Governance Update

NOVEMBER 2019
Welcome to the IoD’s GovernanceUpdate

This is our second GovernanceUpdate for the year, summarising important governance developments, issues and trends in the last 6 months.

The Aotearoa Circle’s legal opinion on directors’ duties and climate change has reinforced the importance of this issue for boards in 2020 and beyond. Culture and conduct has remained high-profile post the Hayne Royal Commission and investigations in New Zealand. This space is still evolving and there are useful learnings coming out of Australia including in ASIC’s Corporate Governance Taskforce’s report on director and officer oversight of non-financial risks. The US Business Roundtable drew global attention with its new statement on the purpose of a corporation in August. This topic was picked up with other future-focused governance issues in our discussion paper Always on duty: the future board, prepared with MinterEllisonRuddWatts.

This GovernanceUpdate covers these and other significant developments, including:

- a special feature on the future of audit
- the latest policy and advocacy matters including a focus on escalating director responsibilities
- an overview of CBL litigation and developments in the class action landscape
- what the cannabis referendum will look like
- some key findings from the IoD/ASB 2019 Director Sentiment Survey (which is published concurrently with this GovernanceUpdate); and
- resources and guidance on topical issues and trends.

All IoD reports and resources referred to in this GovernanceUpdate are available at iod.org.nz.

We welcome your feedback on all GLC publications to glc@iod.org.nz.

Remember you can log up to 10 CPD points per year for governance reading. This includes BoardRoom magazine, articles online and in print and GLC publications such as this GovernanceUpdate and our DirectorsBriefs.
This update is divided into four parts

**PART 1**

**Special features**
- Forecasting the future board
- Escalating director personal responsibilities
- Climate change action
- Confronting conduct risk
- D&O insurance market hardens
- The future of audit

**PART 2**

**Legislative and regulatory updates**
- Trusts Act 2019
- Criminalisation of cartels
- Capital Markets 2029
- Snapshot of NZX ESG reporting
- Revised ASX listing rules
- Comparison of corporate governance codes
- FMA strategic priorities
- Commerce Commission releases 2019/20 priorities
- Update from the External Reporting Board (XRB)
- Policy and advocacy developments

**PART 3**

**Court decisions and other proceedings**
- Litigation funders back separate actions against CBL Insurance
- Landmark decision for class actions
- Trust to pay $500,000 to whistleblower trustee
- FMA settles for insider trading enforceable undertakings
- Prosecutions for bullying under Australian H&S law

**PART 4**

**Governance issues and developments**
- Ngā mea waiwai o te tūranga whakataka, The essentials of being a director
- Directors’ Fees Report 2019
- Executive pay and expenses
- Scientists in the boardroom
- Cannabis debate sparked
- Cyber-resiliency
- New Zealand ranked first for corporate governance
- Blowing the whistle
- Harnessing the power of AI in New Zealand
- Top 5 risks for New Zealand
- What happened with Thomas Cook?
- UK Stewardship Code 2020
- Australian review of H&S law
PART 1

Special features

• Forecasting the future board
• Escalating director personal responsibilities
• Climate change action
• Confronting conduct risk
• D&O insurance market hardens
• The future of audit
Forecasting the future board

Boards have a critical role in leading sustainable success for business and society – but they are under pressure. They have to be across a vast array of complex and diverse issues and also need to be responsive to increasing stakeholder expectations. The legal landscape is also changing, with increasing responsibilities and potential liability for directors, the rise of class actions, active regulators and litigation funders taking actions against directors.

Many boards are facing a time dilemma and can be weighed down by often voluminous board papers, compliance and risk, without sufficient time to discuss and debate critical strategic and performance issues. It is vital to address these challenges to ensure the future board remains effective and drives sound governance.

The discussion paper Always on duty: the future board published by the IoD and MinterEllisonRuddWatts in September explores trends, challenges and opportunities facing directors, today and into the future.

The paper, which is relevant to boards of all organisations, raises a number of issues for discussion including:

- how can technology and innovative practices transform how boards are operating, and help ensure directors get the right information to govern effectively?
- how are constituencies beyond shareholders being heard in New Zealand boardrooms?
- what is the next step in strengthening director professionalism?
- what board competencies and director attributes will the future board need?

In a call to action in the paper, we urge all boards to set aside time to challenge how they are operating and to innovate to improve board effectiveness.

Shareholders v stakeholders

In August, the US Business Roundtable released a new Statement on the Purpose of a Corporation, committing their 181 signatories to leading their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders. Previous versions endorsed principles of shareholder primacy (ie that corporations exist principally to serve shareholders). The shareholders v stakeholders debate has been around for decades and was also reignited this year by the FMA CEO Rob Everett in a speech to the New Zealand Capital Markets Forum.

One of the top five themes for the future-focused board in Always on duty: the future board is shareholders v stakeholders. The issue today is not whether a company should account for stakeholder interests but rather the extent to which it should. Stakeholder expectations on boards and organisations are increasing and they are becoming more vocal in airing their concerns and aspirations. It is important that directors consider whom they serve and why.

What is the future of NGO governance?

The Centre for Social Impact, in partnership with the Superdiversity Institute for Law, Policy and Business, also released a report What is the Future for NGO Governance? in September. The report identifies a number of opportunities and challenges faced by NGO boards and the barriers to good governance which include the low value and low profile of NGO governance, the behaviour of individual board members and poor processes around decision-making. In order for boards to be more effective in the future the report concludes that considerable investment in NGO governance capabilities is needed.
Escalating director personal responsibilities

We are seeing a concerning escalation of laws and regulations extending directors’ personal responsibilities and liability. This is occurring across different regimes and on a piecemeal basis. A summary of key proposals is in Part 2 of this Governance Update.

Accountability is absolutely critical to corporate governance and directors’ personal liability has its place. There is no shortage of statutes in New Zealand imposing obligations on directors, accompanied by civil or criminal liability. However, in the past 12 months we have seen numerous director accountability proposals/reforms including:

- the introduction of criminal liability for the decision-makers of cartels (effective April 2021)
- the Credit Contracts Legislation Amendment Bill introduces a due diligence duty on directors and officers, and personal liability
- the Government has signalled that it will make directors personally liable for company PAYE and GST debt (a recommendation of the Tax Working Group)
- the Government has signalled that it will introduce an accountability regime for directors and executives of financial entities and this is also considered in the Phase 2 of the Reserve Bank Act review.

