only C ratings.

The lowest ratings (C-) were awarded in the area of improving national governance. There has been little momentum in favour of lengthening Parliamentary terms, and the broken COAG process has deteriorated further. In the area of fiscal sustainability, the lack of progress on GST reform was awarded an F for fail – each of the major political parties has ruled out change.

The highest ratings (all B+s) were awarded for the safe harbour corporate reforms, the government's firm resistance to protectionist policies elsewhere, and for the constructive discussion on so-called 'good' versus 'bad' government borrowing.

The bottom line is that much more needs to be done. In the absence of unexpected economic serendipity, as has been the case in the past, the next phase of Australia's growth most likely will be driven by hard-won productivity gains. So, there is precious little time to waste.

> "In the absence of unexpected economic serendipity, as has been the case in the past, the next phase of Australia's growth most likely will be driven by hard-won productivity gains."

2.3 International business environment

2.3.1 Trade wars

Stephen Walters GAICD
Former Chief Economist
AICD

Contrary to what US President Donald Trump has said, there are no winners from trade wars. Only the relative degree of loss matters. Despite this truism, learned from painful experience over many decades, the US administration is pushing ahead with increasingly restrictive and punitive trade policies.

These policies include the imposition of import tariffs, particularly on products made in China like steel and aluminium, but also like washing machines and solar panels. Long standing US trade partners, though, including Canada and the Europeans, also have been affected, the Trump administration seemingly willing to upend decades of previous convention and agreements.

Unsurprisingly, the affected countries are retaliating by imposing tariffs of their own on imports from the US, including orange juice, bourbon and Harley Davidson motor cycles. These tit-for-tat exchanges are the early skirmishes in what risks turning into an escalating trade war. Open conflict has not yet been declared, but it's heading that way.

The risk here, outside political dislocation and the weakening of bilateral alliances, is that growth in world trade slows even more as trade tensions escalate. Already, growth in trade globally has halved in the decade since the global financial crisis, relative to the period before. And that was without the imposition of these new, restrictive trade policies.

Australia has managed to extricate itself from the direct impact of the US tariffs but we are not immune from the fall-out, even though we no longer trade much with the US or Europe. We are a small, open, exporting nation that has benefited greatly from the opening up of global markets over the last four decades. It follows that we stand to suffer if the reverse becomes the norm.

> "China is by far Australia's largest destination for exports, particularly resources, but, increasingly, services too like education and tourism. "

China is by far Australia's largest destination for exports, particularly resources, but, increasingly, services too like education and tourism. An escalation of trade tensions could see Australia caught in a dangerous crossfire between our major long term strategic partner – the US – and our largest trading partner – China.

2.3.2 The Comprehensive and Progressive Agreement for Trans-Pacific Partnership

Stephen Walters GAICD
Former Chief Economist
AICD

Negotiations on the Trans Pacific Partnership (TPP) free trade agreement between 12 nations from the Pacific region were concluded in October 2015. That original 12-nation agreement, however, was transformed into the TPP-11 with the subsequent withdrawal of the US by President Trump back in early 2017. The President had campaigned on a promise to withdraw the US from the draft agreement and delivered on his commitment once in office.

The remaining 11 signatory nations – Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, Peru, New Zealand, Singapore and Vietnam – have pressed on regardless, despite suggestions that the chances of success were diminished without US participation. The TPP framework is open for other nations to join if they meet its high standards of entry but, at least for now, no new members have been admitted. Australia is committed to expanding TPP membership over time.

The Department of Foreign Affairs and Trade claims that even the diminished TPP is an "agreement of unprecedented scope and ambition with great potential to drive job-creating growth across the Australian economy"[16]. It's true that Australia has benefited greatly from the opening up of global markets over recent decades via trade liberalisation. It follows that further measures to liberalise trade also should yield benefits.

For Australia, among the objectives of the TPP are new market access opportunities for exporters of both goods and services, and for investors. The expected benefits are in addition to those accruing from Australia's existing free trade arrangements.

> "For Australia, among the objectives of the TPP are new market access opportunities for exporters of both goods and services, and for investors."

Our government's determined efforts to keep alive the TPP even after the withdrawal of the US are a welcome push back against the unwanted and troubling lurch into protectionism elsewhere. The Trump Administration in the US, for example, continues to announce new restrictive trade policies and import tariffs. Predictably, these now are compelling retaliation from affected countries.

[16] Depart of Foreign Affairs and Trade, Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP-11), [website], **http://dfat.gov.au/trade/agreements/not-yet-in-force/tpp-11/Pages/trans-pacific-partnership-agreement-tpp.aspx**, (accessed 9 July 2018).

2.4 Technology

2.4.1 Future of work in an AI-enabled world

Tim Trumper
Chair of the NRMA, Advisor to Quantium,
Director of the Population Research Network

Writing about the future of anything, especially something as diverse as human work and the complexities of AI, needs caution. With this in mind, wise boards contemplating "What do we need to do now?" might draw from Warren Buffet and consider "Predicting rain doesn't count – building an ark does."

What is new now?
The multi-dimensional speed of the change and its breadth of impact – driven largely by machines that learn via data, analytics and specific-use AI – is what is new. Using data and analytics to predict which customer will prefer what product and at what price point is here now, and companies who are using these techniques are outperforming those who are not in terms of enterprise valuations. Directors need to know what technology relevant to their organisation is available and what is coming fast. This means they should have a view on what's in it for their stakeholders (for example, is this helpful and meaningful to our customers?) and be acutely aware of the reputational risk and ethical obligations surrounding poor use cases for their organisation and society.

Is thinking work in the firing line?
Machines have traditionally taken away physical rather than educated work. But now we are seeing machines impact much more complex human work and what is surfacing is that when trust is solved, utility-enhanced adoption comes fast. For example, core HR functions like working out which staff are disengaged and will leave and how to retain and develop strong performers are among BAU tasks of HR management. Predictive models of how to find and entice high performance talent, which ID to bid on LinkedIn for the job offer and how to personalise the defection risk for high performers can now largely be automated. When HR is being tested with machines, we are at fork in the road for the future of work.

What large scale employment changes are coming?
The Bureau of Labour Statistics in the USA states that 30 per cent of civilian jobs require some form of passenger vehicle driving.[17] With the coming impact of fully autonomous vehicles and the reduced need to drive, this will change a lot of work flow. Autonomous vehicles are expected to scale, once legislation and complicating risks are solved, and organisations can expect to encounter new industries and opportunities to see the transition from work from driving to new areas.

What social responses to AI can be expected?
Schemes such as "universal credit" or "universal basic income (UBI)" are being trialled with various levels of success around the globe.[18] In broad terms, these types of schemes involve the notion of paying a flat, unconditional income to all people in anticipation of, or as a consequence to, large scale unemployment. Is this a partial cure for machine-displaced workers or a solution in search of a problem? Time will tell.

These predictions deliver more questions than answers but what we can be sure about is that while work is likely to be better enabled with large curated data sets and machines that can learn, AI is currently only about complex, specific decisions. In the world of AI, the complex is made simple with data analytics but the simple aspects of being human are still very difficult for machines to mimic.

[17] Bureau of Labor Statistics, 2017, "30 percent of civilian jobs require some driving in 2016", TED: The Economics Daily, United States Department of Labor, 27 June, **https://www.bls.gov/opub/ted/2017/30-percent-of-civilian-jobs-require-some-driving-in-2016.htm**, (accessed 16 July 2018).

[18] G Foster, 2018, "Finland's basic income trial exposes timeless welfare reform dilemma", ABC News, 1 May, **http://www.abc.net.au/news/2018-05-01/finland-universal-basic-income-welfare-reform/9709798**, (accessed 16 July 2018).

2.4.2 Security

Michael Trovato
Managing Director, Information Integrity Solutions and Australian Information Security Association Director

Lucy Han
Consultant, Information Integrity Solutions

In the information era – where 'data is the new oil'[19] – increasingly robust, sophisticated and widespread cyberattacks are being used for data exfiltration.

