2 February 2016 > Regulatory Newsfeed

SAI Global Corporate Law Bulletin No. 221>

Index info.regulatory@saiglobal.com

Bulletin No. 221

Editor: Professor Ian Ramsay, Director, Centre for Corporate Law and Securities Regulation

Published by SAI Global on behalf of Centre for Corporate Law and Securities Regulation, Faculty of Law, The University of Melbourne with the support of the Australian Securities and Investments Commission, the Australian Securities Exchange and the leading law firms: Ashurst, Clayton Utz, Corrs Chambers Westgarth, DLA Piper, Herbert Smith Freehills, King & Wood Mallesons, Minter Ellison.

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 February 2016.

Legislation Hotline

> WHAT'S NEW
> MODIFY MY NEWSFEEDS
> SEARCH NEWSFEED ARCHIVE
> RELEVANT STANDARDS
> SEARCH LEGISLATION
> ABOUT LEGISLATIVE ALERT
> MORE SERVICES
> ABOUT SAI GLOBAL

Detailed Contents

1. Recent Corporate Law and Corporate Governance Developments

1.1 International central bank committees release reports on fixed income markets

On 21 January 2016, the Committee on the Global Financial System (CGFS) of the Bank for International Settlements (BIS) and the Markets Committee of the BIS released two reports on the structure and liquidity of fixed income markets.

The CGFS report Fixed income market liquidity finds signs of greater fragility, with liquidity conditions being more susceptible to disruptions, such as sudden stops of liquidity in key segments of the market and a deterioration of market depth metrics.

The report identifies the key drivers of the change as:

- the rise of algorithmic trading in fixed income markets, which may accelerate the rate at which seemingly ample liquidity can evaporate after the first signs of stress;
- banks' trimming of trading-related exposures in response to lower risk appetite in the wake of the financial crisis and to more demanding regulatory requirements; and
- unconventional monetary policies, which can give rise to crowded trades and one-sided risk expectations on the part of market participants.

The Markets Committee report Electronic trading in fixed income markets focuses on the first driver and finds that the rise of electronic trading in fixed income markets tends to facilitate the matching of buyers and sellers. This improves market quality in normal times, but may also mean less robust liquidity conditions in times of stress.

A survey of more than 30 electronic trading platform providers across the world shows a 40% increase in average daily trading volume between 2010 and 2014. Findings in the report also suggest that automated trading has picked up, although it remains less prominent than in other asset classes.

1.2 IMF paper on virtual currencies

On 20 January 2016, the International Monetary Fund (IMF) published a staff paper, Virtual Currencies and Beyond: Initial Considerations.

The report provides an overview of virtual currencies (VCs), how they work and how they fit into monetary systems, both domestically and internationally. It discusses the potential implications of the technological advances underlying VCs, such as the distributed ledger system, before examining the regulatory and policy challenges posed by VCs, in the areas of consumer protection, financial integrity (money laundering and terrorism financing), taxation, financial stability, exchange and capital controls and monetary policy. The paper also sets out principles for the design of regulatory frameworks for VCs at both the domestic and international levels.

A key conclusion of the paper is that the distributed ledger concept has the potential to change finance by reducing costs and allowing for deeper financial inclusion in the longer run. This could be especially important for remittances, where transaction costs can be high, around 8%. Distributed ledgers can also shorten the time required to settle securities transactions, which currently take up to three days, as well as lower counterparty and settlement risks.

1.3 Public consultation on social and environmental reporting guidelines

On 15 January 2016, the European Commission launched a public consultation to feed into its upcoming non-binding guidelines that will set out how large public-interest entities, such as listed companies and banks, could disclose social and environmental information.

European Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups entered into force on 6 December 2014. The disclosure requirements apply to large public-interest entities with more than 500 employees.

Article 1 of the Directive establishes that companies concerned shall include in the management report a non-financial statement containing information relating to, as a minimum:

- environmental matters;
- social and employee matters;
- respect for human rights; and
- anti-corruption and bribery matters.

Article 1 of the Directive also establishes that the non-financial statement shall include:

- a brief description of the undertaking's business model;
- a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;
- the outcome of those policies;
- the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks; and
- non-financial key performance indicators relevant to the particular business.

The guidelines are aimed at assisting companies in the reporting process, providing them with a methodology that will facilitate the disclosure of relevant, useful and comparable non-financial information.

View Consultation Document: Non-binding guidelines on methodology for reporting non-financial information

---

1.4 Quality of corporate governance in the UK

On 14 January 2016, the Financial Reporting Council (FRC) released Developments in Corporate Governance and Stewardship 2015 report, which found that overall quality of corporate governance in the UK remains high.

The report also found a slight dip in strict compliance with the UK Corporate Governance Code (the CG Code), largely accounted for by new entrants to the market explaining evolving governance and companies deciding to await the implementation in law of the EU *Audit Regulation and Directive* requirements on audit retendering and rotation. This was, nevertheless, found to have been accompanied by an improvement in the quality of explanations, demonstrating a more thoughtful approach to governance.

According to the FRC, while there have been signs of improved engagement and more purposeful dialogue between large companies and investment managers, reporting against the UK Stewardship Code's (the Stewardship Code) principles is of inconsistent quality. The FRC proposal to tier signatories, announced in December 2015, will promote better engagement and ensure that asset owners and managers follow-through on their commitment to the Stewardship Code's principles.

Other key messages from the report include that:

Governance

- Overall levels of compliance with the CG Code remain high with 90% of the *FTSE 350* complying with all but 1 or 2 provisions.
- Board succession planning remains key.
- While there has been very good progress on reporting of boardroom gender diversity policies, a disappointing number of companies make no reference to the broader concept of diversity including race and experience.
- In the *FTSE 100* there has been an increase from 37% in 2014 to 51% in 2015 of companies having longer share retention periods with regards to remuneration.