In the past, the IoD has supported reform where directors could be civilly or criminally liable in appropriate circumstances (eg under the Health and Safety at Work Act 2015). However, care is needed to ensure that honest and diligent directors are not unfairly prejudiced. There are, of course, complexities for policymakers in allocating accountability and liability between a company, directors, officers and other corporate stakeholders. However, we need to take a long-term, holistic and considered approach to policy change.

Coherent regulatory approach required

A piecemeal approach by policymakers to imposing liability is worrying and risks tipping the scales too far, prejudicing directors. If left unchecked this approach could result in significant and adverse effects on governance and ultimately impact on New Zealand’s prosperity and wellbeing. New Zealand needs skilled and experienced leaders. It needs leaders willing to take on the responsibility of guiding organisations, and making challenging choices and decisions that will result in a strong and sustainable future. The impact of good governance is far reaching with the potential to provide benefit to shareholders, customers, organisations, employees and communities. Any proposal to impose director personal liability deserves careful, and considerable, attention from policymakers. There has to be a holistic and system-wide view that takes into account existing director liability, and balances this with the need for, and importance of, non-executive directors and good governance. It is vital that there is more dialogue between policymakers and other relevant stakeholders. The IoD will continue to engage and to strongly oppose proposals that place a disproportionate burden on directors.

More directors deterred from taking on roles

In the 2019 Director Sentiment Survey 40% of directors said the scope of their responsibilities is more likely to deter them from taking on governance roles now than 12 months ago (up from 33% in 2018). Forty-seven percent also said increased personal liability has made them more cautious (risk adverse) in business decision making in the last 12 months (up from 39% in 2018).
Climate change action

The climate crisis is the defining issue of our times and requires action now to chart a new course for the future. Boards have a critical role in confronting and responding to climate-related issues to ensure the long-term sustainability of their organisations, and some boards are further along the journey than others.

Directors’ duties and climate risk

In October, the Aotearoa Circle’s Sustainable Finance Forum published a legal opinion on the legal obligations of New Zealand company directors (and managers of retail managed investment schemes) in relation to climate risk. The opinion summarises the international and domestic scientific, political and regulatory context before considering directors’ duties under the Companies Act 1993 and other obligations. Key findings include:

- climate change is a foreseeable risk of financial harm to many businesses, especially in relation to the impacts arising from transitioning to a low-carbon economy
- directors duties, including the duty to act with reasonable care, mean directors should (and in some cases must) take climate change into account in their decision making
- directors should assess the risk in the same way they would any other financial risk to the business and take action (if appropriate)
- directors of some companies may be required to disclose climate-related risk to their businesses.

Shifting to a sustainable financial system

The Sustainable Finance Forum also published in October an Interim Report on how the financial system in New Zealand may be redesigned to meet sustainability challenges and opportunities now and in the future. The report explores the purpose, the role, and responsibilities of business and finance in society and sets out potential pathways for achieving a sustainable system. Topics covered include fiduciary duties, performance management and remuneration, education, system architecture, data and reporting, and scaling positive impact.

The report is intended to be finalised by July 2020 and is the first step in designing a road map to 2030.

Transitioning to a zero-carbon economy

The Climate Change Response (Zero Carbon) Amendment Bill passed into law in November, amending the Climate Change Response Act 2002. A new long-term 2050 emissions reduction target is set out in the legislation. The target will:

- reduce emissions of biogenic methane within the range of 24% to 47% below 2017 levels by 2050, with an interim requirement to reduce emissions to 10% below 2017 levels by 2030 (biogenic methane is all methane greenhouse gases produced from the agriculture and waste sectors)
- reduce net emissions of all other greenhouse gases to zero by 2050.

The legislation provides for three consecutive emissions budgets to be in place at any given time, with the budgets being met as far as possible through domestic emissions reductions and removal.

Board engagement on climate change

There has been an upward trend in relation to board engagement on climate change related matters over the past 3 years. Still, only 35% of directors in the 2019 Director Sentiment Survey said their boards were engaged and proactive on climate change. All boards should ensure they are aware of the potential impact that climate change could have to their organisations and take action to mitigate climate risks, including physical, transition and liability risks.
It also introduces adaptation provisions (eg a national risk assessment and adaptation plan) and the Climate Change Minister and Climate Change Commission will have the power to request certain organisations (eg SOEs, Public Service, Local Authorities, Crown Entities (excluding school boards) and Lifeline Utilities) provide information on climate change adaptation. A permanent Climate Change Commission is established under the legislation and Dr Rod Carr has been appointed chair.

The Government also introduced the Climate Change (Emissions Trading Reform) Amendment Bill into Parliament in November and this is expected to pass in early 2020.

Climate-related financial disclosures
Consultation has begun on a proposed regime for climate-related financial disclosures in the discussion document Climate-related financial disclosures — Understanding your business risks and opportunities related to climate change. The document considers adopting mandatory climate-related disclosures (on a comply or explain basis) for listed issuers, banks, general insurers, asset owners and asset managers. The Task Force on Climate-related Financial Disclosures (TCFD) reporting framework is proposed as a default framework. Reporting would be required in annual reports and it is not proposed that assurance be mandatory at this stage.

For information on how organisations can approach climate-related disclosures see:
- TCFD Implementation Guide
- TCFD Good Practice Handbook
- UK Financial Reporting Lab’s Climate-related corporate reporting (which includes questions for boards)
- McGuinness Institute’s The climate reporting emergency: A New Zealand case study which includes recommendations for New Zealand’s reporting frameworks
- presentations from the 2019 Climate Change and Business Conference held in October.

MinterEllisonRuddWatts on climate change
Read the highlights from MinterEllisonRuddWatts’ 2019 Corporate Governance Symposium on climate change and see the October/November 2019 BoardRoom article The gathering storm – and how to prepare by Senior Partner Lloyd Kavanagh.

Confronting conduct risk
The biggest stories in corporate governance in New Zealand and Australia over the last 12 months have been in the culture and conduct space. On the back of the Hayne Royal Commission and the banking and life insurer reviews in New Zealand, both countries’ governments and regulators have been busy in seeking to address issues and risks in the sector. The Australian Securities and Investments Commission (ASIC) has dozens of investigations open relating to the Royal Commission, including some involving directors. More regulation is also on the way on both sides of the Tasman. While much of the detail is yet to be seen in New Zealand, boards are already on notice that more is expected of them in leading and overseeing organisational culture.

