SAI Global Corporate Law Bulletin No. 185>

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Bulletin No. 185

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Editor's Note

This is an additional issue of the Corporate Law Bulletin. The 'Recent Corporate Law Decisions' section of the Bulletin will return in the February 2013 issue.

Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 Guidance for non-executive directors on care, skill and diligence

On 24 January 2013, the UK Institute of Chartered Secretaries and Administrators (ICSA) issued a new guidance note for non-executive directors relating to their duty to exercise care, skill and diligence.

The guidance from ICSA includes that non-executive directors should:

- understand that more is expected from a non-executive director with a specific skill or specific experience;
- recognise that part of their role is to uphold high standards of integrity and probity, and to support the chairman and executive directors in instilling the appropriate culture, values and behaviours in the boardroom;
- understand the requirements of the Companies Act in relation to conflicts of interest, and gifts and hospitality, and familiarise themselves with the company's policies on the same;
- insist on receiving high-quality information sufficiently in advance of meetings, which is accurate, clear, comprehensive, up-to-date and timely;
- speak to the company's executives at any time over any concerns they may have, and speak to the company's advisers (for example, the external auditor) if they consider it necessary; and
- appreciate that circumstances may arise such that they may need to consider resigning from a board.

The 'ICSA guidance on liability of non-executive directors: care, skill and diligence' is available on the ICSA website.

1.2 Risk assessment report on the European banking system

On 23 January 2013, the European Banking Authority (EBA) released a risk assessment report on the European Banking System.

The report provides an update on risks and vulnerabilities in the EU banking sector.

Since the publication of the EBA's last risk assessment report in July 2012, 'Report on Risks and Vulnerabilities of the European Banking System', the EU banking sector has seen some improvement in market confidence - from both debt and equity investors. Nevertheless, according to the EBA, these signals may prove temporary and the macroeconomic environment for most European banks remains fragile, especially for banking systems in countries where the sovereign itself is financially-stressed. Thus, serious challenges remain due to increasing credit risk and low profitability levels that could be further depressed by rising loan-loss provisions.

The report, including an executive summary, is available on the EBA website.

1.3 ESMA releases 2013 CRA work plan

On 23 January 2012, the European Securities and Markets Authority (ESMA) released its 2013 Credit Rating Agencies (CRA) Supervision and Policy Work Plan.

The key areas of supervisory focus in 2013 will be:

- thematic review on the rating processes for structured finance products and sovereign credit ratings;
- raising standards of compliance;
- ensuring small and medium sized CRAs meet the required standards; and
- ensuring all firms operating within the scope of the CRA Regulation are registered and subject to supervision.

Policy work will be driven by the CRA III legislation, namely:

- producing the draft Regulatory Technical Standards regarding the development of the European rating platform, the fees charged by CRAs to their clients and the new provisions on transparency requirements for structured finance ratings; and
- implementing the new supervisory tasks on the prevention of conflicts of interest regarding CRAs' significant shareholders and the new provisions for sovereign debt ratings.

The 2013 Work Plan is available on the ESMA website.

1.4 Report on global securities class action filings

On 23 January 2013, Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse released a report indicating that US federal securities fraud class action filing activity decreased sharply in 2012.

According to 'Securities Class Action Filings-2012 Year in Review', only 152 federal securities class actions were filed in 2012 compared with 188 in 2011 - the second-lowest number of annual filings in 16 years.

The decrease in total filings was largely due to declines in federal merger and acquisition (M&A) and Chinese reverse merger (CRM) filings. Together, they accounted for only 23 filings in 2012 compared with 74 in 2011. According to the report, these waves of cases are most likely over, and future filings of these types are likely to remain at very low levels. In addition, 2012 was the first year in which there were no new filings related to the credit crisis.

Overall, filings in the financial sector continued to decrease, with 15 filings in 2012 compared with 25 in 2011 and 43 in 2010. Filing activity continued to be most prevalent against companies in the Consumer Non-Cyclical sector. Of the 49 filings in this sector, 33 were against healthcare, biotechnology, and pharmaceutical companies.

Continuing a pattern observed in 2011, fewer filings targeted very large companies in 2012. An analysis of S&P 500 companies named as defendants in securities class actions shows that only one out of every 29 was the subject of a new filing in 2012, making 2011 and 2012 the least litigious for S&P 500 companies in the past 13 years.

Data in the recently published SEC report on the Dodd-Frank whistleblower program provide potentially valuable insights for possible future securities litigation trends. From 1 October 2011 through to 30 September 2012, the SEC received 3,001 whistleblower tips. The most common tip categories were Corporate Disclosure and Financials, Offering Fraud, and Market Manipulation. Together, these categories accounted for nearly 49% of all tips received.

The report is available on the Cornerstone Research website.

1.5 Report on status of US financial regulatory reforms

On 23 January 2013, the US Government Accountability Office (GAO) released the results of its report examining the status of US financial regulatory reforms arising from the Dodd-Frank Act.

In recognition of the need to improve the regulation of financial markets and institutions to minimize the potential for future financial crises, in 2009 GAO designated reform of the US financial regulatory system as one of the high-risk issues facing the US federal government. In July 2010, the Dodd-Frank Act directed regulators to implement reforms across a range of areas.

Specifically, the report examines:

- the overall status of US financial regulatory reforms arising from the Act;
- the challenges affecting the implementation of the Act; and
- the areas that pose continued risk.

GAO analysed data from private and regulatory sources on the status of required rulemakings, synthesized GAO's body of work on Dodd-Frank Act reforms, and interviewed financial regulators and industry and consumer groups on the status of and challenges to implementing reforms.

GAO found that although regulators have made progress in implementing some key reforms required by the Dodd-Frank Act, others remain incomplete.

Overall, GAO identified 236 provisions of the Act that require regulators to issue rulemakings across nine key areas. As of December 2012, regulators had issued final rules for about 48% of these provisions; however, in some cases the dates by which affected entities had to comply with the rules had yet to be reached. Of the remaining provisions, regulators had proposed rules for about 29%, and rulemakings had not occurred for about 23%.