Reporting and audit

- The CG Code requirement for boards to confirm that the annual report and accounts is fair, balanced and understandable has had a significant impact on the perceived standard of reporting.
- There have been improvements in audit committee reports, with 72% of *FTSE 350* companies now giving more detailed descriptions of the work they do versus 65% in 2014.
- Audit retendering has improved with 46 *FTSE 350* companies putting their external audit engagement out to tender this reporting season as opposed to 27 previously. *FTSE 350* companies disclosures on external auditor appointments have increased from 2% in 2008 to over 50% this year.
- Early take-up of the 2014 CG Code changes has been low with companies taking time to think through reporting on risk management, internal

controls and the longer term viability reporting.
Stewardship and engagement

- Feedback on engagement between companies and investors was positive in 2015 with many feeling that the quality of dialogue has improved and that companies are more responsive.
- 2015 saw an increase in shareholder voting activities at companies meetings with 73% voter turnout in the UK.
- In 2014 there was increasing concern expressed about the role of proxy advisors. In 2015, the FRC convened discussions between proxy advisors, company and investor representatives. All agreed that proxy advisors provide an important service, however, there are still ongoing tensions around perceived box-ticking.

View FRC media statement.

1.5 Exploring the intermediated shareholding model

On 14 January 2015, the UK Treasury published BIS Research Paper 261 - Exploring the intermediated shareholding model, which relates to intermediated shareholding

The research sought to determine:

- the reasons why individual investors held shares in a particular way;
- whether individual investors were aware of alternative methods of holding;
- how investor voting procedures worked in practice;
- whether investors understood the extent to which they could exercise the rights associated with their shares;
- the fees associated with each element of the model and the investor's perception of the value added; and
- the extent to which investors understood what they received for the fees they paid.

This research provides an independent review of the chains of ownership and voting which have developed between the companies and the individual and institutional investors which hold shares in them.

The research focussed on gathering evidence of:

- the workings of the investment and voting chains (particularly on the institutional investment side); and
- the perceived value of elements of the holding chain.

1.6 Report on audit quality indicators

On 12 January 2016, the US Center for Audit Quality (CAQ) issued a report that provides insights from a global series of roundtable discussions with audit committee members and other stakeholders on a potential set of audit quality indicators (AQIs).

Key findings from the roundtables include the following:

- Participants expressed desire for information that can assist audit committees in their assessment of the more qualitative aspects of the audit, such as the engagement team having the right mindset to bring forth professional skepticism and auditor judgment.
- Audit committee members recognized that AQIs can help them oversee the quality of their external audit, even if external audit is just one aspect of quality financial reporting.
- Most participants endorsed a flexible approach that allows an audit committee, working with the external auditor, to tailor or customise the selection and portfolio of AQIs that best suit its specific information needs.
- While supporting the concept of AQIs, some roundtable participants said they already have the tools necessary for them to gauge the quality of their audit.
- Audit committee members agreed that AQIs alone, without context, cannot adequately communicate factors relevant to any particular audit engagement or audit firm.
- There was agreement that the process of identifying and evaluating AQIs needs to be audit committee-driven and iterative, and will require continuous assessment and refinement in order to meet the changing information needs of audit committees.
- Audit committee members expressed strong concerns that public disclosure of engagement-level AQIs could lead to unintended consequences. A strong consensus emerged that any disclosures of engagement-level AQI information should be voluntary.

View Audit Quality Indicators: The Journey and Path Ahead.

1.7 SEC announces 2016 examination priorities

On 11 January 2016, the US Securities and Exchange Commission (SEC) announced its Office of Compliance Inspections and Examinations' (OCIE) 2016 priorities. New areas of focus include liquidity controls, public pension advisers, product promotion, and two popular investment products - exchange-traded funds and variable annuities. The priorities also reflect a continuing focus on protecting investors in ongoing risk areas such as cybersecurity, microcap fraud, fee selection, and reverse churning.

The 2016 examination priorities address issues across a variety of financial institutions, including investment advisers, investment companies, broker-dealers, transfer agents, clearing agencies, and national securities exchanges.

Areas of examination include:

- Retail Investors:
  - Protecting retail investors, including those investing for retirement, remains a priority in 2016.
  - OCIE will continue several 2015 initiatives to assess risks to retail investors seeking information, advice, products, and services to help them plan for and live in retirement.
  - OCIE will also undertake examinations to review exchange-traded funds (ETFs) and ETF trading practices, variable annuity recommendations and disclosure, and potential conflicts and risks involving advisers to public pension funds.
- Market-Wide Risks:
  - To help fulfill the SEC's mission of maintaining fair, orderly, and efficient markets, OCIE will continue its focus on cybersecurity controls at broker-dealers and investment advisers.
  - New initiatives for 2016 include an evaluation of broker-dealers' and investment advisers' liquidity risk management practices, and firms' compliance with the SEC's *Regulation Systems Compliance and Intergrity*, designed to strengthen the technology infrastructure of the US securities markets.
- Data Analytics:
  - OCIE's enhanced ability to analyse large amounts of data will assist examiners' ongoing initiatives to assess anti-money laundering compliance, detect microcap fraud, and review for excessive trading.
  - Data analytics also will help examinations focused on promotion of new, complex, and high-risk products.

View SEC Examination Priorities 2016.

1.8 APRA consults on the publication of ADI liquidity statistics

On 6 January 2016, the Australian Prudential Regulation Authority (APRA) released a consultation package on the proposed publication of liquidity statistics for authorised deposit-taking institutions (ADIs).

APRA proposes to expand the current statistics published in the Quarterly Authorised Deposit-taking Institutions (ADI) Performance publication to include relevant information on the liquidity of ADIs. APRA proposes to introduce liquidity statistics for banks, and expand the existing liquidity statistics published for credit unions and building societies.

View [Discussion Paper - Publication of ADI liquidity statistics]

Further information is available on the [APRA website].

1.9 US: Report on strategies to address representation of women on corporate boards in the US

On 4 January 2016, the US Government Accountability Office (GAO) published [Report - Corporate Boards: Strategies to Address Representation of Women Include Federal Disclosure Requirements].

According to GAO, women make up almost half of the nation's workforce, yet research shows that they continue to hold a lower percentage of corporate board seats compared to men. Research highlights advantages to gender diverse boards, and some countries have taken steps to increase board gender diversity.

The report examines:

- the representation of women on boards of US publicly-traded companies and factors that may affect it; and
- selected stakeholders' views on strategies for increasing representation of women on corporate boards.