Board oversight of culture and conduct risks
In the 2019 Director Sentiment Survey, over three-quarters of directors (77%) said that their board monitors and regularly discusses the culture of the organisation. However, only 43% of boards are receiving comprehensive reporting from management about ethical matters and conduct incidents and actions taken. All boards need to ensure robust monitoring of organisational culture and conduct, and that the right processes are in place for potential issues to be raised.
**ASIC corporate governance taskforce**

The taskforce, set up in 2018, has been engaged in conducting targeted reviews to gain insights into corporate governance practices of large Australian listed entities.

The first report of the taskforce was released in October, *Director and Officer Oversight of Non-financial Risk Report*. Key findings include:

- “All too often, management was operating outside of board-approved risk appetites for non-financial risks, particularly compliance risk. Boards need to actively position themselves to hold management accountable to operate within their stated appetites.

- Monitoring of risk against appetite often did not enable effective communication of the company’s risk position. Boards need to take ownership of the form and content of information they are receiving to better inform themselves of the management of material risks.

- Material information about non-financial risk was often buried in dense, voluminous board packs. It was difficult to identify key non-financial risk in information presented to the board. Boards should require reporting from management that has a clear hierarchy and prioritisation of non-financial risks.

- Companies generally sought to use board risk committees (BRCs) to achieve desired outcomes, but their effectiveness could be improved. BRCs should meet more regularly, devote enough time and be actively engaged to oversee material risks in a timely and effective manner.”

Questions for boards are set out in Appendix 1 of the report.

**What can boards and directors learn from the psychologist’s report?**

Kiel Advisory Group was commissioned by ASIC to provide expert advice on the way board mindsets and behaviours may influence their effectiveness, and this included having a psychologist attend board meetings as an observer. The report *Influence of Board Mindsets and Behaviours on Effective Non-Financial Risk Oversight* highlights several issues and themes for individuals and boards to improve effectiveness including around challenging management and self-reflection.

**What’s next?**

A second report by the taskforce on executive remuneration practices is expected to be released this year.

In New Zealand, the Government is taking steps to regulate corporate conduct (see Part 2 of this GovernanceUpdate).

**Further resources:**

The Australian Prudential Regulation Authority (APRA) has published an Information Paper *Self-assessments of Governance, Accountability and Culture* which is intended to help organisations understand and address the challenges of embedding effective risk governance frameworks and practices.

*A Guide to FMA’s View of Conduct (2017)* provides guidance to directors and executives of licensed financial services providers and how they can demonstrate good conduct, and that they have met their governance and management responsibilities.

**D&O insurance market hardens**

The rise of class actions, litigation funding, active regulators and substantial awards of damages against directors are key causes of the unsettled directors and officers insurance market. Premiums for some organisations have more than doubled in 2019. In June, the IoD, in partnership with Marsh and MinterEllisonRuddWatts, published a report *D&O insurance – trends and issues in turbulent times* covering:

- market developments
- the changing regulatory environment
- insurers’ areas of interest
- key coverage issues for D&O policies, and
- what’s next for D&O insurance?
Future of audit

Audit reform looming

Audit quality is a growing concern globally for regulators and other stakeholders with auditors under increasing scrutiny in relation to corporate failures and scandals. In the UK these include the collapses of BHS and Carillion, fraud in Patisserie Valerie, and corruption at Rolls-Royce which have resulted in the following:

- The 2018 Sir John Kingman review of the Financial Reporting Council. This recommended that it be replaced by a new ‘hard hitting’ regulator (to be named the Audit, Reporting and Governance Authority which could ban firms from auditing large listed groups)
- The 2018 Competition & Market Authority update paper on the review of the audit sector
- The 2019 House of Commons’ Business, Energy and Industrial Strategy Committee report on the future of audit
- The 2019 Sir Donald Brydon review into the quality and effectiveness of audit.

Scrutiny and criticism is also high in Australia, including from former ASIC chairman Greg Medcraft who has warned that conflicts of interests in the auditing profession could result in an Enron scale corporate collapse (ABC interview 6 August 2019).

An Australian Senate (Parliamentary Joint Committee on Corporations and Financial Services) inquiry into the regulation of auditing is now underway and due to report by 1 March 2020. The terms of reference are wide-ranging and include the relationship between audit and consultancy services and potential conflicts of interest, the level of competition in the audit profession and audit quality.

Reform in the UK and Australia could have significant ramifications for New Zealand, especially with the increasing attention on audit quality here, eg of Fonterra and its auditors following asset write downs this year. FMA research published in May, Perceptions of Audit Quality in New Zealand, found a gap in expectations and what auditors are delivering. It found that while 68% of directors said they trusted the audit profession only 57% agreed audit was of high quality.

FMA’s plan for audit oversight

The FMA released its Audit Regulation and Oversight Plan 2019-22 in June, which sets out the following areas of focus during its audit quality reviews of FMC reporting entities:

- improving audit quality
- changes in auditing standards
- developments in the audit profession
- monitoring accredited bodies.

Audit and risk committees

In the 2019 Director Sentiment Survey 71% of directors said that the time their boards spend on risk oversight had increased in the previous 12 months (up from 64% in 2018).

The role of audit and risk committees is becoming more challenging due to the broadening scope of risk oversight and complexity in corporate reporting. In addition to the principal function of assisting the board to produce accurate financial statements many committees are also focused on non-financial reporting as per the rise of ESG requirements and disclosures, and the take up of integrated reporting and other more holistic reporting frameworks.

Oversight of non-financial risk has been highlighted in recent financial sector reviews in New Zealand and Australia. And boards today have to be across a breathtaking range of new and emerging risk issues including culture, cybersecurity, social media, conduct and ethics, health and safety, climate change, technology, modern slavery, global supply chains, data and privacy. Also contributing to this issue is the increasing trend of laws and regulations extending directors’ personal liability (discussed above and in Part 2).

THOUGHT POINT

With risk issues taking up significant time on audit committee agendas, it may be timely to consider whether to have a combined audit and risk committee or to separate into two committees. This issue covered in more depth in our discussion paper Always on duty: the future board.
Legislative and regulatory updates

• Trusts Act 2019
• Criminalisation of cartels
• Capital Markets 2029
• Snapshot of NZX ESG reporting
• Revised ASX listing rules
• Comparison of corporate governance codes
• FMA strategic priorities
• Commerce Commission releases 2019/20 priorities
• Update from the External Reporting Board (XRB)
• Policy and advocacy developments
Trusts Act 2019

After several years in the making, New Zealand now has a new Trusts Act. This is the most significant trust reform in over 60 years and is relevant to many trustees. The Act includes mandatory and default trustee duties and sets out trustees’ obligations to retain records and provide information to beneficiaries. Our August DirectorsBrief What’s Changing for trusts? sets out some of the key features of the Act that trustees need to know.