The report is available on the GAO website.

1.6 Proposed guidance on social media for financial institutions

On 22 January 2012, the US Federal Financial Institutions Examination Council (FFIEC) released proposed guidance on the applicability of consumer protection and compliance laws, regulations, and policies to activities conducted via social media by banks, savings associations, and credit unions, as well as non-bank entities supervised by the Consumer Financial Protection Bureau and state regulators.

The FFIEC is responding to requests for guidance in this area from various industry and consumer interests. The guidance is intended to help financial institutions understand potential consumer compliance, legal, reputation, and operational risks associated with the use of social media, along with expectations for managing those risks. Although the guidance does not impose additional obligations on financial institutions, the FFIEC expects financial institutions to take steps to manage potential risks associated with social media, as they would with any new process or product channel.

The Consumer Compliance Risk Management Guidance is available on the FFIEC website.

1.7 Annual review on global M&A

On 22 January 2013, the International Institute for the Study of Cross-Border Investment and M&A (XBMA) released its 2012 Global M&A Statistical Update.
Highlights of the Annual Review include:

- global M&A volume in 2012 reached US$2.6 trillion, marking the third consecutive year of steady deal volume in the US$2.6 trillion per annum range;

- uncertainty and other familiar constraints held back the M&A markets for the first three quarters of 2012, but deal volume surged in Q4 which, coupled with stabilising markets, cash stockpiles and cheap credit for certain borrowers, bodes well for continued deal activity in 2013;
- larger deals (exceeding US$10 billion in value) rebounded, with 16 deals exceeding US$10 billion in value, and 10 deals exceeding US$15 billion in value;
- notably, spin-offs and divestitures accounted for almost half of global M&A activity in 2012;
- cross-border transaction volume in 2012 exceeded 2011 by a small margin, accounting for 36% of global M&A in 2012 compared to 35% in 2011. The domestic/cross-border split has been consistent over the past three years, still markedly lower than its pre-crisis level in 2007.
- for the second consecutive years, the volume of deals involving a developed economy acquirer and an emerging economy target declined, while the volume of deals involving an emerging economy acquirer and a developed economy target increased, as emerging market companies increasingly look abroad for new markets and resources and seek ways to deploy foreign capital reserves.
- Energy & Power continued to dominate global and cross-border deal volume.

The Annual Review is available on the XBMA website.

1.8 IOSCO releases suitability requirements for distribution of complex financial products

On 21 January 2013, the International Organization of Securities Commissions (IOSCO) released a final report on 'Suitability Requirements with Respect to the Distribution of Complex Financial Products'.

The report sets out nine principles related to the suitability and distribution of complex financial products by intermediaries:

- classification of customers;
- general duties irrespective of customer classification;
- disclosure requirements;
- protection of customers for non-advisory services;

- suitability protections for advisory services (including portfolio management;
- compliance function and internal suitability policies and procedures;
- incentives; and
- enforcement.

The final report is available on the IOSCO website.

1.9 Treasury consultation on the removal of super member protection standards

On 17 January 2013, the Treasury released Exposure Draft: Superannuation Industry (Supervision) Amendment Regulation 2012 and the associated explanatory statement for public comment. The draft Regulation proposes to repeal the member protection standards in the Superannuation Industry (Supervision) Regulations 1994 No. 57 (Cth) (the SIS Regulations).

According to the Treasury, the draft Regulation is needed to facilitate the introduction of the new MySuper default product, which will require that 'all MySuper members be charged fees on the same basis with respect to their MySuper interest'. This requirement cannot be met at the same time as the member protection standards, which require fees for small balances to not exceed the investment earnings on the overall account.

Small inactive accounts will be protected from being eroded by fees and charges by being transferred to the ATO. Interest will paid at a rate equivalent to CPI inflation from 1 July 2013. These balances can be reclaimed from the ATO at any time.

The measure will have effect from 1 July 2013.

1.10 EU approves new credit rating rules

On 16 January 2013, new rules on when and how credit rating agencies may rate state debts and private firms' financial health were approved by the European Parliament. They will allow agencies to issue unsolicited sovereign debt ratings only on set dates, and enable private investors to sue them for negligence. Agencies' shareholdings in rated firms will be capped, to reduce conflicts of interest.

The rules require agencies to explain the key factors underlying their ratings. Ratings must not seek to influence state policies and agencies themselves must not advocate any policy changes.

(a) Set dates for sovereign debt ratings

Unsolicited sovereign ratings could be published at least two but no more than three times a year, on dates published by the rating agency at the end of the previous year. These ratings can be published only after markets in the EU have closed and at least one hour before they reopen.

(b) Agencies to be liable for ratings

Investors who rely on a credit rating can sue the agency that issued it for damages if it breaches the rules set out in this legislation either intentionally or by gross negligence, regardless of whether there is any contractual relationship between the parties. Such breaches would include, for example, issuing a rating compromised by a conflict of interest or outside the published calendar.

(c) Reducing over-reliance on ratings

By 2020, no EU legislation can directly refer to external ratings, and financial institutions must not be obliged to automatically sell assets in the event of a downgrade.

(d) Capping shareholdings

A credit rating agency will have to refrain from issuing ratings, or disclose that its ratings may be affected, if a shareholder or member holding 10% of the voting rights in that agency has invested in the rated entity.

The new rules also bar anyone from simultaneously holding stakes of more than 5% in more than one credit rating agency, unless the agencies concerned belong to the same group.

Further information is available on the EU website.

1.11 Treasury releases discussion paper on regulation of point of sale credit sector

On 16 January 2012, Treasury announced that it is conducting a review of the regulatory oversight of the point of sale credit sector, to determine the appropriate level of regulation which should be applied to this sector. Persons who assist consumers to apply for credit for the purchase of goods at the point of sale are currently exempted from the National Consumer Credit Protection Act 2009 (Cth).

A discussion paper has been released that explores the issues regarding this exemption and outlines a number of options for reform.