This is a major area of concern as it can lead to loss of intellectual property, sensitive information, and personal information for both companies and their stakeholders. It can result in loss of reputation and loss of consumer trust or regulatory impacts. The recent PageUp data breach illustrates how extensive the network of victims can be, as it impacted not just individuals but also the operations of its business customers.[20]

The cost of cyberattacks continues to rise. According to research from the Ponemon Institute and Accenture:

- the average cost of cybercrime for surveyed Australian companies was US$5.41 million, an increase of over 25 per cent from 2016 to 2017;[21] and
- malware attacks, denial of service and malicious insiders were the costliest attack types for Australian companies.[22]

Directors and boards must take a proactive approach to managing the risk of data breaches as prevention is cheaper than the cure.

Data breaches can also reveal problematic privacy practices. A common misconception is that state-of-the-art security measures will also satisfy privacy requirements. This is not the case. If a company is collecting and/or using personal information beyond the limits of privacy frameworks in Australia and elsewhere, it will be exposed to compliance and trust risks, regardless of the strength of its security measures.

> "If a company is collecting and/or using personal information beyond the limits of privacy frameworks in Australia and elsewhere, it will be exposed to compliance and trust risks, regardless of the strength of its security measures."

When something goes wrong, the board will be asked to not only explain how the data breach occurred but also justify why the information involved in the breach was collected in the first place. Good information management therefore requires both sound security as well as privacy practices.

In February 2018, a significant change to the *Privacy Act 1988* (the Act) took effect: the Notifiable Data Breach (NBD) scheme. It applies very widely, including all businesses with a turnover of more than $3 million, health service providers, credit reporting bodies, credit

[19] 2017, "The world's most valuable resource is no longer oil, but data", The Economist, 6 May, **https://www.economist.com/leaders/2017/05/06/the-worlds-most-valuable-resource-is-no-longer-oil-but-data**, (accessed 10 July 2018).

[20] P McGrath and C Blumer, 2018, "Bank details, TFNs, personal details of job applicants potentially compromised in major PageUp data breach", *ABC News*, Sydney, 7 June, **http://www.abc.net.au/news/2018-06-06/australian-data-may-be-compromised-in-pageup-security-breach/9840048**, (accessed 10 July 2018).

[21] K Richards et al, 2017, *Cost of cybercrime study: Insights on the security investments that make a difference*, Accenture and Ponemon Institute LLC, pp 13-14, **https://www.accenture.com/t00010101T000000Z__w__/au-en/_acnmedia/PDF-62/Accenture-2017CostCybercrime-US-FINAL.pdf#zoom=50**, (accessed 12 July 2018).

[22] Ibid, p 24.

providers, and the management of Tax File Numbers by any organisation regardless of whether the Act applies. A company that discovers a data breach must complete an assessment within 30 days to understand if it will likely cause serious harm and to notify the Office of the Australian Information Commissioner (OAIC) and probably those individuals impacted. Many companies today do not have the cyber security capability meet this deadline.

Overall, companies need to focus on resilience. This means more than just making its systems resilient to an attack. It is about the entire organisation – its people, processes and priorities – valuing and protecting its data throughout the information lifecycle. This involves implementing robust security and privacy practices. It also involves placing the individual at the heart of strategic and operational decisions.

Companies must recognise that data is both an asset and a liability in the information era. A proactive focus on the individual will help to mitigate risks while opening new opportunities for data-driven value creation.

REGULATORY ENVIRONMENT

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3.1 Other recent legislative reform

3.1.1 Whistleblowing reform

Lucas Ryan GAICD
Senior Policy Advisor
AICD

Reform to Australia's inadequate whistleblower protection framework is still being negotiated in the federal parliament.

The government introduced the Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill 2017 (the Bill) in December 2017, which aims to consolidate and broaden the protections and remedies for whistleblowers.

The Bill proposes a number of refinements to the framework including:

- consolidating whistleblowing protections (which are currently fragmented across several pieces of legislation) under the *Corporations Act 2001*;
- broadening the range of matters about which a whistleblowing disclosure can be made, including conduct that represents a danger to the public or the financial system;
- expanding the categories of person eligible to make whistleblowing disclosures (including to former officers and employees of a company);
- creating provision for 'emergency disclosures' which protect whistleblowers who go to the media or to members of parliament in certain circumstances;
- enhancing the protection of whistleblowers, including a more detailed definition of 'victimisation' and more robust measures to protect confidentiality;
- developing the compensation framework for whistleblowers; and
- requiring that companies develop a whistleblower policy and that this be disclosed to a company's employees and officers. Although originally contemplated in consultation on the reforms in 2017, the Bill did not include provision for the establishment of a rewards and incentives scheme for whistleblower, similar to the one operating in the US.

The Bill was referred to the Senate Economics Legislation Committee in February 2018[23], which considered and issued a report on the Bill in March. Views on the Bill were mixed, and while many opportunities were identified to improve it, the Committee observed that the balance of views suggested it was a positive move forward for whistleblowing in Australia.

The Committee recommended that the Bill be passed with only minor amendment. However, its report also noted that this would not preclude government from undertaking further reforms in the future to strengthen the framework on certain areas, potentially as part of a statutory review process. It is possible that debate in the parliament about the Bill may result in amendments prior to its passage.

It is expected that Bill will pass in the second half of 2018.

3.1.2 Modern slavery in supply chain reporting requirements

Kerry Hicks GAICD
Senior Policy Advisor
AICD

Commonwealth
The Modern Slavery Bill 2018 (Cth)[24] was introduced into the House of Representatives on 28 June 2018 and has been referred to the Senate Legal and Constitutional Affairs Legislation Committee for report by 24 August 2018. It is aimed at helping to combat modern slavery through the establishment of a reporting requirement for

[23] See Treasury Laws Amendment (Enhancing Whistleblower Protections) Bill 2017, **https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=s1120**, (accessed 20 August 2018).
[24] See Modern Slavery Bill 2018, **https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r6148**, (accessed 20 August 2018).

entities, which extends to entities' supply chains.

Modern slavery is used to describe a number of crimes, including human trafficking, forced labour, sexual slavery, child labour and trafficking, domestic servitude, forced marriage, bonded labour (including debt bondage), slavery and other slavery-like practices. It is estimated that worldwide there are 46 million victims, with estimates that modern slavery in supply chains amounts to US$150 billion of illicit profits per year. The Global Slavery Index suggests that two-thirds of modern slavery occurs in the Asia-Pacific region, where many Australian supply chains extend.

> "The Global Slavery Index suggests that two-thirds of modern slavery occurs in the Asia-Pacific region, where many Australian supply chains extend."

The reporting requirement will apply to all entities (including foreign entities carrying on a business in Australia) with annual consolidated revenue of at least $100 million, impacting more than 3,000 entities. Modern slavery statements will require consideration by the board and will need to be signed by an individual director. Under the current proposal, no new penalties will exist for non-compliance although existing directors' duties will apply. These statements will need to be lodged through a central repository where they are freely available and they must contain four mandatory reporting criteria:

1. the entity structure, operations and supply chains;
2. potential modern slavery risks in the operations and its supply chains;
3. actions taken to address these risks; and
4. how the entity assesses the effectiveness of its actions.

Andrew Forrest, chairman of Fortescue Mining Group and Walk Free Foundation, is quoted as saying:

> *We are all going to have slavery in our supply chains no matter how good we think our corporate social responsibility is.*[25]

New South Wales
For those organisations with NSW employees, in June 2018 the NSW Parliament passed a *Modern Slavery Act 2018* (the Act). This Act also contains a reporting requirement, which potentially duplicates the Commonwealth proposals, with these key differences:

- applicable to commercial organisations only (supplying goods or services for profit or gain);
- applicable where turnover is $50 million or more in a financial year;
- criteria are similar but worded differently;
- the organisation itself is responsible for making its statement public;
- penalties exist for non-compliance.

Note that an exemption from the reporting requirements will exist in circumstances where the entity is subject to obligations under a law of the Commonwealth or another State or Territory that is prescribed as a corresponding law. This should resolve any duplication issues for entities of at least $100 million annual consolidated revenue that are required to comply with the Commonwealth requirements.