Criminalisation of cartels

The Commerce (Criminalisation of Cartels) Amendment Act introduces a new criminal offence for people engaged in cartel conduct. It forms part of the Commerce Act 1986 and is in addition to the existing civil prohibition on cartels. It is targeted at individuals who are the decision makers for the cartel (eg directors) and their legal entity. The new criminal offence for cartel conduct is largely the same as the existing civil prohibition, except that the criminal offence requires an intention to engage in cartel conduct (ie deliberate wrongdoing). The penalty for individuals is up to 7 years imprisonment and/or up to $500,000. There is a transitional period with criminalisation coming into effect on April 2021. Directors and management should familiarise themselves with the changes. The Commerce Commission is expected to publish guidance and we will share this with members.

The IoD advocated against the criminalisation of cartels because we considered that the current civil regime prohibiting cartels (reformed in 2017) is a sufficient deterrent and introducing a criminal offence may be detrimental to business and New Zealand as a whole (eg by having a detrimental effect on pro-competitive activities, and increased compliance costs).

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<td>• The duty to act in accordance with the terms of the trust</td>
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<td>• The duty not to exercise any power directly or indirectly for the trustee’s own benefit</td>
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<td>• The duty to actively and regularly consider the exercise of the trustee’s powers</td>
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November 2019 | GovernanceUpdate | 11
Capital Markets 2029

The report *Growing New Zealand’s Capital Markets 2029*, initiated by the FMA and NZX, was published in September by an industry-led Steering Committee. It sets out a number of recommendations aimed at improving capital markets including changes to KiwiSaver, financial capability, regulation, public sector assets and infrastructure, market development, new listings, tax, and technology. Recommendations relating to regulatory change include:

- simplifying disclosure requirements for regulated offers (including a review to consider how much information should be contained within the product disclosure statement)
- removing the requirement to provide prospective financial information for IPOs
- undertaking a review of continuous disclosure liability and aligning other liability settings. It is also suggested that New Zealand should not follow Australia’s approach in relation to shareholder class actions, relevant to the Law Commission’s impending review of litigation funding and class actions
- establishing a centralised process for AML compliance which market participants can rely on across Australasian capital markets.

The report also recommends the establishment of an advisory group to support capital market regulation. It is critical that directors are represented in this group to ensure they are at the heart of the design of our capital markets. Formal responses by the FMA, NZX and other parties to whom the report makes recommendations are expected.

Snapshot of NZX ESG reporting

The NZX and Wright Communications have released their *ESG Reporting Uptake in S&P/NZX 50 Index and Investor Perspective 2019* report. This report examines the ESG disclosure and provides insights through a number of case studies.

Revised ASX listing rules

The ASX is updating its listing rules and guidance, with most changes effective on 1 December 2019. The changes set out in its *consultation response* are being made following the release last year of the paper *Simplifying, Clarifying and Enhancing the Integrity and Efficiency of the ASX listing rules*. The changes are intended to:

- improve disclosures to the market
- make the listing rules easier to understand and comply with
- assist ASX to better monitor and enforce compliance.

Comparison of corporate governance codes

An updated edition of *Corporate Governance – Codes Compared* has been published. This comparative table brings corporate governance codes relevant to New Zealand directors into one place and summarises the similarities and differences between the codes. Since the table was last updated in September 2017, the following codes have been updated:

- NZX Corporate Governance Code (2019)
- ASX Corporate Governance Council’s Corporate Governance Principles and Recommendations (effective 1 January 2020).
FMA strategic priorities

The FMA’s Annual Corporate Plan outlines its key areas of focus for 2019/20. The plan is intended to be read alongside the refreshed Strategic Risk Outlook which sets out the most significant risks and opportunities over the next 3-5 years in New Zealand’s financial markets. The Annual Corporate Plan has a new sector-based approach that is set out in the Strategic Risk Outlook and is focused on:

- capital markets
- investment management
- sales, advice and distribution
- banking and insurance.

Its updated strategic priorities, which will guide its decision-making and focus are:

- governance culture, systems and controls
- credible deterrence of misconduct
- successful implementation of potential remit changes
- investor and customer decision-making
- promoting trust and confidence in capital markets.

The FMA has also identified a number of longer-term opportunities and challenges including the impacts from innovation and climate change and significant regulatory and legislative changes.

Commerce Commission releases 2019/20 priorities

The Commerce Commission has announced its priority focus areas for 2019/20, which include:

- **enduring priorities**: credit issues, product safety and construction cases, cartel and anti-competitive conduct, mergers including those that are not notified

- **focus areas**:
  - environmental claims
  - online retail
  - motor vehicle financing and related add-ons
  - educating traders about conduct that may contravene cartel laws
  - consulting on and completing the fuel market study
  - resetting the five-year revenue limits and quality standards for electricity networks
  - monitoring and reporting on telecommunications retail service quality
  - new up-front regulatory rules for fibre broadband services

- **connecting** with customers, engaging with businesses and working across the system

- **legislative change** including:
  - providing input into proposed changes to the Fair Trading Act
  - preparing for the new criminal cartel offence to come into force
  - participating in the review of consumer credit law and implementing changes passed into law
  - continuing to implement changes to the Telecommunications Act
  - considering the findings of the Electricity Price Review.
Update from the External Reporting Board (XRB)

Implementing the new leases standard

NZ IFRS 16 Leases became effective from 1 January 2019, which means most entities will be well on their way to implementing this new standard.

The new leases standard will largely remove the distinction between operating and finance leases for lessees. In most instances this will result in lessees recognising lease assets and liabilities on their balance sheet, which could substantially affect key financial ratios.

It is important directors understand why these reporting changes have been introduced and be able to clearly explain the impact to shareholders.

The XRB is receiving feedback that the amount of analysis and process changes required to implement this standard is often underestimated – XRB recommends the adoption process be commenced as early as possible.

Growing demand for Extended External Reporting (EER)

EER is an umbrella term adopted by the XRB to refer to broader and more detailed types of reporting beyond the information presented in an entity’s statutory financial statements. Examples of EER frameworks include integrated reporting (IR), sustainability reporting and environmental, social and governance (ESG) reporting.