The Discussion Paper is available on the Treasury website.

1.12 Report links executive rewards to long term performance

On 14 January 2013, the UK High Pay Centre released a report showing that executive pay packages across the FTSE 100 were overwhelmingly linked to short-term financial measures of corporate performance, such as earnings and share price movement. As a result, executives are encouraged to focus on short-termism, cost cutting and the need for quick returns. However, CEO pay has trebled to £4.8 million in ten years without any accompanying long-term increase in share values.

The report, titled 'Paid to Perform?', states that firms are failing to link important areas of non-financial performance, that improve long-term success, to CEO pay.
The report warns that company priorities, as reflected in executive pay incentives, must reflect a longer term outlook, or businesses will suffer in the face of overseas competitors with more sustainable business models.

The report calls for:

- businesses to link at least half of chief executives' performance-related pay to non-financial yardsticks;
- introduction of mandatory reporting on social and environmental performance;
- new tax and procurement incentives to encourage companies to focus on wider measures of performance;
- requirements for pension fund trustees, investment managers and commercial pension providers to take into account the social/environmental impact of their investments on beneficiaries; and
- employee representatives on company boards, to challenge decisions based on short-term financial considerations that may jeopardise the company in the long-term.

The report discusses how Total Shareholder Return (TSR) is used to calculate at least one element of performance-related pay by 74 out of FTSE 100 companies, with 96 companies using either TSR or Earnings Per Share, or a combination of both to determine performance for their chief executives' Long Term Incentive Plan. Most companies pay little or no regard to the long term benefits of non-financial performance across areas like employee engagement, corporate social responsibility and customer satisfaction.

The report states that a focus on short-term financial measures can encourage executives to increase the share price and profits by cutting costs and investment, or by speculative mergers and acquisitions and share buybacks. However, this can have adverse long-term consequences for companies.

The report is available on the High Pay Centre website.

1.13 Revised NYSE and Nasdaq stock exchange rules for compensation committees and advisers

On 11 January 2013, the US Securities and Exchange Commission (SEC) approved revisions to the equity listing standards of the New York Stock Exchange, the Nasdaq Stock Market and a number of other exchanges relating to compensation committee and compensation adviser independence. These revisions were proposed by the exchanges in September 2012 in response to SEC rules issued under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Under the final NYSE and Nasdaq rules, all US-listed companies must expand the authority of their compensation committees with respect to the oversight of compensation consultants, outside legal counsel and other advisers to the committee by 1 July 2013, and thereafter a compensation committee may select or receive advice from an adviser only after conducting an independence assessment.

Compensation committee members of both NYSE and Nasdaq-listed companies will be subject to enhanced independence standards and the Nasdaq rules will, for the first time, require listed companies to have a standing compensation committee and written compensation committee charter. The Nasdaq compensation committee independence rules are more restrictive than the NYSE rules in that the receipt by a compensation committee member of compensatory fees from the company (other than for board service or fixed amounts under a retirement plan that are not contingent on future service) will be a bar to independence under the Nasdaq rules, but will only be a factor for the board to consider under the NYSE rules.

1.14 Treasury consults on requirements for issuing simple corporate bonds

On 11 January 2013, the Treasury released Exposure Draft - Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013 and the accompanying Explanatory Memorandum for public comment.

The proposed Bill would '[establish] a strong and liquid retail debt market in Australia by facilitating increased offerings of corporate bonds to retail investors' by:

- introducing a streamlined two-part disclosure regime for offers of simple corporate bonds;
- making changes to the civil liability provisions with respect to corporate bonds issued to retail investors; and
- clarifying the application of the defences with respect to misleading and deceptive statements and omissions in disclosure documents relating to corporate bonds issued to retail investors.

1.15 IOSCO consults on financial benchmarks

On 11 January 2013, the International Organization of Securities Commissions (IOSCO) released a Consultation Report on Financial Benchmarks, which seeks comments from the public on policy issues arising from the work of its Board Level Task Force on Financial Market Benchmarks.

The Consultation Report discusses concerns regarding the potential inaccuracy or manipulation of Benchmarks and identifies Benchmark-related policy issues across securities and derivatives and other financial sectors including:

- The appropriate level of regulatory oversight of the process of Benchmarking;
- Standards that should apply to methodologies for Benchmark calculation;
- Credible governance structures to address conflicts of interests in the Benchmark setting process within the reporting financial institutions as well as in the oversight bodies; and
- The appropriate level of transparency and openness in the Benchmarking process.

The Consultation also considers issues that market participants might confront when seeking to make the transition to a new or different Benchmark. There should be sufficient data used to construct a credible benchmark. In cases where there is insufficient data, regulatory authorities should consider the possibility of transitioning away from a Benchmark.

Following the Consultation Report, the Task Force will articulate a framework of globally consistent policy guidance and principles for financial Benchmarks and related activities.

The Consultation Report is available on the IOSCO website.

1.16 BCBS issues principles for effective risk data aggregation and risk reporting

On 9 January 2013, the Basel Committee on Banking Supervision issued its 'Principles for effective risk data aggregation and risk reporting'.

The global financial crisis revealed that many banks, including global systemically important banks (G-SIBs), were unable to aggregate risk exposures and identify concentrations fully, quickly and accurately. This meant that banks' ability to take risk decisions in a timely fashion was seriously impaired with wide-ranging consequences for the banks themselves and for the stability of the financial system as a whole.

The principles are intended to strengthen banks' risk data aggregation capabilities and internal risk reporting practices. They complement other international initiatives underway and will allow banks to comply effectively with them. Implementation of the principles will strengthen risk management at banks - in particular, G-SIBs - thereby enhancing their ability to cope with stress and crisis situations.

G-SIBs are required to implement the principles in full by the beginning of 2016 at the latest, and the Committee will be monitoring their progress towards meeting this deadline. In addition, the Committee suggests that national supervisors apply these principles to institutions identified as domestic systemically important banks three years after their designation as such. Finally, the Basel Committee also believes that the principles can be applied to a wider range of banks, in a way that is proportionate to their size, nature and complexity.