[25] A Patty, 2017, "Fortescue's Andrew Forrest declares beginnings of end of modern slavery", *The Sydney Morning Herald*, 24 August, **https://www.smh.com.au/business/workplace/fortescues-andrew-forrest-declares-beginning-of-end-of-modern-slavery-20170824-gy33p0.html,** (accessed 10 July 2018).

3.1.3 Banking Executive Accountability Regime

Matthew McGirr
Policy Advisor
AICD

The Banking Executive Accountability Regime (BEAR) has commenced for large Authorised Deposit-taking Institutions (ADIs) in July of this year, with small and medium ADIs subject to the regime from 1 July 2019.

The BEAR is an accountability regime designed to put in place a strengthened responsibility and accountability framework for senior directors and executives of ADIs and their subsidiaries. According to the explanatory materials which accompanied the legislation, the BEAR aims to improve the operating culture of ADIs and increase transparency and accountability across the sector.

To achieve this aim, the BEAR introduces new provisions applicable to "accountable persons", which includes non-executive directors of ADIs. These "accountable persons" are required to register with APRA prior to commencement in an accountable person role and are required to:

- act with honesty and integrity and with due skill, care and diligence;
- deal with APRA in an open, constructive and co-operative way (this does not displace legal professional privilege); and
- take reasonable steps to prevent matters which could affect the "prudential reputation or standing" of the ADI.

The Australian Prudential Regulation Authority (APRA) has been given new powers to investigate potential breaches of the BEAR and can seek the disqualification of accountable persons in certain circumstances. Directors are able to access merits review for a disqualification decision by APRA.

In addition, the BEAR:

- requires ADIs to give APRA accountability statements detailing the roles and responsibilities of each accountable person;
- requires ADIs to give APRA accountability maps allocating the roles and responsibilities of accountable persons across the ADI and its subsidiary; and
- imposes new requirements on the deferral of variable remuneration.

A recent Joint Parliamentary Committee inquiry into the life insurance industry has recommended that BEAR be expanded to life insurance, while there have been media reports that the government intends to announce that all APRA-regulated entities (including insurers and superannuation funds) be brought into an expanded BEAR regime.

In August 2018, the Treasurer indicated that the government would look to expand BEAR type arrangements to other sectors such as telecommunications and energy.

3.2 Australian Securities and Investments Commission

3.2.1 Regulatory and enforcement priorities

John Price
ASIC Commissioner

As the corporate regulator, the Australian Securities and Investments Commission (ASIC) works to ensure all Australians have a fair, strong and efficient financial system. We regulate companies, financial markets, financial services organisations and professionals who deal in, and advise on, investments, superannuation, insurance, deposit-taking and credit.

Underpinning our vision is the recognition that every cent in the financial system is other people's money and we make no apologies for approaching this task from a consumer's perspective.

ASIC is focused on identifying regulatory risks, diagnosing the behaviours behind them and addressing the harms they cause to both investors and consumers. We use our regulatory tools to:

- change behaviours to drive good consumer and investor outcomes;
- act against misconduct to maintain trust and integrity in the financial system;
- promote strong and innovative development of the financial system; and
- help Australian control their financial lives.

But this is not without its challenges.

Corporate Australia needs to build trust amongst the broader community and the financial services sector is under unprecedented scrutiny: for example, the Hayne Royal Commission is highlighting misconduct across the industry.

Good conduct is pivotal to well-functioning markets. While this is a shared responsibility across the sector, we are determined to use our full suite of regulatory tools to modify behaviour to improve corporate culture and achieve a level and pattern of behaviour that goes beyond mere compliance (but certainly includes it).

ASIC's 'regulatory toolkit' includes enforcement, supervision, surveillance, engaging with industry and other groups, guidance, education and policy advice to the government. Our work includes making sure that gatekeepers such as directors and officers, auditors, insolvency practitioners and business advisers, adhere to the standards required by law. When they fall short, ASIC will take action.

> "ASIC's 'regulatory toolkit' includes enforcement, supervision, surveillance, engaging with industry and other groups, guidance, education and policy advice to the government."

ASIC's headline enforcement outcomes for 2017-18 include reaching settlements with three of Australia's Big Four banks over unconscionable conduct in relation to the setting the bank bill swap reference rate (BBSW), and winning over $128 million in compensation for consumers in the add-on insurance sector.

Since July 2011, ASIC has conducted over 140 civil proceedings, secured over 150 court enforceable undertakings, and won over $1.82 billion in compensation for investors and consumers. During this time, ASIC continued to act against misconduct by gatekeepers, including disqualifying or removing over 390 people from directing a company.

Over coming months, we will continue to focus on:

- companies with poor corporate governance;
- undisclosed associations and substantial holdings in shares in public companies (including beneficial ownership tracing and corporation fraud);
- related-party transactions involving public companies;
- poor financial reporting by listed companies;
- auditing standards and public company audits;
- insolvency practitioners and others who facilitate serious illegal 'phoenix' activity and improper transactions in the face of insolvency; and
- debenture issuers and other companies exposed to risks in the event of a declining property market.

Directors and senior management play a critical role in driving governance systems and cultures that promote compliance and good investor and consumer outcomes. As recent events have demonstrated, it is not an area that can be ignored. We believe that public companies should treat investors and consumers fairly, be accountable to investors through accurate and timely, clear and understandable disclosure and adopt sound corporate governance practices. We strongly encourage boards and senior management to lead this work.[26]

3.2.2 Increased funding and strategic enforcement focus

Sally Linwood
Senior Policy Advisor
AICD

In August 2018, the government announced $70 million in funding for ASIC to support a strategy of proactive enforcement.

The package of measures includes funds earmarked to:

- accelerate and increase the intensity of ASIC's enforcement activities and enhance its capacity to pursue actions for serious misconduct against well-funded litigants;
- boost supervision of the superannuation sector by strengthening audit and enforcement action;
- implement a new supervisory approach in respect of Australia's five largest financial institutions (the four major banks and AMP) by, for the first time, embedding dedicated staff within these institutions to monitor governance and compliance actions;
- establish a dedicated taskforce which will conduct a proactive, targeted and thematic review into corporate governance to identify and pursue failings in large listed companies, including deploying staff to conduct new on-site surveillance and investigations;
- implement the government's proposed reforms to whistleblower protection laws, so that ASIC can better receive, assess, triage and address whistleblower disclosures about misconduct; and
- promote Australia as a world leader in the development and adoption of regulatory technology solutions for the financial services industry.

These steps represent a significant shift in ASIC's enforcement activities, and it is clear that the shift in approach will be felt beyond the financial services sector. Indeed, ASIC Chair James Shipton has stated that ASIC will be looking 'across-the-board' at corporate governance, signalling that the taskforce's mandate will extend beyond financial services. While there is still limited information about how the taskforce will operate, it is clear that listed company corporate governance will be subject to greater scrutiny from the regulator going forward.

Of course, there may well be further shifts coming down the line, given the recent focus of the Hayne Royal Commission on ASIC and APRA's approach to dealing with misconduct and the potential for recommendations from Commissioner Hayne for further reform. The recent announcement certainly suggests there is an appetite to embrace tougher policing of corporate misconduct and stronger enforcement activities under the new ASIC chair.

[26] For more information and to view ASIC's Corporate Plan and business plans, visit **asic.gov.au**, (accessed 30 July 2018).

3.3 Australian Competition and Consumer Commission

3.3.1 Compliance and enforcement priorities

Rod Sims
ACCC Chair

As you know, as a company director you have a responsibility to ensure that your company is meeting its legal obligations. Beyond the good corporate citizen aspects of compliance, now more than ever the costs of non-compliance are significant. The impact of regulatory action, with increasing penalties and costly litigation, is one thing; lost reputation, reduced customer trust, distracted management and remedial actions also take their toll on companies.

As the economy-wide competition and consumer protection regulator, we like to ensure that company directors understand the compliance and enforcement model employed by the Australian Competition and Consumer Commission (ACCC).

The ACCC makes it clear that it can't pursue all matters that come to its attention. We make it equally clear though that we will pursue important matters, seek serious sanctions, and leverage those interventions to drive broader compliance in the industry and beyond through education and deterrence.