The XRB has observed a growing demand from stakeholders for the reporting of EER by entities within their annual report. The extent to which EER information should be included in the annual report should be based primarily on its relevance and usefulness to the intended primary users of these reports.

The XRB have developed a navigational resource to help preparers trying to navigate the multitude of frameworks, guidance and initiatives in the EER arena, both local and international resources.

Follow up report on the revised auditor reporting requirements

The XRB and the FMA are performing a second follow up review of the New Zealand experience in adopting the revised auditor reporting requirements. The first report, issued in November 2017, covered the results of their joint analysis of Key audit matters – A stock-take of the first year in New Zealand. The follow up review will focus on obtaining the views of the investor community, specifically whether the reporting of key audit matters (KAMs) has improved the communicative value of the auditor’s report, and what more could be done to enhance communication and build trust in the audit. The report should be available in April 2020.

The performance of non-assurance services by auditors

The International Ethics Standards Board for Accountants (IESBA) is expected to approve an exposure draft in December proposing to amend the International Code of Ethics for Professional Accountants (including International Independence Standards), Provision of Non-Assurance Services to an Audit Client. This project is responding to concerns raised by regulatory stakeholders and the Public Interest Oversight Board. The exposure draft is expected to include, among other matters, new strengthened requirements for auditors of both public interest entities (PIEs) and non-PIEs on the provision of non-assurance services (NAS) to audit clients. Included in the proposals is the need for auditors to discuss NAS matters with those charged with governance (TCWG) as part of the discussions about independence, and for the auditors of public entities to obtain pre-approval from TCWG to perform NAS. The NZAuASB will be consulting extensively on these proposals and are very interested in the views of the director community.
Policy and advocacy developments

2019 has been another busy year in advocating on issues relevant to directors and governance, through formal submissions on a range of policy and legislative matters and promoting our views in the media. A particular focus has been responding to policy and bills seeking to increase director responsibilities (see also Part 1 of this Governance Update) and this will continue to be a focus in 2020.

Regulating corporate conduct

The Ministry of Business, Innovation and Employment (MBIE) is reviewing options for improving culture and conduct in financial institutions in New Zealand, and the Government has signalled it will bolster the FMA’s powers. MBIE has recommended the following overarching duties that would apply to all aspects of a financial institution’s activities in their dealings with retail customers:

- a duty to consider and prioritise the customer’s interest, to the extent reasonably practicable
- a duty to act with due care, skill and diligence
- a duty to pay due regard to the information needs of customers and to communicate in a way which is clear and timely
- a duty to manage conflicts of interest fairly and transparently
- a duty to ensure complaints handling is fair, timely and transparent
- a requirement to have the systems and controls in place that support good conduct and address poor conduct.

If an entity breaches a duty, MBIE has proposed that directors and senior managers could be personally liable. In our submission we highlighted our concern about the scope of the proposed duties on financial institutions and directors, and said that they need to be carefully considered (including with regard to existing duties under the Companies Act 1993) and imposed only to the extent necessary. We strongly oppose the introduction of director personal liability.

In September, the Government announced that it will introduce a new conduct licensing system for banks, insurers and non-bank deposit takers. Legislation is expected to be introduced by the end of the year. The Government has also signalled that an accountability regime for directors and senior executives will likely be progressed in the short-term.

Bank director attestation regime and the Reserve Bank’s governance arrangements

The second of three rounds of consultation within Phase 2 of the Reserve Bank Act Review focused on the Reserve Bank’s role in financial policy including how it should be governed and its tools, powers and approach. A key topic under consideration was the current attestation regime which creates a form of director accountability for registered banks by requiring individual directors to attest to the bank’s compliance with conditions of registration and systems of risk management. In our submission, we supported an ‘enhanced status quo’ option including increased supervisory engagement by the Reserve Bank, noting that this should be done in a manner that encourages high quality directors to remain involved in the sector and which includes a process to audit or verify attestations by the Reserve Bank.

In relation to the Reserve Bank’s governance arrangements, we emphasised that it is essential that the Reserve Bank retains sufficient independence from Government. There are opportunities for greater independence from the current model including by ensuring:

- board members are non-executive directors
- the Governor/CEO is not a member of the board
- the board is responsible for appointing and managing the Governor/CEO.

We also encouraged Treasury (who is undertaking the review) to recognise the designation of Chartered Membership by directors in their disclosures as an effective measure to support their attesting to their ongoing suitability as a director. There is also an opportunity when appointing new board members to the Reserve Bank board to include Chartered Members. The final round of consultation within Phase 2 of the review is expected in early 2020.
Credit Contracts Legislation Amendment Bill

This Bill amends the Credit Contracts and Consumer Finance Act 2003 and is intended to address issues in the credit market including strengthening requirements to lend responsibly and addressing harm to vulnerable customers.

The Bill imposes a new duty on directors and senior managers of a lender to exercise due diligence to ensure that the lender complies with its duties and obligations under the Act. Where there is a breach of the new duty, the Bill introduces civil pecuniary penalties (up to $200,000 for an individual and $600,000 for a company), and potential personal liability (jointly and severally with the lender) for statutory damages or compensation.

The potential personal liability for directors and senior managers under the Bill is extensive and we strongly opposed it in our submission, together with the excessive penalties and damages, and an unreasonable prohibition on indemnities and insurance. At the time of writing, the bill was at second reading stage.

Director liability for PAYE and GST arrears

Capital Gains Tax may be off the menu, but the Government’s Response to the Recommendations of the Tax Working Group supports making directors personally liable for PAYE and GST debts of companies and this is a high priority on the work programme. The IoD has strongly advocated against this since it was raised by Inland Revenue in 2016. Our key concern with introducing this new form of personal liability is that it may deter appropriately qualified people from serving on boards. Other concerns include the likelihood of higher compliance and insurance costs, and boards becoming weighed down by conformance rather than focusing on their core strategic role of driving business forward. Withholding funds from Inland Revenue is unlawful and it already has wide powers to take action.

Improving governance in local government

The Productivity Commission’s draft report into Local Government Funding and Financing makes a number of findings and recommendations for improvement. Recommendations to improve financial governance and decision-making include:

- the Department of Internal Affairs, Local Government New Zealand (LGNZ) and the New Zealand Society of Local Government Managers should work together to improve elected council members’ governance skills and knowledge
- LGNZ should increase participation by elected members in their ongoing professional development
- all local authorities should have an audit and risk committee (or equivalent assurance committee):
  - with an independent chair and ideally with at least one other external expert
  - with appropriately skilled and qualified independent members
- councils should use the existing good practice guidance and resources already available to develop and run their committees
- Council participation in existing performance reviews and improvement initiatives, such as CouncilMARK, should be encouraged with an emphasis on learning for continuous improvement.