The principles are available on the BIS website.

1.17 Superannuation fund-level performance data

On 9 January 2013, the Australian Prudential Regulation Authority (APRA) released performance data for individual superannuation funds, covering the nine-year period from 2004 to 2012.

The performance data are for APRA-regulated funds - with the exception of small APRA funds, single-member approved deposit funds and pooled superannuation trusts - and are provided in the following two publications:

- 'Superannuation fund-level rates of return', which contains performance data on the 200 largest funds by asset size as annualised five-year and nine-year average returns, as well as for each of the nine years. These 200 largest funds cover 98% of the members and 99.7% of the assets of APRA-regulated (excluding small) funds, as well as eligible rollover funds (ERFs); and

- 'Superannuation fund-level profiles and financial performance', which contains detailed data for all funds each year from 2004 to 2012. The detailed data allow observers to analyse APRA-regulated funds across a range of measures (subject to privacy considerations).

The superannuation fund-level data publications are available on the APRA website.

1.18 Annual superannuation figures to 30 June 2012

On 9 January 2013, the Australian Prudential Regulation Authority (APRA) released its 'Annual Superannuation Bulletin' for the financial year to 30 June 2012. Total superannuation assets increased during the year by $49.6 billion, or 3.7%, to $1.40 trillion.

During this period, industry funds' assets increased by 6.6%. Public sector funds' assets increased by 5.7%. Small funds' assets, which include self-managed super funds (SMSFs), single-member approved deposit funds and small APRA funds, increased by 3.7% and retail funds' assets by 0.9%. Corporate funds' assets decreased by 4.1%.

In the year to 30 June 2012, the industry-wide rate of return (ROR) for large funds (more than four members) was 0.5%. Public sector funds recorded an ROR of 1.7%, corporate funds 1.0%, industry funds 0.9% and retail funds -0.6%.

In the 10 years to 30 June 2012, the industry-wide ROR for large funds was 4.4% per annum. Public sector funds recorded an ROR of 5.5% per annum, industry funds 5.1% per annum, corporate funds 4.8% per annum and retail funds 3.4% per annum.

For the year to 30 June 2012, contributions to all superannuation entities totalled $117.5 billion, with employers contributing $82.1 billion and members contributing $34.2 billion. Contributions to large funds totalled $90.9 billion, of which public sector funds received 34.7% ($31.5 billion), retail funds 31.0% ($28.2 billion), industry funds 30.2% ($27.5 billion) and corporate funds 4.1% ($3.7 billion).

For large funds, total accumulation retirement benefits are estimated to be 82.7% of total assets, or $759.0 billion, at 30 June 2012, with 17.3% or $158.5 billion in defined benefits.

The Bulletin also includes features on competition in the superannuation industry and on pension payments. The first feature, 'Considering statistics to measure industry competition', examines industry consolidation over the 12 years to 30 June 2012, the concentration of the industry and member behaviour. The analysis found that further consolidation in the industry would be unlikely to create market structures harmful to competition.

The second feature, 'Superannuation pension payments', examines trends in pension payments over the eight years to 30 June 2012. The analysis found that there are more pension members in 2012 than ever before. Retirement-age members, on aggregate, withdrew proportionately less of their vested benefits as lump sums and more as pension payments in 2012 than in 2005.

The Bulletin is available on the APRA website.

1.19 Treasury consultation on strengthening regulation of retail debenture issuing finance companies

On 22 December 2012, the Treasury announced that ASIC and APRA will consult in 2013 on proposals to strengthen the regulation of finance companies that issue debentures to retail investors.

The proposals have two broad aims. The first is to improve the financial strength of retail debenture issuing finance companies. The second is to more clearly differentiate debenture issuers from banks, building societies and credit unions that are regulated under APRA's prudential framework.

The proposals involve:

- mandatory minimum capital and liquidity requirements;
- restricting the ability of issuers to offer 'at call' investments and use 'bank-like' terms to describe their products;
- improving on-going disclosure to investors; and
- enhancing the capacity of trustees to monitor the financial performance of issuers and compliance with their legal obligations.

Following consultation on the proposals, the Government and regulators will make a final decision on a new framework, including appropriate transitional arrangements.

Finance companies have been a significant source of loan finance in some regional areas. However, the recent collapse of Banksia Securities highlights the need to place the industry on a more sustainable footing and restore investor confidence.

In particular, investors need to appreciate that investments in finance companies carry higher risks and are not the same as deposits with ADIs that are actively supervised by

APRA.

Further details of the proposals are available on the Treasury website.

1.20 IOSCO releases two reports on credit rating agencies

On 21 December 2012, the International Organization of Securities Commissions (IOSCO) released two reports on credit rating agencies: the final report on 'Credit Rating Agencies: Internal Controls Designed to Ensure the Integrity of the Credit Rating Process and Procedures to Manage Conflicts of Interest' and a consultation report on 'Supervisory Colleges for Credit Rating Agencies'.

Both reports form part of IOSCO's effort to improve the integrity of credit rating agencies (CRAs), as part of the global effort to enhance investor protection and the fairness, efficiency and transparency of securities markets.

(a) Internal controls and conflicts of interest

The final report provides an overview of the internal controls and conflicts of interest procedures adopted by a diverse array of credit CRAs. The findings from the report will help inform IOSCO's current review of the IOSCO Code of Conduct Fundamentals for CRAs (the Code), which is aimed at ensuring the Code remains relevant as the international standard for CRA self-governance. The Code was last revised after the 2008 financial crisis raised concerns about the quality of credit ratings and credit rating methodologies, the timeliness of adjustments to credit ratings, the integrity of the credit rating process, and how conflicts of interest are managed by CRAs.