Each year the ACCC publishes its compliance and enforcement priorities. Some phrased in terms of industries and others in terms of conduct. This is a pretty good road map for areas of likely intervention as each year demonstrates. As some commentators have picked up, the growing list of ACCC market studies is also a pretty good predictor of enforcement focus.

This year, the ACCC has been focusing on consumer issues in broadband and energy, competition in the financial services and commercial construction sectors, systemic consumer guarantee issues, and conduct that may contravene the new misuse of market power and concerted practices provisions.

Another priority for the ACCC this year is monitoring compliance with the compulsory Takata airbag recall, and ensuring better product safety for consumers in the online market more broadly.

We are also focussing on competition and consumer issues in the agricultural sector, and examining digital platforms, algorithms and consumer data, as part of our Digital Platforms Inquiry.

But this is not the extent of our focus. While we generally expect many of our enforcement interventions to fall within these priority areas, we retain the capacity to address any other issues that arise.

At the ACCC, we keep our ear to the ground and listen to the issues that are impacting consumers and businesses so that we can decide where to focus year-to-year. Our priorities are drawn in part from our consultation with industry bodies, consumer groups, other regulators, both domestic and international, as well as by conducting internal and external surveys to see what issues are top of mind for Australia's consumers.

> "Anything that lands on our priority list is something that concerns many consumers and businesses across Australia"

That means that anything that lands on our priority list is something that concerns many consumers and businesses across Australia. If one of the priority areas is within your company's sphere, then I urge you to check your compliance with Australia's competition and consumer laws to avoid ACCC enforcement action.

3.4 Australian Taxation Office

3.4.1 Achieving justified trust

Provided by **Jeff Stevenson**
ATO Assistant Commissioner

The Australian Taxation Office (ATO) is committed to providing the community with assurance that large corporate groups are paying the right amount of tax according to law through proactive engagement.[27] Large corporate groups, some 1,450, each with a turnover of more than $250 million, make a significant contribution to our tax system and the Australian economy.

We work closely with these corporates, using the justified trust methodology, to obtain a higher level of assurance over their tax affairs across income tax, indirect taxes (GST and excise) and the petroleum resource rent tax. Our interaction is tailored to the specific circumstances of each corporate and we objectively analyse information, applying a holistic approach across taxes.

Under the justified trust methodology, we concentrate on four key areas:

1. understanding their tax governance framework with reference to our guides:
    a. the *tax risk management and governance review guide*[28] for public and multinational businesses; and
    b. the *tax governance for privately owned groups*;[29]
2. understanding their economic performance and the reasons why tax outcomes may differ;
3. understanding any new or significant transactions;
4. identifying if they are involved in arrangements we have indicated we are concerned about or consider high risk.

There are a number of benefits for directors who work with us to obtain justified trust, including:

- reduced compliance costs in future years where their company's arrangements remain largely unchanged;
- having confidence in their company's tax compliance;
- greater certainty over their company's tax affairs;
- lighter touch approaches applied to their company's tax affairs and a shift to more service focused approaches.

We have been encouraged by the increasing openness and transparency with which large corporate groups are engaging with us to obtain justified trust.

[27] *Large business*, Australian Taxation Office, **https://www.ato.gov.au/Business/Large-business/?=redirected**, (accessed 10 July 2018).
[28] *Tax risk management and governance review guide*, Australian Taxation Office, **https://www.ato.gov.au/business/large-business/in-detail/key-products-and-resources/tax-risk-management-and-governance-review-guide/**, (accessed 10 July 2018).
[29] *Tax governance for privately owned groups*, Australian Taxation Office, **https://www.ato.gov.au/Business/Privately-owned-and-wealthy-groups/Tax-governance/**, (accessed 10 July 2018).

3.5 Australian Prudential Regulation Authority

3.5.1 Regulatory priorities

Mark Standen
Partner
MinterEllison

Kate Hilder
Consultant
MinterEllison

Given the intense focus on the financial sector in light of the Hayne Royal Commission and a number of high profile corporate scandals that have damaged public trust in the sector, culture and governance, lifting industry standards and ensuring accountability for poor outcomes has emerged as a key focus for the Australian Prudential Regulation Authority (APRA) in 2018.[30]

APRA Chair Wayne Byres has said that the recommendations and insights into improving governance, culture and accountability frameworks included in APRA's Final Report of the Prudential Inquiry into the Commonwealth Bank of Australia are of general relevance to all organisations, and that it is APRA's expectation that institutions are able to demonstrate how they have considered the issues raised in the report.[31]

In the superannuation sector, APRA has identified improving member outcomes as a priority and recent thematic reviews into governance and outsourcing arrangements have provided specific guidance as to the steps industry should take to address specific weaknesses.[32] [33]

With respect to private health insurers, APRA's focus on lifting industry standards is evident in the package of measures entitled *Governance, fit and proper, audit and disclosure requirements for private health insurers*[34] released earlier this year, and the staged roll out of cross industry standards to the sector.

In the banking sector, APRA's powers and oversight have been significantly strengthened with the passage of legislation[35], which collectively will: implement an enhanced accountability framework for authorised deposit taking institutions (ADIs) and persons in direct and senior executive roles (Banking Executive Accountability Regime (BEAR)); strengthen APRA's crisis management powers; and provide APRA with a new reserve power over the lending activities of non-banks. With respect to the eventual scope of BEAR, it remains to be seen whether the Parliamentary Joint Committee recommendation[36] that it be extended to life insurers will be adopted.

[30] W Byres, 2018, *Opening statement: Appearance before Senate Economics Legislation Committee*, 30 May, **https://www.apra.gov.au/media-centre/speeches/opening-statement-senate-economics-legislation-committee-4**, (accessed 10 July 2018).

[31] MinterEllison, 2018, *Final APRA report into CBA culture* released, 4 May, **https://www.minterellison.com/articles/final-apra-report-into-cba-culture-released**, (accessed 10 July 2018).

[32] B Mclean, 2018, *APRA seeks further improvements from superannuation licensees to manage conflicts of interest*, [media release], APRA Media Unit, 29 May, **https://www.apra.gov.au/media-centre/media-releases/apra-seeks-further-improvements-superannuation-licensees-manage**, (accessed 10 July 2018)..

[33] H Rowell, 2018, *Related party arrangements thematic review*, letter to RSE licencees, APRA, 29 May, **https://www.apra.gov.au/sites/default/files/rpatr_-_letter_to_rsels_-_29_may_2018.pdf**, (accessed 10 July 2018)..

[34] 2018, *Discussion paper: Governance, fit and proper, audit disclosure requirements for private health insurers*, APRA, February, **https://www.apra.gov.au/sites/default/files/Governance%2520fit%2520proper%2520PHI%2520discussion%2520paper.pdf**, (accessed 10 July 2018)..

[35] *The Treasury Laws Amendment (Banking Executive Accountability and Related Measures) Act 2018*; the Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018; and the Treasury Laws Amendment (Banking Measures No 1) Act 2018.

[36] MinterEllison, 2018, *Final PJC Report into life insurance* released, 3 April, **https://www.minterellison.com/articles/final-pjc-report-into-life-insurance-released**, (accessed 10 July 2018)..

3.6 Financial reporting (AASB and AUASB)

3.6.1 Revenue

Kerry Hicks GAICD
Senior Policy Advisor
AICD

The new revenue standard – contracts with customers
All for-profit entities with financial years commencing on or after 1 January 2018 will need to apply the new accounting standard AASB 15 *Revenue from contract with customers*. Those not-for-profit entities have an additional year to apply the standard. This standard will have the most wide reaching impact on organisations that have long term arrangements with customers such as telecommunications, software, technology, construction and not-for-profit sectors.

The new standard may have a significant impact on how and when revenue is recognised – being determined through review of revenue arrangements in order to determine the existence of performance obligations and the timing of when they are satisfied. Where contracts involve the bundling of goods and services, they will need to be unbundled and the performance obligations assessed as distinct goods and services. This could require the review and collation of a great deal of information in order to assess the impact on the entity.