In our submission, we strongly endorsed the Commission’s recommendations to help build local government governance and financial capability and we highlighted how the IoD can support this.

Technological change and the future of work

The New Zealand Productivity Commission published an issues paper on Technological Change and the Future of Work in April which raises a number of challenges for consideration. As part of the work being completed in this area, the Commission is publishing the following draft reports before delivering a final report to the Government in March 2020.
An opportunity to raise the standards of governance in charities

Charities and not-for-profits (NFP) governance are of core interest to the IoD, with 51 per cent of our members serving on a NFP board. The Department of Internal Affairs is considering over 250 submissions on its discussion document on modernising the Charities Act 2005, the first public consultation on the Act in 14 years.

This review is one of many relevant to the NFP sector (eg trusts, incorporated societies and education reforms). Reform of the Charities Act will need to take into account these wider reforms to ensure that there is cohesion across the sector, and NFPs will need to refocus their attention on their governance arrangements and what they are doing.

A key part of the review is about whether New Zealand needs governance standards like other similar jurisdictions. New Zealand doesn’t have governance standards or a code specifically for charities or NFPs. However, there are several governance codes in New Zealand relevant to NFPs including IoD’s Code of Practice for Directors, the FMA’s Corporate Governance in New Zealand: Principles and Guidelines and Sport New Zealand’s Governance Framework.

In our submission, we said that there is considerable benefit in introducing governance standards through a specific governance code for the charitable/NFP sector that is fit for purpose and value adding to help raise the standard of governance. A key challenge will be to balance raising standards without burdening organisations and deterring people from getting involved in leadership. Rather than having legislative governance standards, we support the establishment of a voluntary governance code. Key considerations for a New Zealand code include whether it should:

- be solely for charities, or other NFPs and impact/purpose driven organisations; and
- have differential requirements for large and small organisations (eg like the charities code in England and Wales).

A summary of submissions is expected to be released shortly, together with next steps and timing.

<table>
<thead>
<tr>
<th>Draft report</th>
<th>Release date</th>
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<tbody>
<tr>
<td>New Zealand, Technology and Productivity</td>
<td>September 2019</td>
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<tr>
<td>Employment, labour markets and income</td>
<td>October 2019</td>
</tr>
<tr>
<td>Education and skills</td>
<td>November 2019</td>
</tr>
<tr>
<td>Preparing New Zealand for the future</td>
<td>December 2019</td>
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Education hubs abandoned

The Tomorrow’s Schools Independent Taskforce delivered its final report in July to the Government setting out recommendations to reform the school system. In November, the Government released its response Supporting all schools to succeed: Reform of the Tomorrow’s Schools system.

The Government intends to progress most of the Independent Taskforce’s recommendations in substance. However, boards will retain most of their current governance responsibilities and the controversial proposal for education hubs has been abandoned. Providing greater support and training for boards is also a key focus. Other matters relevant to trustees include:

- Board responsibility for property and major capital works has been removed from boards of state schools, although there is an option to retain responsibility for some schools
- Property maintenance, financial and procurement services will be made available to boards
- Enrolment schemes will be carried out by the Ministry of Education (and not by boards)
- A new role of Leadership Advisor will be established to support boards and principals
- Mandatory governance training for boards and specific training for chairs is being considered
- Possible mandatory mana whenua representation on boards is still being explored
- A new code of conduct for board members will be created and this will specify individual and collective duties.

A detailed timeline for changes can be found in Appendix 1 of the Government’s response.
### Update on other policy and bills

<table>
<thead>
<tr>
<th>Policy/Bills</th>
<th>What’s proposed?</th>
<th>Timeline</th>
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<tbody>
<tr>
<td>Director identification numbers and residential addresses</td>
<td>The IoD has been advocating since 2016 to enable directors to publish a service address on the Companies Register, rather than a residential address. There was public consultation on this in 2018. Any change with addresses would likely be introduced with director identification numbers which would provide administrative efficiencies for directors and also improve the Companies Register. The Ministry of Business, Innovation &amp; Employment (MBIE) has advised that these matters are being considered with beneficial ownership reforms (discussed below).</td>
<td>This is with MBIE and detailed proposals are expected in early 2020 (depending on decisions by Cabinet).</td>
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<td>Beneficial ownership</td>
<td>MBIE consulted on measures to improve the transparency of beneficial ownership of companies and limited partnerships in New Zealand in 2018. This included exploring the establishment of a public register of beneficial ownership information.</td>
<td>This is with MBIE and detailed proposals are expected in early 2020 (depending on decisions by Cabinet).</td>
</tr>
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<td>Incorporated Societies</td>
<td>The Incorporated Societies Act 1908 is being overhauled and replaced by a new modern statute. MBIE consulted on this in 2016. Proposed changes will significantly improve governance structures and arrangements for incorporated societies.</td>
<td>In May 2019, the Government agreed to make a number of changes to the draft Bill and intends to introduce a Bill into Parliament this year or early next year.</td>
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<td>Whistleblowing</td>
<td>The State Services Commission is leading a review of the Protected Disclosures Act 2000 to ensure it is fit for purpose and in line with international best practice. Five potential options for reform were put forward as part of the review in 2018.</td>
<td>This is with the State Services Commission.</td>
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<tr>
<td>Public service</td>
<td>The State Sector Act is being revised with the aim of creating one unified modern, agile and adaptive Public Service.</td>
<td>A Bill is expected in November 2019.</td>
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<tr>
<td>Education (Vocational Education and Training Reform) Amendment Bill</td>
<td>The Bill is intended to create a unified and cohesive vocational education and training system and this includes the establishment of the New Zealand Institute of Skills and Technology.</td>
<td>At Select Committee.</td>
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<td>Privacy Bill</td>
<td>The Bill will replace the Privacy Act 1993. It keeps the principles-based framework while updating the law to reflect the needs of the digital age. A key part of is the introduction of mandatory privacy breach reporting.</td>
<td>At Committee of the Whole House.</td>
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<tr>
<td>Equal Pay Amendment Bill</td>
<td>The Bill is aimed at improving the process for raising and progressing pay equity claims, and eliminating and preventing discrimination on the basis of sex in the remuneration and employment terms and conditions for work done within female-dominated jobs.</td>
<td>The Bill is at second reading stage.</td>
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PART 3

Court decisions and other proceedings

- Litigation funders back separate actions against CBL Insurance
- Landmark decision for class actions
- Trust to pay $500,000 to whistleblower trustee
- FMA settles for insider trading enforceable undertakings
- Prosecutions for bullying under Australian H&S law
Litigation funders back separate actions against CBL Insurance

In October, two litigation funded actions relating to CBL Insurance Ltd (CBL) were announced:

- The first class action against CBL was announced by litigation funder IMF Bentham and law firm Glaister Ennor. The class action against CBL will allege that the company breached disclosure obligations under the Financial Markets Conduct Act 2013.