An objective of the report is to increase public understanding of the internal workings of CRAs, and to enable CRAs to compare their internal controls and procedures with those of their peers. By shedding light on the processes and controls some CRAs utilize to ensure the integrity of the credit rating process and manage conflicts of interest, this report, in conjunction with disclosures that individual CRAs make about their controls and procedures, may help users of ratings draw their own conclusions about an individual CRA's controls and procedures, and thereby help the users make informed decisions with respect to their reliance on credit ratings.

The final report concludes that CRAs tend to adopt different policies and procedures to ensure the quality and integrity of the rating process, and to manage conflicts of interest, because they vary in size. However, despite these differences, all surveyed CRAs have adopted some form of policies and procedures to provide internal controls and safeguard against conflicts of interest.

(b) Establishing and operating supervisory colleges

The consultation report recommends establishing supervisory colleges for internationally active CRAs and provides preliminary guidelines on how to establish and operate them.

The dispersion of internationally active CRA affiliates worldwide poses a challenge to supervisors, as they may only have perspective on the CRA activities in their jurisdiction. The creation of CRA colleges could ultimately enhance the effectiveness of supervisors' risk assessment and oversight of these internationally active CRAs by facilitating information exchange and, if appropriate, cooperation.

A number of international bodies and standard setters, including IOSCO, have identified high-level principles relevant to the establishment of supervisory colleges. The consultation report draws from that work and seeks to tailor existing principles to the CRA business model.

The report makes preliminary recommendations on the subjects of a supervisory college, as well as its membership, chairperson, meetings, functions, and confidentiality safeguards and use of information.

The final report and consultation report are available on the IOSCO website.

1.21 Treasury releases draft insolvency reforms

On 19 December 2012, Treasury released for public comment draft laws reforming the way insolvency professionals are registered, disciplined and regulated.

The draft Insolvency Law Reform Bill 2012 amends the personal and corporate insolvency laws to improve regulatory oversight of the insolvency profession, improve value for money for recipients of insolvency services, and enhance creditor rights across all forms of insolvency administration.

In particular, the draft laws provide greater powers for creditors to remove practitioners and curb excessive fees, and therefore deliver better outcomes for creditors, many of whom are small businesses.

The draft Bill implements the reform package outlined in the Government's proposals paper, 'A modernisation and harmonisation of the regulatory framework applying to insolvency practitioners in Australia', released in December 2011.

The draft Bill seeks to harmonise the regulation of personal insolvency or bankruptcy, which is administered by the Insolvency and Trustee Service Australia within the Attorney-General's portfolio, and corporate insolvency, which is regulated by the Australian Securities and Investments Commission under the Treasury portfolio.

Treasury states that the reforms outlined in the draft Bill would make it easier for the two Commonwealth insolvency regulators to communicate with each other about practitioner concerns, with the aim of ensuring that Australia's insolvency industry promotes a high level of practitioner professionalism and competence.

The draft Bill and explanatory material are available on the Treasury website.

1.22 FRC reports positive uptake of UK Corporate Governance and Stewardship Codes in 2012

On 19 December 2012, the UK Financial Reporting Council (FRC) published its annual report on its monitoring of developments in corporate governance; in particular the impact and implementation of the UK Corporate Governance and Stewardship Codes.

The FRC reports that the Stewardship Code has been a catalyst for greater engagement between companies and their shareholders in 2012. Introduced in 2010, there are now over 250 signatories to the Code, including most major institutional investors.

The FRC also found strong take-up by companies of the recommendations introduced to the UK Corporate Governance Code in 2010. Ninety six percent of FTSE 350 companies now put all directors up for re-election every year, and the majority of those companies will have the effectiveness of their board independently reviewed at least every three years. Overall compliance with the Code among listed companies of all sizes remains high.

The annual report is available on the FRC website.

1.23 BCBS releases consultation paper on the Basel Securitisation Framework

On 18 December 2012, the Basel Committee on Banking Supervision (BCBS) released a consultation paper entitled 'Revisions to the Basel Securitisation Framework'.

The performance of securitisations and the central role they played during the financial crisis were a key motivation for the Basel Committee to perform a broader review of its securitisation framework for regulatory capital requirements. The Committee's objectives are to make capital requirements more prudent and risk-sensitive; to mitigate mechanistic reliance on external credit ratings; and to reduce current cliff effects in capital requirements.

In July 2009, the Committee introduced enhancements to the Basel II framework to address deficiencies identified during the financial crisis. These measures primarily addressed immediate concerns over re-securitisations, forming part of a set of reforms commonly referred to as 'Basel 2.5'. The Committee subsequently agreed to conduct a more fundamental review of the securitisation framework, including its reliance on external ratings.

The major elements of the proposed revised framework include the following:

- two possible hierarchies that would be significantly different from those employed in the existing securitisation framework. These two proposed hierarchies differ in aspects such as the specific approach to be applied for certain types of exposures; the order and scope of application of approaches; and the flexibility that is given either to jurisdictions or to banks to opt for one approach or the other.
- proposed enhancements to the current ratings-based approaches and the supervisory formula approach that are part of the Basel II securitisation framework. The proposal contains a revised ratings-based approach and a modified supervisory formula approach, both of which are intended to create a more risk-sensitive and prudent calibration. To accomplish these objectives, underlying assumptions of the current framework have been revised to reflect lessons learned during the crisis; and
- the introduction of new approaches, such as a simplified supervisory formula approach and different applications of the concentration ratio-based approach that was included in the Basel 2.5 enhancements.

The consultation paper is available on the BIS website.

1.24 Government consults on draft governance standards and financial reporting regulations for charities

On 17 December 2012, the Government released for public consultation a paper on draft governance standards for charities registered with the Australian Charities and Not-for-profits Commission (ACNC) and draft regulations on the new ACNC financial reporting framework.

The draft governance standards are intended to reflect a minimum set of basic governance outcomes for registered charities, whilst providing entities with flexibility to determine how they achieve these outcomes in the context of their organisation's particular circumstances.

The draft governance standards cover six topics, including the purposes and not-for-profit (NFP) nature of charities, accountability to members, compliance with Australian laws, responsible management of financial affairs, and suitability and duties of those who manage charities.