Some entities will already have prepared their half-year reporting results using the new standards, others will still be working their way through the conversion to the new standards. We expect that not-for-profits will be lagging in their assessment, given the later application date.

Directors should be questioning the finance team about their implementation plans: At what stage is our implementation plan? What is the impact to our entity? What do the numbers look like? What conversations or disclosures can we make to our stakeholders?

The income standard for not-for-profits
All not-for-profit entities with financial years commencing on or after 1 January 2019 will need to determine the applicability of new accounting standard AASB 1058 *Income of Not-for-profit entities* which applies to:

- transactions where the consideration paid is significantly less than fair value; and
- the discount is to further the not-for-profit objectives.

Typically the following types of transactions will be captured in this new accounting standard: general government grants, capital grants, unconditional donations, gifts, volunteer services, below market lease arrangements (or peppercorn leases).

In conjunction with the new revenue standard, where the not-for-profit has enforceable contracts with sufficiently specific performance obligations, revenue will be recognised as performance obligations are satisfied. Otherwise, the revenue will be recognised immediately.

In conjunction with the new leasing standard, peppercorn lease arrangements will need to be capitalised on the balance sheet at fair value with a lease liability recognised for the present value of minimum lease payments. Any difference will be recognised in the profit or loss.

Directors should be questioning their finance teams about implementation plans: At what stage is our implementation plan? Have we ensured we have identified all contracts that could be impacted, including peppercorn lease arrangements? What is the impact on the balance sheet and the profit or loss? What conversations or disclosures can we make to our stakeholders?

3.6.2 Financial instruments

Kerry Hicks GAICD
Senior Policy Advisor
AICD

All entities with financial years commencing on or after 1 January 2018 will need to apply the new accounting standard AASB 9 *Financial Instruments*. It will affect businesses across most industries, resulting in impairment losses on loans and receivables being booked much earlier. The standard also addresses the classification and measurement of financial assets (being investment portfolios being held by many organisations) and liabilities and provides a set of new hedge accounting rules.

Some entities will already have prepared their half year reporting results using the new standards, others will still be working their way through the conversion to the new standard.

Directors should be questioning the finance team about the progress of implementation: What is the impact to our entity? What do the numbers look like? Can you explain the differences between the old numbers and the new numbers?

> "[The new Financial Instruments accounting standard] will affect businesses across most industries, resulting in impairment losses on loans and receivables being booked much earlier."

3.6.3 Leases

Kerry Hicks GAICD
Senior Policy Advisor
AICD

All entities with financial years commencing on or after 1 January 2019 will need to apply the new accounting standard AASB 16 *Leases*. It will affect entities that take out operating leases – such as for leasing buildings, transport equipment (including cars), heavy plant, and computer equipment.

The standard will affect an entity's debt ratios by requiring organisations to incorporate the cost of most operating leases and service agreements on the balance sheet, increasing assets and liabilities. All information about every lease held in the organisation will need be to be collated and assessed – a potentially very substantial compliance project.

Implementation plans should already be in the place for the transition to the new standard which should include the assessment of the various transition options that will have a different financial impact on the entity. Such plans should also include the identification of the required system, process or internal control changes, assessment of business and compliance impacts, disclosures in current financial reports or continuous disclosure considerations, assessment of impacts on debt covenants, employee incentive schemes and regulatory capital requirements.

Directors should be questioning the finance team about their implementation plans: Are all arrangements captured in the analysis? What is the impact on the balance sheet and the profit and loss? What conversations or disclosures should we make to our stakeholders?

3.7 Australian Charities and Not-for-profits Commission

3.7.1 Regulatory and enforcement priorities

Murray Baird FAICD
Assistant Commissioner General Counsel at the Australian Charities and Not-for-profits Commission

A high proportion of AICD members serve on not-for-profit boards. Many of these organisations are charities registered with the Australian Charities and Not-for-profits Commission (ACNC), the national regulator of charities. ACNC registers eligible charities and supervises the conduct of charities on the ACNC Charity Register. Most of the concerns about charities result from poor governance.

Awareness of the ACNC is increasing, which is resulting in more concerns being raised by the public as evidenced in the *Charity Compliance Report 2017*.[37] Consequently, there has been a marked increase in completed investigations and actions.

In 2017, the ACNC received 1,695 concerns, up 42 per cent from 2016. Over two hundred investigations were opened, resulting in 26 revocations, 16 Compliance Agreements and one Enforceable Undertaking. A further 50 charities were provided with advice to ensure future compliance.

The ACNC also issued 115 charities with penalty notices for failing to lodge Annual Information Statements, and a further 780 'double defaulter' charities had their registration revoked for failing to file two Annual Information Statements. Charities are required to report to the ACNC annually to maintain registration.

Most concerns investigated by ACNC compliance in 2017 related to:

- financial mismanagement;
- failure to address harm to beneficiaries;
- private benefit; and
- other fraudulent or criminal activity.

The ACNC will continue to review concerns raised and analyse our own data to regulate charities, as well as working with other regulators and law enforcement agencies to identify charities that are involved in illegal activities. This process was boosted by the announcement in May 2018 that the ACNC is now a designated agency in the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*, allowing direct access to AUSTRAC information about international movements of money by charities.

Under the leadership of the recently-appointed commissioner, the Hon. Dr Gary Johns, the ACNC's regulatory priorities will continue to centre on proactively identifying and addressing risk.

In 2018-19, compliance resources will remain focused on:

- fraud and financial mismanagement;
- terrorism;
- harm to beneficiaries; and
- political or unlawful activities.

Not-for-profits require high standards of governance. Accordingly, boards need to be familiar with compliance issues and put in place rigorous processes to meet compliance requirements.[38]

3.7.2 Deductible Gift Recipient system review

Lucas Ryan GAICD
Senior Policy Advisor
AICD

The Australian Government consulted on reform opportunities to the administration of Deductible Gift Recipient (DGR) status in the second half of 2017.

Taxpayers can deduct the amount of a donation to an organisation with DGR status from their assessable income in a given tax year (where the value of the donation is $2 or greater). The cost of these deductions to the Australian Government is more than $1 billion each year.

[37] Australian Charities and Not-for-profits Commission, 2018, *Charity compliance report 2017: Protecting public trust and confidence in Australia's charity sector*, February, **http://www.acnc.gov.au/ACNC/Publications/Reports/ComplianceRpt2017.aspx**, (accessed 10 July 2018).

[38] Australian Charities and Not-for-profits Commission supports board education and guidance at **http://www.acnc.gov.au/**, (accessed 10 July 2018).

In December 2017, the government announced a reform package which aims to ensure that organisations with DGR status are subject to appropriate oversight and to reduce red tape for these organisations.

These reforms include:

- automatically registering all non-government DGRs as charities with the Australian Charities and Not-for-profits Commission (ACNC) from 1 July 2019;
- the abolition of the requirement that certain DGRs maintain a public fund; and
- additional funding for the ACNC and the Australian Taxation Office to support them to undertake risk-based review into DGR eligibility.

The government also announced that it will integrate existing DGR registers as well as the Overseas Aid Gift Deduction Scheme into the ACNC Register. This will eliminate duplicative reporting requirements for charities on these registers and provide a streamlined reporting and application process through the ACNC.

As part of this reform package, the government announced its intention to issue the 'external conduct standards'. The ACNC legislation gives the government power to form these standards through regulation but these have not yet been issued.

These standards will address the conduct and governance of charities that operate or send money overseas. Registered charities will have to meet these standards to become and remain registered with the ACNC.

3.7.3 Australian Charities and Not-for-profits Commission review

Lucas Ryan GAICD
Senior Policy Advisor
AICD

In December of 2017, the Australian Charities and Not-for-profits Commission (ACNC) completed its fifth year of operation, bringing a close to its 'establishment' phase as a regulator. This milestone triggered a statutory review, which was conducted between December 2017 and May 2018.

The government appointed an independent panel to undertake the review chaired by Patrick McClure AO and including Su McCluskey MAICD, Greg Hammond OAM MAICD and Dr Matthew Turnour FAICD. The results of the review were published on 22 August 2018.