GAO analysed a dataset of board directors at companies in the S&P 1500 from 1997 through 2014 and conducted interviews with a non-generalizable sample of 19 stakeholders including chief executive officers (CEOs), board directors, and investors. GAO selected stakeholders to reflect a range of experiences, among various factors. GAO also reviewed existing literature and relevant federal laws and regulations.

Key findings include that:

- Representation of women on the boards of US publicly-traded companies has been increasing, but greater gender balance could take many years.
    - In 2014, women comprised about 16 percent of board seats in the S&P 1500, up from 8 percent in 1997.
    - This increase was partly driven by a rise in women's representation among new board directors.
    - However, even if equal proportions of women and men joined boards each year beginning in 2015, GAO estimated that it could take more than four decades for women's representation on boards to be on par with that of men's.
- Based on an analysis of interviews with stakeholders, board director data, and relevant literature, GAO identified various factors that may hinder women's increased representation among board directors. These include boards not prioritising recruiting diverse candidates; few women in the

traditional pipeline to board service-with CEO or board experience; and low turnover of board seats.
- Stakeholders GAO interviewed generally preferred voluntary strategies for increasing gender diversity on corporate boards, yet several large investors and most stakeholders interviewed (15 of 19) supported improving SEC disclosure requirements on board diversity.

View GAO media statement.

1.10 Global and regional trends in corporate governance for 2016

In December 2015, Russell Reynolds Associates published the report Global and regional trends in corporate governance for 2016.

Russell Reynolds Associates interviewed numerous governance executives and experts at some of the world's largest asset managers, pension funds, shareholder organisations, proxy advisory firms, and activist investors to learn what trends they see emerging for 2016. According to Russell Reynolds Associates, the drivers of global and regional trends are myriad: scandals, the globalisation of companies' investor bases, and stewardship issues are all factors. The institutional investors interviewed want to "trust, but verify" the work of boards on behalf of the owners.

The report predicts key trends in 2016 will be:

- More focus on what makes a highly effective board, with attention particularly being paid to independence, composition, diversity, and board leaders' roles;
- More scrutiny of individual directors by investors, or their advisors, and increasing demand in many markets for internal and/or external board and director assessments to drive board performance;
- More regulations, more revisions to corporate governance codes, and more rules on disclosure to drive increased transparency; and
- More shareholder engagement, particularly around ESG concerns, and more activist investor interventions when shareholder engagement is absent or trust breaks down.

The report also explores in more detail the corporate governance trends in five key markets: the United States, Brazil, the European Union, Japan, and India.

View Russell Reynolds Associates media statement.

1.11 IOSCO reports on business continuity plans for trading venues and intermediaries

On 22 December 2015, the Board of the International Organization of Securities Commissions (IOSCO) published two reports that seek to enhance the ability of financial markets and intermediaries to manage risks, withstand catastrophic events, and swiftly resume their services in the event of disruption.

The report Mechanisms for Trading Venues to Effectively Manage Electronic Trading Risks and Plans for Business Continuity:

- provides a comprehensive overview of the steps trading venues take to manage the risks associated with electronic trading and the ways they plan for and manage disruptions through business continuity plans;
- makes recommendations to help regulators ensure that trading venues are able to manage effectively identified risks, such as those related to technology; and
- proposes sound practices that should be considered by trading venues when developing and implementing risk mitigation mechanisms and business continuity plans aimed at safeguarding the integrity, resiliency and reliability of their critical systems.

The second IOSCO report, 'Market Intermediary Business Continuity and Recovery Planning', sets out two standards for regulators and sound practices that regulators could consider as part of their oversight of market intermediaries. These practices may also prove useful to intermediaries who are developing and implementing business continuity plans.

View IOSCO media statement.

1.12 Draft regulations on crowd-sourced funding for small business

On 22 December 2015, Australian Assistant Treasurer Kelly O'Dwyer, released a draft regulation that provides additional detail to Australia's new crowd-sourced equity funding (CSEF) framework.

Exposure Draft - Corporations Amendment (Crowd-Sourced Funding) Regulation 2015 provides additional detail on a range of matters, including:

- the class of securities that may be offered;
- the minimum requirements for what a CSEF issuer must include in their offer document;
- the prescribed checks intermediaries must undertake before allowing an offer to be made on their platform; and
- wording of the mandatory risk warning and retail investor risk acknowledgment that investors must agree to before they may invest in CSEF products.

View Corporations Amendment (Crowd-Sourced Funding) Bill 2015 (Cth).

View [Treasury media statement](#).

1.13 IOSCO publishes sound practices on assessment of creditworthiness and the use of external credit ratings

On 22 December 2015, IOSCO published [Final Report - Sound Practices at Large Intermediaries Relating to the Assessment of Creditworthiness and the Use of External Credit Ratings](#).

The report recommends 12 sound practices that regulators could consider as part of their oversight of market intermediaries. Large market intermediaries also may find the sound practices useful in the development and implementation of effective alternative methods for the assessment of creditworthiness. IOSCO believes that identifying sound practices regarding suitable alternatives to credit ratings should reduce the overreliance on credit rating agencies (CRAs) for credit risk assessment. Such a development would help increase investor protection, while contributing to market integrity and financial stability.

CRA ratings can offer investors and lenders an efficient way to label the risks associated with a particular borrowing or lending facility. But the recent global financial crisis illustrated how reliance on CRA ratings can potentially contribute and exacerbate the fallout on the markets.

In response, numerous international and national bodies have taken measures to address the possible over-reliance of market participants such as broker-dealers on credit ratings.

These efforts have mainly focused on two areas:

- requirements for financial firms to undertake their own due diligence and internal risk management instead of relying mechanistically on external CRA ratings; and
- reconsideration of references to ratings in the regulatory framework, in light of their implicit potential to be regarded as public endorsement of CRA ratings, and their potential to negatively influence market behaviour.

1.14 IOSCO publishes a statement and survey report on crowdfunding

On 21 December 2015, IOSCO published [Statement on Addressing Regulation of Crowdfunding](#) and the [Crowdfunding 2015 Survey Responses Report](#) (the CSR Report).

IOSCO believes it is important for regulators and policy makers to balance the need for supporting economic growth and recovery with that of protecting investors when developing crowdfunding as a means to invest in small firms and start-ups.