The draft financial reporting regulations set out the content requirements for financial reports lodged with the ACNC, and also propose to significantly expand the range of individuals able to conduct a review of medium sized registered charities which will reduce on-going compliance costs.

The governance consultation paper and proposed financial reporting regulations are available on the Treasury website.

1.25 2012 Annual Report on OECD Guidelines for Multinational Enterprises

On 12 December 2012, the Organisation for Economic Cooperation and Development (OECD) released its '2012 Annual Report on the OECD Guidelines for Multinational Enterprises'. The Annual Report provides an account of the actions taken by the adhering governments over the 12 months to June 2012 to enhance the contribution of the Guidelines to the improved functioning of the global economy.

The Guidelines are recommendations to international business for conduct in such areas as labour, environment, consumer protection and the fight against corruption. The recommendations are made by the adhering governments and, although not binding, governments are committed to promoting their observance.

The Annual Report is available on the OECD website.

2. Recent ASIC Developments

2.1 Consultation on database for small amount loans

On 25 January 2013, ASIC released a consultation paper to assist it report to Government on whether amendments to the Consumer Credit Legislation Amendment (Enhancements) Act 2012 (the Enhancements Act) are necessary.

The paper seeks comment on whether an online database or similar system would be of assistance in determining whether consumers applying for a small amount loan have outstanding small amount debts and whether the contracts offered by the credit licensee are consistent with regulations.

Consultation Paper 198, 'Review of the effectiveness of an online database for small amount lenders', seeks feedback on:

- whether it should be mandatory for credit licensees to register all small amount loans in a database and to make an inquiry from the database before entering into a new small amount loan;
- if a database of small amount loans is in place in Australia, what information should be recorded in it and made available to a small amount lender on enquiry; and
- whether there are other regulatory requirements that the database could be usefully and practically used to test proposed loan contracts against.

Consultation Paper 198 is available on the ASIC website.

2.2 Release of guidance on FOFA fee disclosure statements

On 25 January 2013, ASIC released guidance for Australian financial services (AFS) licensees and their representatives on how to comply with the fee disclosure statement (FDS) requirements under the Future of Financial Advice (FOFA) reforms.

Regulatory Guide 245, 'Fee disclosure statements', outlines the requirements that will apply to AFS licensees and their representatives who receive ongoing fees from retail clients to whom they have given personal advice.

Under the FOFA reforms, advice providers receiving fees for giving personal advice under an ongoing arrangement with a retail client must provide the client with an annual FDS setting out information about:

- the fees paid by the client;
- the services provided to the client; and
- the services that the client was entitled to receive.

This obligation is designed to help clients determine whether the ongoing fees they are paying are proportionate to the services they have received, or they were entitled to receive.

The regulatory guide explains:

- the FDS obligations and when they apply;
- who must give an FDS;

- the circumstances giving rise to the obligation to give an FDS; and
- the information that must be disclosed in the FDS.

The regulatory guide also sets out three limited no-action positions ASIC is taking to assist industry make a smooth transition to meeting the FDS obligations within the FOFA regime.

Regulatory Guide 245 is available on the ASIC website.

2.3 Focus on improved disclosure from defined benefit fund trustees

On 21 January 2013, ASIC announced that it was encouraging trustees of defined benefit superannuation funds to make timely and appropriate disclosures to members in the wake of poor returns caused by the global financial crisis (GFC).

This follows a review of the disclosure practices of defined benefit funds following the GFC, during which time funds across the superannuation sector experienced poor investment returns. ASIC's focus is on ensuring trustees make appropriate disclosure to members and improving disclosure practices in relation to defined benefit funds more generally.

Trustees of defined benefit superannuation funds are required to notify members of significant events and changes in their fund's financial situation, particularly if there is a funding shortfall that an employer will not rectify.

To determine the extent of the impact of the GFC on other defined benefit funds, and examine the disclosure practices of those funds, ASIC contacted defined benefit fund trustees about their funds' financial position and the disclosures they were making to members about their funds' financial situation, particularly where there is a funding shortfall.

ASIC paid particular attention to the funds' Vested Benefits Index (VBI), a measure of the financial position of a fund. The VBI is the ratio which represents a fund's ability to pay vested benefits to members if all members were to voluntarily leave the fund on the same day.

ASIC's review of approximately 470 defined benefit funds and sub-funds found, among other things, that:

- 58% of these funds' current or most recent VBI is at 100% or above;
- 30% reported a VBI between 90-100%;

- 7% reported a VBI between 80-90%; and
- 1% reported a VBI of less than 80%.

The remaining 4% of funds had either closed, had no more defined benefit members, or had not disclosed their VBI on the basis they are government funds.

More than 70% of trustees of funds with a funding shortfall disclosed the shortfall to members in the trustee's annual report. Most remaining trustees did not disclose their fund's funding shortfall on the basis that the employer has agreed to a suitable rectification plan to bring the VBI back to above 100%.

Further information is available on the ASIC website.

2.4 Extension of relief from regulation for all funded representative actions and funded proof of debt arrangements

On 11 January 2013, ASIC announced that it had extended the interim class order relief granted to lawyers and funders involved in legal proceedings structured as funded representative proceedings and funding claims lodged with liquidators to prove in the winding up of an insolvent company.

ASIC has also granted new interim class order relief from the application of the National Consumer Credit Protection Act 2009 (Cth) (the National Credit Act).

Relief from the application of the National Credit Act

Class Order 13/18 'Funded representative proceedings and funded proof of debt arrangements exclusion from the National Credit Code' will apply until 12 July 2013. It will relieve the requirements that would otherwise apply to funded representative proceedings and funded proof of debt arrangements if they amount to 'credit' to which the National Credit Act applies. The relief means funded representative proceedings and proof of debt arrangements can commence or progress without needing to comply with specific requirements, including holding an Australian credit licence and complying with the conduct, disclosure and responsible lending requirements.