The review noted the broad support of the ACNC among charities and did not recommend any changes to its objects or functions. It made several recommendations about how the regulatory framework could be improved including:

- Removing the power of the ACNC Commissioner to dismiss directors;
- Significantly raising the reporting thresholds for charities;
- Reviewing the ACNC's secrecy provisions to enable the ACNC Commissioner to disclose greater information about their regulatory activity;
- Bringing certain tax exempt not-for-profits that are not charities under the ACNC regulatory framework; and
- Removing, subject to certain preconditions, the exemptions granted to 'basic religious charities'.

One of the more surprising recommendations of the review concerned directors' duties for charities incorporated under the *Corporations Act 2001* (Cth). The intention behind the establishment of the ACNC was that these duties would be replaced by the governance standards, however the review noted that there was some uncertainty about whether and how this applied. Recognising this, the review recommended that these duties be reinstated until a referral of powers could be negotiated to resolve this issue.

The review also recommended the adoption of the '#fixfundraising' campaign's recommendations to improve the regulatory framework around fundraising. It recommended that the Australian Consumer Law be amended to ensure its broad and clear application to fundraising, that state and territory regulatory regimes be repealed or amended, and that a mandatory code of conduct for fundraisers be developed. The AICD has been an active participation in the '#fixfundraising' campaign and has welcomed this recommendation by the review.

The government has yet to respond to the review.

INTERNATIONAL ENVIRONMENT

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4.1 Key global governance trends

4.1.1 Global Director Survey Report

The Global Network of Director Institutes (GNDI) will be publishing their inaugural Global Director Survey Report in September 2018.

More than 2,000 respondents from 17 GNDI member organisations around the world (including the Australian Institute of Company Directors) participated in the survey, providing a high level view of the economic, social, business, environmental and technological governance issues facing directors.

Preliminary findings echo many of the general themes addressed in this year's Essential Director Update.

- Big data is on the global radar with 63 per cent of directors viewing it as the top technological disruptor to their organisation.
- The board's oversight role in data governance has come into focus, with the increasing reliance on data and corresponding concerns about privacy, protection and value creation.
- The board's performance needs to be regularly evaluated and focused on continual improvement.
- Succession planning helps build a balanced mix of diversity that underpins board quality, continuity and future success.
- Boards should consider their role in building and preserving stakeholder trust.
- Ethical behaviour, health and safety and employee engagement are the three most relevant environmental and social variables for directors.

4.1.2 European Union General Data Protection Regulation

The European Union (EU) General Data Protection Regulation (GDPR) came into full effect on 25 May 2018. This affects any companies that do business with EU residents or entities or have a presence in the EU.

The GDPR sets out a data protection framework to be applied across the EU. This framework substantially enhances individual data protection and privacy rights. The New Zealand Privacy Commissioner, John Edwards, has noted that "it is widely perceived as the most stringent and most influential privacy law in the world: the 'gold standard'".[39]

The GDPR states that compliance is mandatory and applies worldwide to all entities that hold or use data concerning people within the EU. This means that if an overseas organisation collects data on even one EU individual, they must comply with GDPR regulations. Non-compliant organisations risk fines of up to €20 million or 4 per cent of their total worldwide annual turnover.

The GDPR gives a range of new rights for individuals, including the:

- right to be forgotten – this gives individuals a right to require data controllers to delete their data in certain circumstances;
- right to data portability – this gives a right to receive personal data that an individual has provided to an online service provider, in a structured, commonly used, machine-readable format and the right to transmit that data to another online service provider;
- right to object, at any time, to the processing of an individual's personal data – if an objection is made, the processing generally must be stopped. This right only applies to certain types of processing, such as where the legal basis for processing is for legitimate business interests or for direct marketing.

In April 2018, the Office of the Privacy Commissioner for Personal Data, Hong Kong, issued a booklet entitled *European Union General Data Protection Regulation 2016 (effective 25 May 2018)*. This booklet raises awareness of the possible impact of the new regulatory framework for data protection in the EU, as well as comparing some of the major requirements with those set out in the Hong Kong Personal Data (Privacy) Ordinance. A number of features of the GDPR that are highlighted in the booklet include:

[39] Privacy Commissioner, 2017, *Report to the Minister of Justice under Section 26 of the Privacy Act 1993: Six Recommendations for Privacy Act Reform*, 3 Feb, p 5, **https://www.privacy.org.nz/assets/Files/Reports-to-ParlGovt/OPC-report-to-the-Minister-of-Justice-under-Section-26-of-the-Privacy-Act.pdf**, (accessed 30 July 2018).

- extra-territorial application;
- personal data covered;
- new data privacy governance, data mapping and impact assessment;
- sensitive personal data;
- consent;
- mandatory breach notification;
- data processors' obligations;
- new and enhanced rights for individuals;
- data protection seals, codes of conduct and cross-jurisdiction data transfer;
- sanctions.

4.1.3 Risk management

Risk management is an important responsibility for all boards but especially for those operating internationally as their companies are exposed to a wider range of risks. The World Economic Forum's *The Global Risks Report 2018* suggests that the top 10 global risks in terms of likelihood[40] are:

1. Extreme weather events
2. Natural disasters
3. Cyber attacks
4. Data fraud or theft
5. Failure of climate-change mitigation and adaptation
6. Large-scale voluntary migration
7. Man-made environmental disasters
8. Terrorist attacks
9. Illicit trade
10. Asset bubbles in a major economy

The report notes that cybersecurity risks are growing, both in their prevalence and in their disruptive potential; attacks against businesses have almost doubled in five years and incidents that would once have been considered extraordinary are becoming more and more commonplace. The financial impact of cybersecurity breaches is rising.

Some of the largest costs in 2017 related to ransomware attacks, which accounted for 64 per cent of all malicious emails. Notable examples included the WannaCry attack, which affected 300,000 computers across 150 countries, and NotPetya, which caused quarterly losses of US$300 million for a number of affected businesses.

Another growing trend is the use of cyberattacks to target critical infrastructure and strategic industrial sectors, raising fears that, in a worst-case scenario, attackers could trigger a breakdown in the systems that keep societies functioning.

4.1.4 Board composition

Diversity

The percentage of female board members in Asia continues to be very low: China, Hong Kong and Thailand are between 9 to 14 per cent.

In Singapore, female representation in boards of top 100 listed companies has jumped from 11 to 13 per cent in a single year. The total representation of women on all listed companies is at 10.3 per cent. The Diversity Action Committee Singapore has set an aspirational target for female board representation of 20 per cent by 2020. In addition to gender, it has been recommended that age should be one of the aspects of diversity for companies to consider.

The Hong Kong Exchange proposes in a consultation paper to upgrade CP A.5.6 to Rule 13.92, requiring issuers to have a diversity policy and to disclose the policy or a summary of it in their corporate governance reports. It also proposes to revise CP A.5.5, requiring, on a 'comply or explain' basis, that the board should state in a circular to shareholders accompanying the resolution to elect a director: the process used for identifying the nominee; the perspectives, skills and experience the nominee is expected to bring to the board; and how the nominee would contribute to diversity of the board.

[40] World Economic Forum, 2018, *The Global Risks Report 2018*, 13th Edition, Fig 1: The Global Risks Landscape 2018, **http://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2018/January/Global-Risks-Report-2018.pdf**, (accessed 30 July 2018).

In Australia, the percentage of women on ASX 200 boards is 28.2 per cent.

The UAE has made it compulsory for all public and private sector organisations to include a female representative on their board of directors.

Director overboarding

The broad stand which is being taken against overboarding can be seen from the policies of Blackrock, the world's largest asset manager with more than US$6 trillion in assets under management.

Blackrock's *Proxy voting guidelines for U.S. securities* states[41]:

> *"The following illustrates the maximum number of boards on which a director may serve before he she is considered to be over-boarded:*

	Public Company CEO	# Outside Public Boards*	Total # of Public Boards
Director A	√	1	2
Director B		3	4

> **In addition to the company under review"*

In Hong Kong, changes are proposed which will require a company to take specific actions where an independent director has seven or more directorships (see 4.2.3 below).

Tenure

A number of jurisdictions are taking the view that a director will not be considered independent after they have served on a board for nine years.