- The second action funded by LFP Group is being fronted by Harbour Asset Management and Argo Investments, as representative shareholders in CBL. The action will allege that there were false or misleading statements made in CBL’s IPO documents and also breaches of disclosure obligations. The action is against CBL and its former directors.

At this stage, it is unclear how the courts will deal administratively with the two actions. We also understand that the FMA investigation into CBL is still ongoing.

Earlier in the year, the Reserve Bank of New Zealand released An Independent Review for the RBNZ of the Supervision of CBL Insurance Ltd. The report looks at the Reserve Bank’s supervisory processes in the context of CBL and recommends improvements including in relation to governance and risk management. The Reserve Bank has accepted the recommendations in the report. Around the time of the report, former directors of CBL launched a website and advertised in newspapers to present their side of the story.

Increase in FMA litigation fund

The FMA’s litigation budget will be increased by $4 million to $6 million for 2019/20 to ensure it has access to resources to bring proceedings where appropriate. See the FMA’s media statement.

Landmark decision for class actions

In September, the Court of Appeal in Ross v Southern Response ruled that two homeowners who claimed Southern Response had provided them with incomplete information about the cost of rebuilding before they settled their insurance claim could bring a class action on an “opt out” basis.

This means that instead of requiring other claimants wanting to be involved in the action to “opt-in”, the homeowners could bring their proceedings on behalf of them (approximately 3000 homeowners who had also settled in the same manner) without having to obtain their consent first. This “opt-out” order applies only however during the first stage of the proceedings (related to liability) and not to the second stage (related to compensation).

MinterEllisonRuddWatts’ article Court of Appeal opts-out of “opt-in” for class actions notes that “this is the first order of its kind in New Zealand and is likely to make class actions easier to commence and will likely result in larger damages claims.”

Law Commission review of class actions and litigation funding

The Government announced in June that the Law Commission will reactivate its review into the rules relating to class actions and litigation funding (originally started in 2017).

The report Growing New Zealand’s Capital Markets 2029 refers to the review and makes the following recommendation in relation to class actions: “Market participants have noted that the balance in Australia appears to have tilted too far in the direction of imposing liability on issuers and their directors. As such, we suggest the New Zealand Law Commission not to go down the same track as the Australian regime in relation to shareholder actions. In our view, a more appropriate balance would be served by an ‘opt in’ regime for class actions, rather than the current ‘opt out’ approach taken by Australia.”
Trust to pay $500,000 to whistleblower trustee

A former trustee of the Te Kōhanga Trust Board has been awarded $500,000 for his legal costs after being unlawfully removed after he made allegations to Ministers about Trust Board members and the trust’s commercial arm, Te Pātaka Ōhanga. The Trust Board removed the trustee on the basis he had brought the trust into disrepute. In substantive proceedings in 2018, the High Court found that there was no factual foundation for the board to assert the Trust had been brought into disrepute and therefore the board could not justify its decision to remove the trustee. The trustee was also entitled to payment by the Trust of the honorarium he would have received but for his unlawful removal, from the date of his removal to the date of the 2018 judgment.

FMA settles for insider trading enforceable undertakings

There have been two high profile insider trading enforceable undertakings this year:

- A former director and chair of NZX listed Promisia Integrative Limited agreed to pay $75,000 and be banned for 5 years from being a director, senior manager or consultant for a listed company and to resign from all personal and family investment companies after admitting to insider trading and breaching director disclosure obligations in an *enforceable undertaking* with the FMA in August. The breaches related to information obtained while he was a director and shares acquired shortly after he left the board.

- A former CFO of VMob (now Plexure) agreed to pay $150,000 and be banned from being a director or manager of a listed company for 5 years after admitting to insider trading breaches in an *enforceable undertaking* with the FMA in April. He also entered a guilty plea to one representative charge for a breach of disclosure obligations. The breaches occurred in relation to the purchase of VMob shares just before the company announced it had been awarded a major contract.

Prosecutions for bullying under Australian H&S law

South Australia has had its first convictions for workplace bullying under health and safety legislation (similar to New Zealand’s legislation) in relation to an incident where an apprentice of an electrical company had a flammable liquid squirted on him and was set alight. Two employees of the company were convicted (on the charge that they had engaged in conduct that exposed an individual to a risk of death or serious injury or illness) and fined (one employee was fined $21,000 and the other $12,000). The employer has also been charged in connection with the incident.
Governance issues and developments

- Ngā mea waiwai o te tūranga whakataka, The essentials of being a director
- Directors’ Fees Report 2019
- Executive pay and expenses
- Scientists in the boardroom
- Cannabis debate sparked
- Cyber-resiliency
- New Zealand ranked first for corporate governance
- Blowing the whistle
- Harnessing the power of AI in New Zealand
- Top 5 risks for New Zealand
- What happened with Thomas Cook?
- UK Stewardship Code 2020
- Australian review of H&S law
Ngā mea waiwai o te tūranga whakataka

The essentials of being a director

In partnership with the FMA, we have released a te reo Māori translation of the popular guide *The essentials of being a director, Ngā mea waiwai o te tūranga whakataka*. It covers key directorship matters such as:

- due diligence before taking up a directorship
- working with other board members and management
- decision making
- conflicts of interest
- solvency
- signing off financials
- what happens if things go wrong.

Directors’ Fees Report 2019

The 2019 IoD Directors’ Fees Report, released in August, highlights that directors are spending more time on board responsibilities. The number of hours worked by non-executive directors has increased 10% since last year to 140 hours per board. Other results include:

- non-executive directors, who made up 61.7% of the report’s voluntary participants, had a median fee increase of 3.0% since last year
- non-executive chairs, who made up 21.9% of the report’s participants, had a median fee increase of 2.5%
- the largest median fee industry movement (+10.8%) was within the information, media and telecommunications industry. The lowest (-4.8%) was within the construction industry.