Drawing on the findings from the CSR Report, IOSCO proposes to raise awareness regarding some of the major risks investors face when investing in crowdfunding. It also encourages regulators and policy makers to note the measures currently taken by regulators to address the risks inherent in crowdfunding.

Because crowdfunding is in its infancy, IOSCO has not yet proposed a common international approach to the oversight or supervision of crowdfunding. But the Statement encourages regulators to take into account possible cross border implications.

The CSR Report presents a summary of responses to a fact-finding survey of 23 IOSCO members. The Study had two goals - first, to enhance IOSCO's understanding of developments in members' current or proposed regulatory regimes for investment-based crowdfunding and second, to highlight emerging trends and issues in this area.

The jurisdictions surveyed reported a variety of approaches to regulate crowdfunding. Some jurisdictions apply their general securities regulatory framework, which may be sufficiently broad and flexible to address crowdfunding. Other jurisdictions have either introduced (or have proposed to introduce) specific regulatory crowdfunding regimes.

The CSR Report highlights that most regulatory regimes for crowdfunding are in their early days and also provides an overview of factors that regulators may find useful to the development of regulatory measures for addressing the inherent risks unique to crowdfunding activities. The goal is to achieve a balance between promoting crowdfunding and ensuring investor protection and market integrity.

Some of the regulatory measures described in the CSR Report include:

- customising entry, registration, or licensing requirements;
- setting disclosure requirements for issuers and funding portals;
- limiting the services that may be provided by crowdfunding platforms;
- requiring the appointment of a third party custodian to hold investor assets;
- imposing measures to favour the channeling of resources into local businesses; and
- addressing cross-border issues.

The CSR Report also seeks to raise investors' understanding of crowdfunding, e.g. that crowdfunding may differ from investing in more traditional securities products.

1.15 Consultation on proposed guidance for the regulation and supervision of institutions relevant to financial inclusion

On 21 December 2015, the Bank for International Settlements Basel Committee on Banking Supervision (the Basel Committee) issued for public consultation its proposed Guidance on the application of the Core principles for effective banking supervision to the regulation and supervision of institutions relevant to financial inclusion (the proposed Guidance).

The proposed Guidance builds on past work by the Basel Committee to elaborate additional guidance in the application of the Committee's *Core principles for effective banking supervision* (the Core Principles) to the supervision of financial institutions engaged in serving the financially unserved and underserved. This includes a report on the Range of practice in the regulation and supervision of institutions relevant to financial inclusion, and expands on Microfinance activities and the Core Principles for Effective Banking Supervision.

The proposed Guidance identifies 19 of the total 29 Core Principles where additional guidance is needed, and both essential criteria and additional criteria which have specific relevance to the financial inclusion context.

1.16 EBA publishes final guidelines on sound remuneration policies and its opinion on the application of proportionality

On 21 December 2015. the European Banking Authority (EBA) published Final Report - Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013 (the Guidelines), together with its Opinion on the application of the principle proportionality to the remuneration provisions in Directive 2013/36/EU, recommending exemptions from the remuneration principles in the Capital Requirements Directive (CRD IV).

The Guidelines ensure that institutions calculate correctly and consistently the so called "bonus cap" by setting out specific criteria for mapping all remuneration components into either fixed or variable pay and detailing how specific remuneration elements such as allowances, sign-on bonuses, retention bonuses and severance pay are to be recognised over time.

In particular, the Guidelines set out the governance process for implementing sound remuneration policies across the EU and clarify the process for identifying those categories of staff to whom the specific remuneration provisions of the CRD IV apply, including the so called bonus cap. Guidance is also provided on the application of deferral arrangements and the pay-out instruments ensuring that variable remuneration is aligned with the institution's risk profile in the long-term and that ex-post risk adjustments can be applied as appropriate.

Considering the huge diversity of national rules regarding the application of proportionality, including the waiving of requirements, which has led to an uneven playing field between institutions across the EU, the EBA, in its Opinion, considers that legislative action should be taken in order to clarify and ensure that the CRD IV remuneration requirements are applied consistently across the EU.

The EBA Guidelines will apply, as of 1 January 2017, to competent authorities across the EU, as well as to institutions on a solo and consolidated basis, including all subsidiaries which are not subject to the CRD IV framework.

1.17 ESMA publishes report on proxy advisors' best practice principles

On 18 December 2015, the European Securities and Markets Authority (ESMA) published Report - Follow-up on the development of the Best Practice Principles for Providers of Shareholder Voting Research and Analysis which examines the proxy advisory industry's progress in establishing and following a self-regulatory code of conduct.

Overall, ESMA finds that the industry is moving in the right direction but sees room for improvement in some areas. This assessment is necessarily preliminary given that ESMA reviewed the 2015 proxy season only, the first following the adoption of the *Best Practice Principles for Providers of Shareholder Voting Research and Analysis* (the Principles) by signatories.

ESMA's key findings are that:

- the Principles generally meet ESMA's expectations;
- as a result, there is more transparency, so issuers and investors can better understand how proxy advisors operate; and
- the industry group behind the Principles would benefit from better governance and further clarity over what monitoring it performs.

The Principles were published by a group of proxy advisors in March 2014 in response to ESMA's 2013 recommendation to develop a code of conduct to improve investors' and issuers' understanding of what they can expect from proxy advisors. ESMA's recommendation was based on its finding that while there was no clear evidence of market failure in relation to proxy advisors' interaction with investors and issuers, stakeholders raised a number of concerns regarding the independence of proxy advisors and the accuracy and reliability of their advice.

1.18 Identification and measurement of step-in risk released by the Basel Committee

On 17 December 2015, the Basel Committee released Consultative Document - Identification and measurement of step-in risk. The objective is to mitigate potential spillover effects from the shadow banking system to banks. This work falls within the G20 initiative to strengthen the oversight and regulation of the shadow banking system and mitigate the associated potential systemic risks.

Step-in risk refers to the risk that a bank will provide financial support to an entity beyond, or in the absence of, its contractual obligations should the entity experience financial stress. The proposals would form the basis of an approach for identifying, assessing and addressing step-in risk potentially embedded in banks' relationships with shadow banking entities (although without limiting the proposals to specific entities).

To capture and address such risk, the focus is on the identification of unconsolidated entities to which a bank may nevertheless provide financial support, in order to protect itself from any adverse reputational risk stemming from its connection to the entities. The proposals also include potential approaches that could be used to reflect step-in risk in prudential measures.