In the UK, it is proposed that this be a hard limit (see 4.2.1 below).

The Singapore Code of Corporate Governance presently requires that the independence of any director who has served on the board beyond nine years from the date of their first appointment, should be subject to a "particularly rigorous review". The Council proposes two options to address current issues of ambiguity related to the "particularly rigorous review": the first is to incorporate the nine-year rule in the SGX Listing Rules as a hard limit; the second is to subject the appointment of independent directors who have served beyond nine years to an annual vote (see 4.2.2 below).

"A number of jurisdictions are taking the view that a director will not be considered independent after they have served on a board for nine years."

[41] Blackrock,2018, *Proxy voting guidelines for U.S. securities*, February, p 3, **https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf**, (accessed 24 August 2018).

4.2 Key market governance trends

4.2.1 United Kingdom

Major revisions to The UK Corporate Governance Code

In December 2017, the UK Financial Reporting Council released its proposed revisions to the Corporate Governance Code. The Council published the final version of The UK Corporate Governance Code in July 2018.[42] The new Code will apply to accounting periods on or after 1 January 2019.

Major changes to be included in the new Code include the following.

Employee and stakeholder engagement

The board will be required to establish a method for gathering the work force's views. This would normally be a director appointed from the work force, a formal work force advisory panel or a designated non-executive director. There should also be a means for the work force to raise concerns in confidence and anonymously.

The board should ensure that arrangements are in place for the independent investigation of such matters and for follow-up action. The board will also be required to explain in the annual report how it has engaged with the work force and other stakeholders and how their interests and the matters set out in s 172 of the Companies Act 2006 influenced the board's decision making.

Action where shareholder opposition

There is a new provision requiring listed companies with significant shareholder opposition to resolutions to publish an interim action statement within six months and a final summary in the next annual report.

Diversity

Board appointments and succession plans should be based on merit and objective criteria, and promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.

The annual report should describe the work of the nominations committee and should include:

- the process used in relation to appointments, its approach to succession planning and how both support building a diverse pipeline;
- what other actions it has taken to oversee the development of a diverse pipeline for future succession to board and senior management appointments;
- an explanation of how diversity supports the company in meeting its strategic objectives; and
- the gender balance of those in the senior management and their direct reports.

Remuneration

In normal circumstances, long-term incentives should be subject to a vesting and holding period of at least five years (formerly three years). Longer periods, including post-employment periods, may be appropriate

Time limit of board service

The amended Code provides that individual non-executive directors, including the chair, should not be considered independent if he or she has served on the board for more than nine years from the date of their first election

Insolvency and corporate governance

The UK Government published a consultation paper entitled *Insolvency and Corporate Governance* in March 2018. The paper seeks proposals to better hold to account directors who may currently avoid the consequences of their responsibility for an insolvency or who asset strip or sell struggling companies to the detriment of employees and creditors. These measures could include the power to claw back money for creditors or to disqualify directors who recklessly sell a company or subsidiary or knowing it would fail.

[42] Financial Reporting Council, 2018, *The UK Corporate Governance Code*, July, **https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf**, (accessed 20 August 2018).

4.2.2 Singapore

Code of Corporate Governance reform

The Singapore Code of Corporate Governance was last reviewed in 2012. In February 2017, the Monetary Authority of Singapore set up a Corporate Governance Council to review the Code to consider how the 'comply-or-explain' regime under the Code could be made more effective. This includes improving the quality of companies' disclosure of their corporate governance practices and explanations for deviations from the Code.

The Singapore Corporate Governance Council has proposed amendments to the Code of Corporate Governance in a consultation paper published in January 2018. The proposed amendments include the following.

Diversity

The Council recommends adding age as one of the aspects of diversity for companies to consider and for companies to disclose their board diversity policy and progress made in achieving the same.

Relationships with company

A new provision has been recommended for the board to comprise a majority of directors who have no management or business relationships with the company, on a comply-or-explain basis.

Director independence threshold

The Council recommends lowering the shareholding threshold in relation to determining director independence from 10 to 5 per cent. This will bring Singapore in line with similar thresholds in Hong Kong and Australia.

Nine-year rule

Under the current Code, the independence of any director who has served on the board beyond nine years from the date of their first appointment should be subject to a 'particularly rigorous review'.

The Council proposes two options to address current issues of ambiguity related to the concept of 'particularly rigorous review'. The first is to incorporate the nine-year rule in the Singapore Exchange Listing Rules (SGX LR) as a hard limit. The second is to subject the appointment of independent directors who have served beyond nine years to an annual vote to be approved by: (i) the majority of all shareholders; and (ii) the majority of non-controlling shareholders, in the SGX LR. The Council recommends that a transition period of three years be provided regardless of the option that is finally adopted.

Where the chair is not independent

The Council recommends revising the current provision in place, for independent directors to comprise a majority of the board (instead of half of the board) where the chair is not independent, on a comply-or-explain basis.

Stakeholders

The Council noted that the current Code does not provide for a company's engagement with stakeholders other than shareholders. To address this gap, the Council proposed the following amendments to the Code:

- The company should put in place processes to identify its important groups of stakeholders and to manage relationships with such stakeholders.
- The primary areas of focus with regard to the management of stakeholder relationships are to be disclosed by the company during the reporting period.
- The company should have an updated corporate website that enables stakeholders to keep abreast of important updates in a timely manner.

Personal data protection reform

On 1 February 2018, Singapore Personal Data Protection Commission released its response to feedback on its public consultation on approaches to managing personal data in the digital economy.

The purpose of the public consultation was to seek public feedback on proposed changes to Singapore's data protection regime, the Personal Data Protection Act.

The Commission has proposed two significant changes to the requirements when gathering personal information from Singapore individuals. The first change is to the requirement to notify individuals of the purpose for collecting data at the time of collection. Currently, organisations must obtain consent from individuals before collecting, using or disclosing their personal data.

The Commission has proposed allowing business to simply notify the individual of the purpose of collection at the time of collection (without the need to gather specific consent) if:

- it is impractical for the organisation to obtain consent; and
- the collection, use or disclosure of personal data is not expected to have any adverse impact on the individuals.

The second change would be to permit businesses to make use of personal information of an individual without obtaining specific consent if that use is necessary for legal or business purposes, provided the organisation can show that:

- it is not desirable or appropriate to obtain consent from the individual; and
- the benefits to the public (or a section thereof) clearly outweigh any adverse impact or risks to the individual.

Another important proposed change is to require businesses to notify the Commission and the affected individuals if there has been an unauthorised disclosure of the personal information that the business has collected, subject to certain criteria.

Listing framework for dual class shares

Following two rounds of public consultation, the Singapore Exchange introduced to the SGX-ST Mainboard Listing Rules in June 2018 a primary listing framework for issuers with dual class share (DCS) structures.

The new rules include a requirement for an enhanced voting process in some instances, where all shares carry one vote irrespective of class. These instances include:

- the appointment and removal of independent directors and/or auditors;
- variations of rights attached to an class of shares;
- a reverse takeover, winding-up or delisting.

In order to ensure sound governance, it is now a requirement for the majority of DCS companies' board committees, and their respective chairs, to be independent directors.

Safeguards against the risk of shareholders with multiple votes (MV) of a DCS issuer entrenching control of the issuer include: capping each MV share at 10 votes per share, limiting the holders to named individuals or groups specified at IPO, and sunset clauses where MV shares convert to ordinary shares in certain cases, also specified at IPO.

Cybersecurity

Under Singaporean law, a director is expected to seek advice from fellow directors, and make proper enquiries, on aspects of the company's business that they are unfamiliar with. Failure to make proper enquiries with respect to cyber risk could lead to both civil and criminal liability.

The Singapore Cybersecurity Act 2018 was passed into law on 5 February 2018. This law provides a framework for the regulation of Critical Information Infrastructure (CII) and authorises the Cyber Security Agency of Singapore to prevent and respond to threats and incidents.

The Act requires owners of CII to comply with:

- codes of practice and performance standards;
- conduct cybersecurity audits and risk assessments; and
- participate in cybersecurity exercises.