The report is produced in collaboration with EY and includes information about 2,027 directorships, covering 803 members and 1,393 organisations.
Executive pay and expenses

The pay and allowances CEOs receive and the board’s role in effectively overseeing expense claim disclosures received significant attention early this year. Executive pay and allowances remain a major governance issue globally, including issues relating to the size of executive packages, the use of company assets, inconsistent alignment between executive pay and company performance, and pay disparity between executives and employees. Our April DirectorsBrief On the Money? Board accountability for executive pay and expenses focuses on the board’s role in overseeing executive pay and expenses and provides best practice guidance for New Zealand directors.

Scientists in the boardroom

As organisations and society face increased uncertainty and complexity, the breadth of issues that directors are having to consider is expanding to new territory. With simultaneous complex challenges on the horizon, boards need to ensure that they have the right information and diverse perspectives to operate at their best when making decisions.

In our November 2019 DirectorsBrief Scientists in the boardroom: enhancing evidence-based decision making, prepared in collaboration with the Royal Society Te Apārangi, we look at the skillsets that scientists bring to the boardroom and how boards can improve decision-making through greater use of evidence.

Cannabis debate sparked

The debate on legalising recreational cannabis will be lit up in the coming months as the referendum at the 2020 election draws closer. The Government has announced that the referendum will take place following the release of draft legislation detailing how the regime would work. The vote is intended to be binding and it will consist of a “Yes/No” question based on the draft legislation which will include:

- a minimum age of 20 to use and purchase recreational cannabis
- regulations and commercial supply controls
- limited home-growing options
- a public education programme
- stakeholder engagement

The draft legislation is expected to be made public between March and June 2020.

Boards and their organisations are already dealing with the issues of drugs and alcohol in the workplace and many have policies in place to address such matters. Canada, Uruguay and some states in the United States have legalised the recreational use of marijuana. Some of the issues encountered by employers are set out in Marsh’s article Marijuana Goes Mainstream: Challenges for Employers.

As the global cannabis industry progresses at a rapid pace the first Responsible Cannabis Framework has been released at the 2nd annual World Cannabis Congress. The 45 member organisations of the Global Cannabis Partnership have agreed to the Framework’s four guiding principles of responsibility, collaboration, transparency and continuous improvement.
Cyber-resiliency

Despite the trend and potential consequences of a cyberattack or incident, the 2019 Director Sentiment Survey found only 50% of boards (down from 58%) regularly discuss cyber risk and are confident their company has the capacity to respond to a cyberattack or incident. Only 41% said that their boards were getting comprehensive reporting from management about data risks and incidents (down from 47% in 2018).

Cyber-resilience in FMA-regulated financial services

The FMA has published a report summarising the findings of its thematic review of Cyber-resiliency in FMA-regulated Financial Services. The report identifies areas for improvement and provides guidance and key recommendations for market participants including:

• making use of CERT NZ
• including cyber-risk as part of a wider risk assessment programme – both for their own firm and on a broader global level
• using a recognised cybersecurity framework to help manage cyber-resilience
• having an appropriate balance between protection and detection measures
• board and senior management must have ownership and visibility of the cyber-resilience framework.

See also the IoD’s Cybersecurity fundamentals for boards and MMC’s Cyber handbook 2020 report.

New Zealand ranked first for corporate governance

The World Economic Forum Global Competitiveness Report 2019 has ranked New Zealand 1st out of 141 countries for its corporate governance and macroeconomic stability; and 2nd for transparency. New Zealand ranked 19th overall. The measures for corporate governance cover the strength of auditing and accounting standards, conflict of interest regulation and shareholder governance. The 2017 version of the report ranked New Zealand 1st for the efficacy of corporate boards, the last time this measure was reported.

Blowing the whistle

There have been a number of high-profile whistleblowing incidents in New Zealand this year including by board members. Our 2019 Director Sentiment Survey revealed that only 35% of directors discussed whistleblowing and how to make speak-up provisions more effective in the last 12 months (down from 44% in 2018). The Government is currently reviewing the Protected Disclosures Act 2000 to ensure it is fit-for-purpose and meets international best practice standards.

For resources on whistleblowing, see:

• the Ombudsman’s guidance (2019)
• Clean as a Whistle – A five-step Guide to Better Whistleblowing Policy and Practice in Business and Government, a joint 3 year Australian and New Zealand study (2019)
• our 2018 DirectorsBrief Whistleblowing, Speak Up culture and the board.
Harnessing the power of AI in New Zealand

The AI Forum of New Zealand has published *Towards Our Intelligent Future – An AI Roadmap for New Zealand*. The report builds upon previous work with the aim of informing the national conversation on AI and providing a more action-oriented, practical guide for New Zealand.

Top 5 risks for New Zealand

The World Economic Forum’s Regional Risks for Doing Business 2019 report released in October offers a business perspective on the impact of global risks and how they are experienced in each region. New Zealand’s top 5 risks are:

1. Natural catastrophes
2. Cyberattacks
3. Failure of critical infrastructure
4. Failure of urban planning
5. Extreme weather events

What happened with Thomas Cook?

In October, the Business, Energy and Industrial Strategy Committee of the UK House of Commons initiated an inquiry into the collapse of travel company Thomas Cook. The inquiry focuses on issues regarding stewardship of the company, executive remuneration, accounting practices and the role of auditors. Former directors and executives of the company have appeared before the Committee and a report is due later this year.

UK Stewardship Code 2020

The new UK Stewardship Code 2020 establishes stewardship standards for asset owners and asset managers, and for service providers that support them. The Code, which replaces the 2012 version, comprises a set of ‘apply and explain’ principles.

Australian review of H&S law

The introduction of a new industrial manslaughter offence has become a topic for discussion following SafeWork Australia’s Review of the model work health and safety laws. The report makes a number of recommendations including increasing penalty levels, prohibiting insurance for fines (already in New Zealand law) and introducing a new industrial manslaughter offence providing for “gross negligence causing death”. The first charge of industrial manslaughter in Queensland was recently laid against a company accused of negligently causing the death of a worker. The directors of the company have been charged with reckless conduct and face fines of up to $600,000 each or up to five years imprisonment. In New Zealand, the Minister of Justice has previously raised the possibility of introducing a corporate manslaughter offence.