1.19 Implementation monitoring of the PFMI: Level 2 assessment report for Australia

On 17 December 2015, the Committee on Payments and Market Infrastructures (CPMI) and IOSCO published Implementation monitoring of PFMI: Level 2 assessment report for Australia (the PFMI Report).

The PFMI Report presents the findings of the CPMI-IOSCO Level 2 assessment of whether, and to what degree, the legal, regulatory and oversight frameworks for systemically important payment systems (PSs), central securities depositories (CSDs), securities settlement systems (SSSs), central counterparties (CCPs) and trade repositories (TRs) in Australia, are complete and consistent with the Principles for financial market infrastructures (the PFMI).

The authorities responsible for regulation, supervision and oversight of financial market infrastructures (FMI) in Australia are the Reserve Bank of Australia (RBA) and the Australian Securities and Investments Commission (ASIC). The RBA has sole responsibility for PSs, while ASIC has sole responsibility for TRs. ASIC and the RBA have co-regulatory responsibilities for CCPs and CSDs/SSSs based on the legal framework of the Corporations Act 2001 No. 50 (Cth) (the Corporations Act). The RBA is responsible for ensuring compliance with the *Financial Stability Standards* and reduction of systemic risk, while ASIC is responsible for ensuring compliance with the remaining obligations under the Corporations Act.

Overall, the assessment found that Australia has consistently adopted most of the PFMI in all types of FMI. The RBA and ASIC took differing approaches to the adoption of the PFMI, which reflect their different approaches to policy and rule-making. For PSs, the RBA's adoption of the PFMI through a policy statement was assessed to be consistent and complete. For CCPs and CSDs/SSSs, the RBA and ASIC have largely adopted the PFMI consistently, with three areas that were found to be broadly consistent. For TRs, while ASIC's rules do not always mirror the language and structure of the PFMI, the relevant requirements were found generally to have been implemented in a consistent or broadly consistent way - with five areas of broad consistency.

1.20 IOSCO publishes report on liquidity management tools in CIS

On 17 December 2015, IOSCO published Final Report - Liquidity Management Tools in Collective Investment Schemes: Results from an IOSCO Committee 5 survey to members, which maps existing liquidity management frameworks in 26 member jurisdictions with a particular focus on tools to help deal with exceptional situations (e.g. significant redemption pressure). The report is based on a survey sent to members of IOSCO's Committee 5 on Collective Investment Schemes.

According to IOSCO, greater attention has been focused recently on the tools available to manage liquidity risk in the asset management space, including on the availability of tools, their use, effectiveness and system-wide implications. The report sets out, for a large number of jurisdictions, the various frameworks and policy tools currently at the disposal of asset managers and the scope of funds to which they apply. As such, the document provides a useful, jurisdictional level, reference point on the liquidity management tools available globally.

The report highlights the following observations:

- many liquidity management tools are available to jurisdictions, some of which are specifically tailored to the features and nature of the funds considered (e.g. money market funds, real estate funds, hedge funds). In particular, most jurisdictions clearly distinguish open-ended schemes from closed-ended ones;
- the most common tools are redemptions fees, redemptions gates, redemptions in kind, side pockets and suspension of redemptions. Suspension of redemptions is available in all responding jurisdictions, with the power to activate, in exceptional circumstances, in both the hands of the fund/asset manager and regulator;
- funds are generally required to have appropriate risk management and internal quality controls to ensure that all material risks are properly identified, assessed, monitored and controlled;
- open-ended funds are generally subject to additional regulatory requirements dealing with fund leverage, asset concentration, investor concentration, restrictions on illiquid asset investment and short-term borrowings; and
- historically, many of the liquidity management tools outlined in the report have been activated within individual jurisdictions, with the recent financial crisis being a particularly rich source of recent case studies.

1.21 Harmonisation of the Unique Product Identifier (UPI): Consultative report issued by CPMI-IOSCO

On 17 December 2015, the CPMI and the IOSCO have published for public comment Consultative report - Harmonisation of the Unique Product Identifier.

The consultative report makes proposals for the harmonised global unique product identifier (UPI), whose purpose is to uniquely identify over-the-counter (OTC) derivatives products that authorities require to be reported to trade repositories (TRs). The UPI would consist of a product classification system and associated code. The focus of this report is the product classification system.

The report responds to a G20 agreement in 2009 that all OTC derivatives contracts be reported to TRs, as part of the G20 commitment to reform OTC derivatives markets with the aim of improving transparency, mitigating systemic risk and preventing market abuse.

Aggregation of the data reported across TRs will help ensure that authorities can obtain a comprehensive view of the OTC derivatives market and its activity.

1.22 IOSCO publishes results of the third annual risk outlook survey

On 16 December 2015, the IOSCO Research Department published Staff Working Paper - A Survey of Securities Market Risk Trends 2015, which provides a detailed analysis of responses to its annual *Risk Outlook Survey*.

The Risk Outlook Survey is an annual exercise formulated to collect the views of financial market regulators and experts globally on those risk areas that are of concern. The main purpose of the survey is to gather views on risks to and within securities markets and to help identify or highlight pockets of risk that may not be captured by normal statistical analysis or desk research.

The working paper offers a synthesis of expert opinions. Key points highlighted include that:

- In the areas of financial stability, cyber-security threats to financial markets are now considered a prominent risk by respondents, while micro-prudential risks are clustered around the areas of corporate governance, financial risk disclosure and shadow-banking activities;
- Most respondents saw financial stability risks to the system either being transmitted or amplified by securities markets. Regarding the economy, respondents thought that banking vulnerabilities, housing markets and capital flow volatility would have considerable impact on the real economy if these risks materialised;
- In the area of investor protection, survey participants identified harmful conduct as the top risk; harmful behaviour by capital market participants

damages the proper function of the capital market, harms the investing public and undermines public confidence and trust in capital markets; and

- Market liquidity, especially that of secondary trading in bond markets, was considered by respondents to be the biggest challenge to fair and efficient markets - an interesting finding given that much of the recent global commentary has been about the systemic implications (not market efficient implications) of such a risk.