Relief from the application of the Corporations Act 2001

Class Order 13/19 extends the relief in Class Order 10/333 'Funded representative proceedings and funded proof of debt arrangements' until 12 July 2013. The relief has been extended to allow time for the commencement of the Corporations Amendment Regulations 2012 (No 6) (Cth) which will commence on 12 July 2013.

From that date:

- a litigation scheme and a proof of debt scheme will be exempt from the definition of a managed investment scheme in section 9 of the Corporations Act 2001 (Cth) (the Corporations Act); and
- funders and lawyers providing financial services for litigation schemes and proof of debt schemes will be exempt from the requirements that would otherwise apply under Chapter 7 of the Corporations Act, including the licensing, conduct and disclosure requirements, but they must have adequate arrangements to manage conflicts of interest.

ASIC released Consultation Paper 185 'Litigation schemes and proof of debt schemes: Managing conflicts of interest' (CP 185) outlining its proposals on how funders and lawyers can satisfy this conflicts management obligation in August 2012.

In the meantime, CO 10/333 has been extended to avoid any interim disruption that could adversely impact plaintiffs, or interfere with the timely and efficient running of litigation.

Class Orders 13/18, 13/19 and 10/333 are available on the ASIC website.

2.5 Consultation on changes to scheme property arrangements

On 20 December 2012, ASIC released a consultation paper on proposed changes to Regulatory Guide 133 'Managed investments: Scheme property arrangements' (existing RG 133), together with a draft updated RG 133.

The paper also seeks comments on a possible change to Class Order [CO 11/1140] 'Financial requirements for responsible entities' (existing [CO 11/1140]), which would amend the definition of 'special custody assets'.

Consultation Paper 197 'Holding scheme property and other assets' (CP 197 including draft updated RG 133) seeks feedback on:

- the types of pre-contract enquiries that a custodian should make in relation to its own clients;
- the proposal that the client agreement executed by the custodian and the responsible entity contains certain content requirements;
- primary production schemes ensuring registered interests in the land are by members or an entity controlled by members, on trust for members;

- how the role of a custodian should be explained in product disclosure statements and retail facing marketing material;
- the requirement that custody assets must be held on trust, by the custodian or the responsible entity;
- encouraging custodians to report a broader range of suspicious transactions; and
- the proposed renewal and modification of Class Order [CO 98/51] 'Relief from duty to separate assets of a managed investment scheme', which permits the use of omnibus accounts on certain conditions.

The proposed requirements would also apply to investor directed portfolio service operators, managed discretionary account operators and sub-custodians as discussed in RG 133.

2.6 Release of review findings on money market funds sector

On 20 December 2012, ASIC released the findings of a review of managed investment schemes that are money market funds (Report 324).

Money market funds typically invest in government bills, very short-term bank certificates and other loans that are highly rated liquid - which means the assets can be turned into cash quickly - and offer daily redemption. The investment objectives are capital preservation and yield generation.

Money market funds have grown substantially over several decades in overseas markets. One implication of their growth is the increased role they play in the short-term funding markets and their wide use by wholesale and retail investors. In September 2008, concerns with some money market funds, in particular in the US, alerted regulators to the systemic relevance of money market funds. This has prompted reviews of their regulation, both in the United States and in Europe and by the International Organization of Securities Commissions (IOSCO).

ASIC conducted a systemic review of money market funds in Australia following these international developments. The review's aim was to increase ASIC's understanding of key characteristics and risks, including the liquidity, asset maturity, NAV structure, redemption terms, credit risk, and investment and investor profiles, and to consider whether or not any regulatory intervention was warranted in Australia.

The role of money market funds in the Australian short-term funding market is significantly smaller compared to overseas markets. Estimates put the short-term funding market to be around $250.6 billion. It is estimated that money market funds represent no more than 9.5% of the short-term funding market and currently account for 0.5% of financial system assets in Australia.

ASIC's analysis to date does not support regulatory intervention for money market funds. ASIC believes that its current regulation and market practice in Australia is aligned with IOSCO recommendations.

However, ASIC will liaise with industry to encourage standardisation in product branding to better distinguish funds that are known as 'enhanced' money market funds from other money market funds. ASIC considers it would be preferable if the term 'money market fund' or similar terms such as 'cash', were used only by funds that have a low weighted average life and dollar weighted average maturity.

IOSCO published its policy recommendations on money market funds in October 2012.

'FR07/12 Policy Recommendations for Money Market Funds, Report of the Board of IOSCO' is available on the IOSCO website.

Report 324 is available on the ASIC website.

2.7 Release of amended regulatory guidance for clearing and settlement facilities

On 18 December 2012, ASIC released its amended regulatory guidance for clearing and settlement facilities (CS facilities). The guidance (RG 211) takes into account updated international standards and recent Council of Financial Regulators' (the Council) policy.

These changes ensure continuing access by Australian-based CS facilities to overseas participants and provide an appropriate degree of regulatory influence over foreign-based facilities that wish to offer services in Australia.

The amended regulatory guidance provides clarity for overseas CS facilities operating in Australia and domestic CS facilities seeking to move or outsource some operations overseas. It clarifies the circumstances under which a systemically important overseas CS facility with a strong domestic connection may need to hold a domestic licence.

The guidance also sets out examples of when ASIC may advise the Minister to impose conditions on cross-border CS facilities; for example, an overseas CS facility wising to offer services in Australia or a domestic CS facility operating overseas, to ensure appropriate influence for Australian regulators. ASIC intends to take a graduated and proportionate approach to advising the Minister to impose conditions. The nature of the conditions may vary depending on the characteristics of a CS facility and how it changes over time. For example, if a CS facility entered the Australian market with a small operation, the requirements for both systemically important facilities and those facilities with a strong domestic connection can apply, should its market share grow substantially or the nature of its operations or participants change.

The regulatory guide provides examples of the types of conditions ASIC may advise the Minister to impose, including requiring an overseas CS facility to establish a domestic operational presence and requiring a domestic CS facility to set controls around how it deals with outsourcing of critical functions.