Non-compliance could see offenders hit with a maximum penalty of SGP$100,000, two years in jail or, in the worst case, both outcomes.

4.2.3 Hong Kong

Corporate governance review
According to Grant Thornton's *Hong Kong Corporate Governance Review 2017*[43], 46 per cent of HSCI companies claimed full compliance with the Hong Kong Corporate Governance Code, 87 per cent of HSCI companies integrated the disclosure of risk management and internal control in their corporate governance reports, 92 per cent of companies had an internal audit function and 97 per cent of companies discussed ESG in either their annual report or a separate report.

Proposed reforms to the Corporate Governance Code
In November 2017, the Hong Kong Stock Exchange released the consultation paper *Review of the Corporate Governance Code and Related Listing Rules*.

Some of the consultation in relation to independent non-executive directors include proposals on overboarding and time commitment. Currently, the Code requires the board to state, in the circular to shareholders accompanying the resolution to elect the independent non-executive director, its reasons for electing him or her and why it considers the person to be independent. It is proposed to amend the Code so that, if the proposed independent directorship will be holding his or her seventh (or more) listed company directorship, the circular to shareholders should give reasons for determining that the proposed independent non-executive director would be able to devote sufficient time to the board.

The proposal is not to impose a cap on multiple directorships. Rather it is intended to enhance transparency on the considerations given by the nomination committee or the board in respect of the director's time commitments when the person will be holding his or her seventh (or more) listed company directorship.

Factors cited as affecting independence include:

- Cooling off period for former professional advisers.
  The consultation paper proposes extending the cooling off period for former professional advisors from one year to three years in line with other jurisdictions (for example, United States, Australia, United Kingdom).
- Cooling off period for those with material interests.
  The consultation paper also proposes introducing a one-year cooling off period for a proposed independent non-executive director who has had material interests in the issuer's principal business activities in the past year. The proposal does not alter the concept of material interests which is in the current Rule but it takes into account such interests for one year before the proposed appointment of the director.
- Immediate family members.
  There is a proposal to introduce a new note to encourage inclusion of an independent non-executive director immediate family members in the assessment of the director's independence.
- Significant links with other directors.
  At present, there are no restrictions on cross-directorships or having significant links with other directors through involvements in other companies or bodies. The Hong Kong Stock Exchange proposes to recommend disclosures of an independent non-executive director's cross-directorships or having significant links with other directors in the Corporate Governance Report.

Significant controllers register
New requirements on the keeping of significant controllers registers by companies incorporated in Hong Kong commenced operation on 1 March 2018. These changes, introduced by the Companies Ordinance (Amendment) 2018, require Hong Kong companies to:

- identify the person/persons who has/have significant control over the company;
- prepare and maintain a significant controllers register, which will be accessible by law enforcement officers upon demand;
- designate a representative to provide assistance relating to the register to law enforcement officers;

[43] Grant Thornton, 2017, *Hong Kong Corporate Governance Review 2017*, Grant Thornton Hong Kong Ltd, **https://www.grantthornton.cn/upload/GT_CG_Review_Nov2017_Online.pdf**, (accessed 30 July 2018).

- keep the register at the company’s registered office or a prescribed place in Hong Kong; and
- keep the register updated.

A significant controller is defined as a person or legal entity who meets one or more of the following conditions:

- holds, directly or indirectly, more than 25 per cent of the company’s issued shares or a right to share more than 25 per cent of the capital or profits of the company;
- holds, directly or indirectly, more than 25 per cent of the voting rights of the company;
- holds, directly or indirectly, the right to appoint or remove the majority of the company's board of directors;
- has the right to exercise, or actually exercises, significant influence or control over the company;
- has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or a firm that is not a legal person, but whose trustees or members satisfy any of the above four conditions in relation to the company.

Listing regime broadened
The Stock Exchange of Hong Kong Limited (the Exchange) introduced new rules to broaden Hong Kong’s listing regime, which took effect on 30 April 2018. Companies in emerging and innovative sectors seeking to list under the new regime may now submit formal applications.

As part of the reforms, the Exchange added three new chapters in the Main Board Listing Rules and made consequential changes to the Rules to:

- permit listings of biotech issuers that do not meet any of the Main Board financial eligibility tests;
- permit listings of companies with weighted voting right structures; and
- establish a new concessionary secondary listing route for Greater China and international companies that wish to secondary list in Hong Kong.

The Exchange has proposed investor safeguards. These include detailed criteria for determining the suitability of applicants, a higher market capitalisation requirement, as well as enhanced disclosure requirements. For pre-revenue biotech issuers, measures would be put in place around fundamental changes of principal business and a more streamlined de-listing process to address potential “shell” concerns.

4.2.4 United Arab Emirates

100 per cent foreign ownership by end of year
On 20 May 2018, the UAE Cabinet approved a decision to allow 100 per cent foreign ownership of UAE companies. The Cabinet has instructed the Ministry of Economy to implement the decision by the end of this year.

> “On 20 May 2018, the UAE Cabinet approved a decision to allow 100 per cent foreign ownership of UAE companies.”

Currently 100 per cent foreign ownership of UAE companies is only permitted in free zones. To carry on business onshore in the UAE, a company established under the UAE Commercial Companies Law must be at least 51 per cent owned by a UAE national company or individual.

A new visa system will be introduced whereby investors and professionals in the medical, scientific, research and technical fields, along with their families, as well as all scientists and creative people, will get a 10 year UAE residence visa.

Privacy

There is no general federal data protection law in the United Arab Emirates comparable to those applicable in Europe. However, since 25 May 2018, UAE-based companies that offer goods or services to European Union consumers will need to carefully consider whether they fall within the scope of the General Data Protection Regulation Regulation (GDPR) on the protection of natural persons with regard to the processing of personal data and on the free movement of such data.

Political uncertainty impacting risk strategy

The increasingly polarised and fragmented politics that have surfaced around the world in recent times – for example, Brexit and the Catalan efforts for independence – are also impacting the geographical area around the United Arab Emirates with examples such as the 2017-18 Qatar diplomatic crisis and the tensions between the Gulf Cooperation council and Iran. Companies operating in the region should consider stress testing when reviewing their strategies in 2018.

Environmental, social and governance (ESG) and sustainability issues

The United Arab Emirates Government has made it clear that it intends to maintain its position as a global leader in sustainable development. This can be seen, for example, in the UAE Energy Plan 2050. This Plan aims to cut carbon dioxide emissions by 70 per cent, increase the contribution of clean energy in the total energy mix to 50 per cent, and improve energy efficiency by 40 per cent by 2050.

KPMG's *The road ahead: Growing momentum in corporate responsibility reporting in the UAE*[44] states that:

> *"A key trend observed in our analysis was the increase in reporting by the top 100 companies in the UAE – in 2017, 44 of the top 100 companies were observed to be reporting on their sustainability performance, compared to 36 in 2016, an increase of 22 per cent in the reporting rates.*
>
> *KPMG also observed an increase in the number of non-financial metrics being reported. These areas included:*
>
> - *Social and environmental impacts generated by the organisation's business operations;*
> - *Human rights;*
> - *Adoption of sustainability and/or specific codes of conduct across the supply chain;*
> - *Quantifying financial risks related to environmental, social and governance (ESG) aspects of an organisation's business practices."*

4.2.5 Fiji

Governance in Fiji has been enhanced by the establishment of the Pacific Corporate Governance Institute, which held its first workshop in March 2018. The Institute was set up with the support of the Australian Government and with technical guidance provided by the International Finance Corporation (a member of the World Bank Group).

The Institute is an independent, non-profit organisation promoting principles of good corporate governance to companies in Fiji and the broader Pacific region. It provides corporate governance training, helps raise public awareness on governance-related topics and serves as an advocacy body for ongoing market reforms. Particular emphasis is placed on family owned businesses, which are very common in the Pacific region.

[44] R B Batra and H Ymer, 2017, *The road ahead: Growing momentum in corporate responsibility reporting in the UAE*, KPMG, 11 December, **https://home.kpmg.com/ae/en/home/insights/2017/12/uae-sustainability.html**, (accessed 30 July 2018).

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