1.23 EBA issues final guidelines on institutions exposures to shadow banking entities and recommends approach to limiting risks

On 15 December 2015, the EBA published its final Guidelines regarding limits on institutions' exposures to shadow banking entities that carry out bank-like activities outside a regulated framework. In particular, these Guidelines introduce an approach that will allow EU institutions to set internal limits for their exposures to "shadow banking entities", hence addressing in a proportionate way the risks that these exposures pose to the EU banking sector. The Guidelines were informed by a Report on institutions' exposures to shadow banking entities and the impact of setting limits.

The focus of the Guidelines is on entities that pose the greatest risks in terms of both the direct exposures institutions face and also the risk of credit intermediation outside the regulated framework. For this purpose, "shadow banking entities" are defined as entities that carry out credit intermediation activities (i.e. bank-like activities involving maturity transformation, liquidity transformation, leverage, credit risk transfer or similar activities) without falling within the scope of consolidated supervision (or equivalent third country legal frameworks). In addition, "excluded undertakings", which are subject to an appropriate and sufficiently robust prudential framework, are not to be considered as shadow banking entities.

1.24 FCA consults on aspects of the Markets in Financial Instruments Directive II implementation

On 15 December 2015, the UK Financial Conduct Authority (FCA) published its first consultation paper on the implementation of the new *European Markets in Financial Instruments Directive II* (MiFID II) in the UK.

MiFID was originally introduced in 2007 and the revised regime aims to strengthen investor protection, increase market resilience, reduce systemic risks and increase the overall efficiency and transparency of financial markets.

The proposals mainly cover changes to the trading of financial instruments. These include issues affecting trading venues, transparency of trading and algorithmic and high frequency trading. There are also proposals covering changes to the scope of the application of the FCA's *Principles for Businesses* and the supervision of the new Data Reporting Service Providers category of firms.

View Consultation Paper I - Markets in Financial Instruments Directive II Implementation - Consultation Paper I

1.25 FCA calls for views on social investments

On 14 December 2015, the UK FCA released a call for input on how regulation is working in relation to the social investment market.

Social investment is a term used to describe investments where the aim is to provide a wider social benefit, rather than the primary driver being a purely financial benefit to investors.

The FCA is publishing a wide-ranging call for input asking for social entrepreneurs' experience of raising capital. In addition, the FCA is seeking input from financial advisors recommending social investments, views about the potential risks to consumers investing in this sector and views from individual consumers.

Following the call for input, the FCA will consider whether it is necessary to clarify the requirements that apply to social entrepreneurs and the protection available to consumers for social investments.

View Call for Input: Regulatory Barriers to Social Investments

2. Recent ASIC Developments

2.1 Update on red tape reduction

On 28 January 2016, ASIC released Report 466 - ASIC's work to reduce red tape, a further update on its work to cut red tape and reduce compliance costs. The report outlines ASIC's current deregulation work, reports on progress implementing the measures highlighted in Report 391 - ASIC's deregulatory initiatives, and responds to new deregulatory ideas received from the market since the report was released. It also outlines ASIC's plans for future deregulatory work.

Examples of ASIC incorporating red tape reduction into its everyday work include:

- granting waivers from the law, which allows the law to apply flexibly and helps innovation where appropriate;

- improving systems, such as ASIC's forms, website and lodgement facilities, for faster and easier public interactions with ASIC;
- advocating for international recognition of ASIC laws, which makes cross-border operations easier for business; and
- suggesting changes to the law that will have a deregulatory benefit.

2.2 Margin lenders improve lending standards following ASIC review

On 21 January 2016, ASIC announced that, following an ASIC review, margin lenders have moved to better address the different levels of risk for investors seeking margin loans, especially in relation to double geared margin loans.

ASIC reviewed the lending practices of six margin lenders, covering 90% of the market, and found that five of the six margin lenders approved 'double geared' margin loans. Double geared margin loans are where a consumer borrows money (using another asset as security, such as their home) to purchase shares, and then obtains a margin loan on these shares to purchase additional shares. Because of the extra risks associated with double gearing, the law requires margin lenders to meet responsible lending obligations.

ASIC found that in certain circumstances, four of the five margin lenders who approved double geared margin loans did not take additional steps when approving such loans, despite the additional risks associated with double geared margin loans.

Following ASIC's review, one margin lender decided to cease offering double geared loans. The remaining four lenders have made several commitments to reduce risks, including ensuring that their policies have, or continue to have, the following requirements for double geared borrowers:

- extra buffers to allow for interest rate rises and/or changes in expenses;
- lower maximum allowable loan amounts; and
- lower loan to value ratios.

ASIC's review also identified two lenders that provided double geared margin loans in circumstances where the borrower would not be able to fully service the margin loan relying only on their available income. Instead, such borrowers would need to sell assets in order to meet their ongoing interest payments. While 'asset-lend' margin loans are not prohibited, ASIC considers that such margin loans are significantly more likely to be unsuitable. Following ASIC's review, both margin lenders agreed to cease approving double geared asset-lend margin loans.

View ASIC media release.

2.3 Report on debt management firms

On 21 January 2016, ASIC released Report 465 - Paying to get out of debt or clear your record: The promise of debt management firms, a research report that aims to better understand the debt management industry in Australia and the consumer experience in using debt management firms.

According to ASIC, debt management firms promise to help consumers in financial hardship or with listings of payment defaults on their credit reports. The report was commissioned by ASIC's Consumer Advisory Panel.

Some of the report's findings include that:

- fees and costs were opaque making it difficult for consumers, often in significant financial hardship, to assess the cost relative to the purported value;
- fees were often "front loaded" - that is, fees were payable before services were provided thereby increasing consumer commitment through sunk costs;
- some sales techniques create a high-pressure sales environment;
- little information was given about important risks and some firms had a poor understanding of the relevant law and the consequences of particular strategies which may lead to unsuitable services for consumers.
- a growing number of firms are representing consumers at external dispute resolution (EDR) - this is concentrated among a few large players, with an increasing number of small firms entering the market;
- the disputes brought to EDR schemes by debt management firms relate almost exclusively to arguments about the removal of default listings on consumer credit reports (despite the breadth of other issues that can arise for indebted consumers); and
- while an increasing number of consumers are being represented at EDR by debt management firms, this is not leading to more credit reporting related disputes being found in favour of consumers.