ASIC will continue to work bilaterally with CS facility licensees and applicants, taking into account the nature of the entity, the service it is providing and any other relevant circumstances.

Regulatory Guide 211 is available on the ASIC website.

3. Recent ASX Developments

3.1 Domestic and international banks to work with ASX on OTC derivatives clearing

On 20 December 2012, ASX announced that seven domestic and international banks in Australia have signed non-binding commitments to help develop ASX's new OTC Interest Rate Derivatives Clearing Service.

The ASX OTC clearing service will provide significant risk and operational benefits to ASX customers. ASX is working closely with regulatory agencies on the regulatory clearance process.

The new OTC clearing service is one of the investments ASX is making to deliver a world-class financial market infrastructure for Australia. Other investments in 2013 will target solutions for client clearing and collateral management.

The first phase of ASX's OTC clearing solution will be delivered by mid-2013.

The media release is available on the ASXGroup website.

3.2 Reports

On 7 January 2013, ASX released:

- the ASX Group Monthly Activity Report; and
- the ASX Compliance Monthly Activity Report

for December 2012.

3.3 Liquidity Alliance launched to address global collateral crunch

On 17 January 2013, ASX announced that a Liquidity Alliance had been launched to address the global collateral crunch. The initial members of the Liquidity Alliance are ASX (Australia), Cetip (Brazil), Clearstream (Germany/Luxembourg), Iberclear (Spain) and Strate (South Africa).

The five members of the Liquidity Alliance will exchange information, identify common needs and extend global collateral solutions while encouraging the development of informed research, which the Liquidity Alliance will promote as a neutral source of pan-industry information, ideas and opinions. The Liquidity Alliance members embrace open architecture and are therefore looking forward to integrating new members in the future.

Members will meet each quarter to discuss partnership plans, key developments, commercial opportunities in collateral management and to share individual market news while also investing resources on studies and industry research. The fact that the members are from different regions of the world brings together a unique pool of global insight and expertise that is expected to be a trusted source of valuable information.

The media release is available on the ASXGroup website.

4. Recent Takeovers Panel Developments

4.1 Panel publishes index of its decisions 2006-2012

On 24 January 2013, the Takeovers Panel announced it had released an index of its decisions from 2006-2012.

The index can be found at the 'Index of Reasons' tab on the Takeovers Panel's website.

Since 13 March 2000, the Panel has considered over 390 applications. The index has been designed to assist practitioners and market participants researching the Panel's reasons.

The index is a work in progress. Work on completing the index for 2000-2005 has commenced. The Panel welcomes any comments on the index. Emails can be sent to takeovers@takeovers.gov.au.

5. Recent Research Papers

5.1 Bank regulation and supervision around the world: A crisis update

This paper presents the latest update of the World Bank Regulation and Supervision Survey, and explores two questions. First, were there significant differences in regulation and supervision between crisis and non-crisis countries? Second, what aspects of regulation and supervision changed significantly during the crisis period? The paper finds significant differences between crisis and non-crisis countries in several aspects of regulation and supervision.

In particular, crisis countries:

- had less stringent definitions of capital and lower actual capital ratios;
- faced fewer restrictions on non-bank activities;
- were less strict in the regulatory treatment of bad loans and loan losses, and
- had weaker incentives for the private sector to monitor banks' risks.

Survey results also suggest that the overall regulatory response to the crisis has been slow, and there is room to improve regulation and supervision, as well as private incentives to monitor risk-taking.

Specifically, comparing regulatory and supervisory practices before and after the global crisis, the paper finds relatively few changes:

- capital ratios increased (primarily among non-crisis countries);
- deposit insurance schemes became more generous; and
- some reforms were introduced in the area of bank governance and bank resolution.

The paper is available on the SSRN website.

5.2 Which does more to determine the quality of corporate governance in emerging economies, firms or countries?

Scholars of corporate governance have debated the relative importance of country characteristics and firm characteristics in understanding variations in the corporate governance practices of firms in emerging economies. Using panel data and a number of model specifications, the authors shed new light on this debate. The authors find that firm characteristics are as important as and often meaningfully more important than country characteristics in explaining governance ratings variance. The authors' findings show that firms in emerging economies over recent years had more capability to rise above home-country peer firms in corporate governance ratings than has been previously suggested.

The paper is available on the SSRN website.

5.3 The public enforcement of directors' duties

The general duties owed by directors to their companies are a critical element of company law overall, and corporate governance in particular. If these duties are breached the board, acting on behalf of the company, is empowered to decide whether to take action against the miscreant directors. If no action is taken by the board UK law essentially leaves it to private parties to take any action against the miscreants.

The parties who can take action are the shareholders of the miscreant director's company, and they must do so pursuant to a derivative action. This might be seen as the primary private enforcement mechanism used in the UK when directors commit breaches. This is in line with the UK's general approach to fostering a private rather than a public approach to corporate governance.

It appears that there have been relatively few derivative actions commenced by shareholders, probably because of the many disincentives that confront shareholders. Given this state of affairs the aim of this paper is to investigate whether there is a need for the public enforcement of duties so that there is an enhancement of corporate governance in the UK. This then leads the author to ask whether it is feasible and/or desirable to grant powers to a public authority to take enforcement action in appropriate cases.

The paper is available on the SSRN website.

5.4 The rise of a giant: securitization and the global financial crisis

The rapid growth of the securitization market was a primary factor in the 2008 global financial crisis. This paper explores the emergence and explosive growth of asset securitization in the period leading up to the recent crisis. Understanding this basic and pressing issue is vital for future policy recommendations on the legal framework of securitization.

The paper thus offers both a pragmatic look at the rise of securitization as well as a theoretical analysis of its effects on third parties. It provides unique insight into the driving forces behind this financial tool, showing how the legal structure of securitization facilitates the shifting of the default risk to nonadjusting creditors.

Finally, the paper demonstrates how the potential gain from externalizing default risk creates distorted incentives for asset securitization, leading in turn to its excessive use, even when economically inefficient.

The paper is available on the SSRN website.