2.4 Consultation on "sunsetting" class order about financial calculators

On 22 December 2015, ASIC released a consultation paper proposing to remake its class order on generic financial calculators. The class order is due to expire ("sunset") on 1 April 2016.

The new instrument would continue the relief currently given by *Class Order [CO 05/1122] - Relief for providers of generic calculators* with some changes. For example, ASIC proposes that an estimate of a future return, must be adjusted for inflation.

View Consultation Paper 249 - Remaking ASIC class order on generic financial calculators: [CO 05/1122]

2.5 Consultation on "sunsetting" class orders: Financial reporting relief for certain small proprietary companies and registered foreign companies

On 22 December 2015, ASIC released a consultation paper proposing to remake two class orders that are due to expire ("sunset") on 1 April 2017. The class orders affect financial reporting by small proprietary companies controlled by a foreign company and by registered foreign companies.

The class orders proposed to be remade are:

- Class Order [CO 98/98] Small proprietary companies which are controlled by a foreign company but which are not part of a large group in Australia; and
- Class Order [CO 02/1432] Registered foreign companies: financial reporting requirements.

ASIC proposes that the two class orders be remade as a single legislative instrument which preserves the existing relief, with one substantive change upon which comment is specifically sought. Under the proposed change, ASIC will have the ability to give notice to an individual entity that it may not rely on the relief. In giving such notice, ASIC may have regard to information provided to it by the Australian Taxation Office or other regulators.

View Consultation Paper 248 - Remaking ASIC class orders on reporting by foreign entities: [CO 98/98] and [CO 02/1432]

2.6 ASIC remakes "sunsetting" employee redundancy funds class order

On 17 December 2015, following public consultation, ASIC made a new legislative instrument to replace the employee redundancy funds class order that was due to expire ("sunset") on 1 October 2016. ASIC remade this class order without significant changes before it sunsets, so that its ongoing effect is preserved without any disruption to the entities that rely on it.

ASIC has made the ASIC Corporations (Employee Redundancy Funds Relief) Instrument 2015/1150. This instrument provides interim relief until 1 October 2018 to employee redundancy funds from the managed investment and associated provisions in the Corporations Act 2001 No. 50 (Cth) (the Corporations Act), including the requirements to:

- hold an Australian financial services (AFS) licence with appropriate authorisations;

- register the employee redundancy fund as a managed investment scheme, and
- comply with the managed investment provisions in Chapter 5C of the Corporations Act and other associated provisions, including those relating to Product Disclosure Statements, ongoing disclosure requirements and the anti-hawking provisions.

This relief was previously provided in ASIC *Class Order [CO 02/314] - Employee redundancy funds: relief.*

View ASIC Corporations (Repeal) Instrument 2015/1157

View Report 463 - Response to submissions on CP 238 Remaking ASIC class order on employee redundancy funds, which reports on the responses to the public consultation.

2.7 Draft guidance on review and remediation programs and proposed changes to record-keeping requirements for advice licensees

On 16 December 2015, ASIC released a consultation paper proposing guidance on review and remediation programs conducted by AFS licensees that provide personal advice. The consultation paper also proposes clarifications to the record-keeping requirements for AFS licensees relating to the best interests duty.

A key part of an AFS licensee's obligations is remediating clients for losses suffered following non-compliant advice, fraud or other breaches of the law. At times, establishing a review and remediation program may be the most appropriate approach to address client loss.

The draft guidance sets out how an effective review and remediation program should be designed and operated and how such a program operates alongside other key consumer compensation obligations, namely the internal and external dispute resolution obligations.

ASIC has identified that, in some cases, client remediation would be facilitated by clearer record-keeping obligations for AFS licensees that provide personal advice and is seeking to address this issue through proposals set out in the consultation paper.

The consultation paper provides draft guidance on:

- when to establish a review and remediation program;
- determining the scope of the program;
- designing a comprehensive and effective program;
- communicating effectively with clients; and
- ensuring access to the external review of decisions.

The proposed changes to the record-keeping obligations relating to the best interests duty seek to place beyond doubt that AFS licensees must have access to records for the period of time in which the records are required to be kept, even if a person other than the licensee holds the records. These changes are to be reflected by way of an amendment to *Class Order [CO 14/923] - Record-keeping obligations for AFS licensees when giving personal advice*.

View [Consultation Paper 247 - Client review and remediation programs and update to record-keeping requirements]()

2.8 Consultation on addressing "sunsetting" securitisation class order

On 16 December 2015, ASIC released a consultation paper proposing to maintain relief that ASIC has previously provided from the requirement to obtain an AFS licence for certain entities. This relief is due to expire ("sunset") on 1 April 2016.

The instrument that ASIC proposes to remake is *Class Order [CO 04/1526] - Securitisation special purpose vehicles*.

ASIC has found the class order is operating effectively and efficiently, and continues to form a necessary and useful part of the legislative framework. However, ASIC is proposing to omit one condition on the grounds that it does not appear to be relied on. This condition currently requires an AFS licensee to enter into an irrevocable deed poll agreeing to be liable for the securitisation entity's acts or omissions: see cl. 3(a) of [CO 04/1526].

View [Consultation Paper 246 - Remaking ASIC class order on securitisation special purpose vehicles]()

3. Recent ASX Developments

3.1 Amendments to the ASX listing rules and ASX enforcement and appeals rules

On 24 December 2015, the rules providing a right of appeal to the Australian Securities Exchange (ASX) Appeal Tribunal in respect of decisions made by the ASX under the ASX Listing Rules were removed. Amendments were made to the ASX Listing Rules (rll. 18.10 and 18.11) and ASX Enforcement and Appeals Rulebook (rll. 1.12.1, 2.1.1 and 3.1.4).

Further information is available from the [ASX website]().

3.2 Consultation paper: Central Counterparty Recovery - Consultation on exposure draft rules for interim replenishment of default funds

On 4 December 2015, the ASX released a consultation paper to seek feedback on exposure draft rules to facilitate more rapid replenishment of the default funds of ASX Clear and ASX Clear (Futures) if they are depleted as a result of a participant default loss.

The consultation paper is available on the ASX website.

3.3 Reports

On 6 January 2016, the ASX released:

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

for December 2015.

4. Recent Research Papers

4.1 Equity crowdfunding: A new phenomena

Crowdfunding has recently become available for entrepreneurs. Most academic studies analyse data from rewards-based (pre-selling) campaigns. In contrast, in this paper the authors analyse 636 campaigns, encompassing 17,188 investors and 64,831 investments between 2012 and 2015, from one of the leading European equity crowdfunding platforms. The authors provide descriptive statistics and carry out cross-campaign regression analysis. The descriptive statistics address its size, growth and geographic distributions in the UK. The regressions analyse which factors are associated with the probability of a successful campaign. The authors find some similarities and some interesting dissimilarities in both descriptives and regression results compared to research on rewards-based crowdfunding. Practically, the data show that equity crowdfunding will likely pose great challenges to venture capital and business angel financiers in the near future.

This paper is available on the Social Science Research Network (SSRN) website.

4.2 Rethinking limited liability of parent corporations for foreign subsidiaries' violations of international human rights law

The doctrine of limited liability of shareholders often prevents victims harmed by a corporation's foreign subsidiary's violation of international human rights norms from obtaining a remedy when that subsidiary operates in a country that has a weak or ineffective judicial system. This is because victims are often unable to obtain a remedy in these countries, and the doctrine almost always prevents victims from seeking a remedy from the parent corporation. Given this problem, in what situations should parent corporations be liable for the tortious activities of their foreign subsidiaries?

This article discusses the circumstances where imposing liability on parent corporations is justified and provides a specific statutory recommendation for such liability. The article recommends that US Congress or states (or both) should enact legislation disregarding limited liability of parent corporations for claims of customary international human rights violations and serious environmental torts where a parent corporation takes a majority interest or creates a subsidiary as part of unified economic enterprise that operates in a "high-risk host country," i.e., one that has a weak, ineffective, or corrupt judicial system, and victims cannot obtain an adequate judicial remedy for such harms in the host country.

This proposed solution moves away from the current notion that a parent corporation should only be liable where it has some actual control over the subsidiary, toward parent corporate liability where the parent benefits financially from the subsidiary's actions at the expense of unconsenting, third parties - typically members of the community where the subsidiary operates.

This paper is available on the SSRN website.

4.3 The history of hedge fund regulation in the United States

The hedge fund industry in the US evolved from a niche market participant in the early 1950s to a major industry operating in international financial markets. Hedge funds in the US were originally privately-held, privately-managed investment funds, unregistered and exempt from federal securities regulation. With increasing investor demand and significant growth of the hedge fund industry came a tectonic shift in the regulatory framework applicable to the industry. The book chapter summarises the regulatory evolution of the hedge fund industry.

This paper is available on the SSRN website.

4.4 Takeover litigation in 2015

This report provides preliminary statistics for takeover litigation in the US in 2015. Takeover litigation was substantially disrupted in 2015 by the Delaware courts' willingness to challenge "disclosure only" settlements. For the full year, lawsuits were brought in 87.7% of completed takeovers versus 94.9% in 2014. However, the lawsuit rate dropped precipitously in the fourth quarter of 2015 to 21.4% of all transactions in the wake of Delaware's challenge. There were also substantial delays in the approval of litigation settlements and attorneys' fee awards. Multi-jurisdictional litigation continued its sharp decline, falling approximately 50% from its 2012 high. Despite the higher rates of dismissals, large awards and settlements were given in litigation arising from the Rural/Metro, Dole and Freeport-McMoRan transactions, among others.

This paper is available on the SSRN website.

4.5 The pattern in securitization and executive compensation: Evidence and regulatory implications

The US Dodd-Frank financial reforms of 2010 promised to better align risk-reward incentives by, among other things, reducing imprudent securitzation (i.e. sales of financial assets) and excessive executive compensation. This would, in turn, promote systemic stability. To assess whether Dodd-Frank's elaborate rules on securitization and compensation are likely to achieve this goal, the authors explore the connection between the two empirically. Using a unique dataset covering 1993 - 2009 (the largest of its kind) they find that securitizing banks (regulated depositaries) on average paid their CEOs twice as much as non-securitizing banks, a finding that is both statistically and economically significant. By contrast, non-bank (industrial) firms that securitized actually paid their CEOs less than non-securitizers. Because securitizing banks performed no better than other firms (non-securitizing banks or industrials), the authors find evidence of agency cost; because bank-originated securitizations performed especially poorly in the financial crisis, they find evidence of social cost.

The authors' findings have important implications for Dodd-Frank, because its rules on securitization and compensation fail to account for the incentive effects of securitization by banks. Its compensation provisions are disconnected from controls on securitization, in particular its risk-retention ("skin in the game") rules. Moreover, it focuses not on those who "originate" securitizations, such as the banks the authors study, but instead the "securitizers" who issue securities backed by the financial assets in question. Because banks originated many of the worst securitizations - and yet paid their CEOs more for doing so - Dodd-Frank may be aimed at the wrong segment of securitization. Simpler, better-tailored regulation that accounts for the pattern the authors observe would more likely achieve Dodd-Frank's goals of systemic stability and accountability.

This paper is available on the SSRN website.

4.6 Angel investors around the world

Angel investors finance small high growth entrepreneurial firms in exchange for equity. Unlike venture capital (VC) and private equity (PE) funds that invest capital from institutional investors, Angels invest with their own money. This comparative disintermediation of Angel finance enables the authors to examine the impact from legal and cultural conditions on financial intermediation. The authors use PitchBook's comprehensive data collect of over 5,000 Angel deals and 80,000 PE/VC deals from 96 countries over the years 1977-2012. The data indicate that relative to PE/VC funds, Angel investors are more sensitive to stock market conditions, legal environments, and Hofstede's cultural conditions (specifically higher levels of individualism and risk intolerance). The data further indicate that investee firms funded by Angels are less likely to successfully exit in either an initial public offering or acquisition on average, whether those Angels are involved in the first round or later stages. In addition to those results, the authors also perform difference-in-differences tests to confirm that more stringent disclosure regulation and more forgiving bankruptcy legal changes can spawn entrepreneurial activities induced by both Angels and PE/VC funds.

This paper is available on the SSRN website.

5. Contributions

If you would like to contribute an article or news item to the Bulletin, please email it to: law-cclsr@unimelb.edu.au.