ASIC

Australian Securities & Investments Commission

AN UPDATE ON ASIC'S PRIORITIES FOR 2007/2008 AND HOW THESE RELATE TO AICD MEMBERS

Paper presented by

Tony D'Aloisio

Chairman

Australian Securities and Investments Commission

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Thank you for the invitation to speak to you and, Mark Carmichael, thank you for your kind introduction.

I took on the role of ASIC Chairman on 13 May this year, some 6½ months ago. This was preceded by a short stint as Commissioner following my departure from ASX. Now, why did I take the role? It's always interesting to reflect on such a question. Indeed, in order to get to know the inner workings of ASIC, I have met separately with all 54 ASIC teams over the course of a few months (1500 staff in all). At a number of those meetings, I was asked the question of why I took the role on.

And, on at least 2 occasions (which reflects the open culture at ASIC which is good) the question was put rather starkly – given the payout you received when you departed from ASX, why on earth would you come to ASIC?

As can often happen the answer to this question was really put well by someone else. In fact, by my general physician during a yearly check up. Quite unsolicited (as he prodded and probed my body in places I'll leave to your imagination and I might add, he was impressed that my blood pressure was normal and not affected by the stress of the role) he said you are really well qualified for the role. Your background in law and financial markets really sets you up well for ASIC Chairman.

The unsolicited comment resonated with me. I feel that my experience and skills will hopefully enable me to add some value to ASIC's work. And I chose to accept the role for the opportunity to see if I could add value.

Having taken the job of Chairman, I thought there would be a period of settling myself in … taking some time to evaluate, you know that sort of thing particularly as our predecessor Jeffrey Lucy was staying on as a Commissioner. That was not to be. ASIC had a Senate Estimates appearance (Senate Estimates is the Parliamentary oversight committee) on 30 May and, if a first appearance for a new Chairman did not have enough excitement (read for that "anxiety"), we had in mid May the failure of ACR which had been preceded by the failure of Fincorp and sometime earlier than that Westpoint. Investors stood to lose substantial amounts.

You can expect that around that mid May period, I was wondering whether, instead of Chairman, I should have chosen the beach and vineyard option!

It is at times like that, however, when you appreciate the strength and quality of people in an organisation such as ASIC. While ASIC had its share of criticism, the way we pulled together as a team to respond was very gratifying for a new Chairman.

We drew together the work which ASIC had been doing and were able to go to Senate Estimates with a plan – the "3 Point Plan" as it has been referred in order to deal with the property related failures. We set out a plan over 12 months which had 3 elements – deal with the existing debenture issue, new issues and past problems. Fairly straightforward.

We said, if after 12 months, the plan was not likely to work we would seek assistance with possible legislation. We do not, however, see the need to resort to legislation now (or hopefully at all as legislation inevitably adds to business costs). We considered that we needed to first test the existing disclosure regime to its limits.

Six months or so into the plan, we have taken all the major steps outlined in the plan:

(a) For existing and new issues of debentures:

- A new disclosure regime on an "if not, why not" basis is in place (RG69).

- A new draft advertising guide has been circulated.

- Investor research is well under way to come up with "investor education" programs for retail investors.

(b) In relation to the past property failures, we have investigation teams examining the behaviour of those involved. Importantly, for Westpoint investors, we are now using our s50 ASIC Act powers, to see if we can recover compensation for them over and above what they may get out of the liquidations.

Our team handling the work is and will continue over the next 4 to 5 months, meet with all existing issuers of debentures and work through how the new regime will apply to them. The focus will be on assistance and working through some of the difficult issues.

We will, around May 2008, produce a report of the outcomes of the 3 Point Plan – well within (we believe) the 12 months we set ourselves.

In carrying out this work, we are, of course, assisting retail investors make more informed choices – using existing law, for example, for better disclosure. In the end, however, investing capital has and will always carry risks. The market recognises and accepts that there will be failures. That is the nature of our free enterprise system. When failures occur, ASIC is not and can never be a guarantor of last resort. We do not want investors to forget that when they are making risk/reward choices.

<u>The Six Priorities</u>

Now, at Senate Estimates on 30 May, we also outlined 6 priorities … notice how things go in 3's for me. 3 Point Plan and 6 priorities!

The role of Chairman of ASIC is very much a CEO role. It is a full time executive role and in Government agency terms, the Chairman is the CEO. It may seem odd that one person occupies both roles (CEO and Chairman) and yet good Corporate Governance for you (members of AICD) requires a separation of those roles. However, when analysed more closely, checks and balances are in place through the decision making process of ASIC (i.e. decisions need to be Commission decisions and there are at present 3 other full time Commissioners).

Also, ASIC has Parliamentary oversight bodies such a Parliamentary Joint Committee and, Senate Estimates. There are important checks and balances.

Being a CEO type role, when I took on the role of Chairman we felt that it was important to outline early on in my term, what we would focus on. Hence the 6 priorities at Senate Estimates.

ASIC is a complex organisation. It has many functions. We can, however, encapsulate what it does and it is this; it plays an important role in both the Real Economy (economy for goods and services) and in the Financial Economy (capital and financial markets).

It would not surprise you therefore that the 6 priorities relate to these two economies. Two of the priorities in the Real Economy. Three in the Financial Economy. The sixth is across both – a strategic review of ASIC.

Let me expand on these priorities with a brief update on where we are on them.

When we look at the Real Economy, ASIC performs a number of functions around the 'corporation' the central legal infrastructure to our free enterprise system. ASIC registers and deregisters corporations. It licences a range of people like auditors, financial services licensees and so on.

Central to these functions is efficiency and costs to business. The 2 priorities we have set in the Real Economy are aimed at making a contribution to the "red tape" debate. To improve efficiency and reduce costs in a tangible and measurable way. We have set ourselves objectives around improving operational effectiveness and service levels and making better use of our technology for the benefit of our stakeholders (e.g. some 1.6 million companies registered with us).

It is useful to focus on some examples to illustrate these benefits (i.e. what we are delivering):

- We are making it easier for companies to meet their compliance obligations by expanding our electronic document lodgement services. About 60% of all documents received by ASIC are now lodged online.

- ASIC has also developed a web-based software application to further streamline common transactions. Last year, 80% of these e-enabled documents were lodged electronically.

- Our e-charges (i.e. charges over company assets) project commenced on 1 July this year and has delivered an electronic registration and payment service for the 170,000 charge forms received and processed by ASIC annually. Benefits for business include reduced time to prepare documents, the removal of the need to post forms or lodge documents over the counter and payment electronically rather than by cheque.

Our broader vision with these priorities is to leverage technology in a way which simplifies and improves processes which enhance services to our stakeholders, particularly small to medium businesses.
We feel that with these initiatives we can deliver measurable and tangible benefits. Taken individually, these measures produce small or incremental savings and efficiencies. Cumulatively, however they will add up to significant savings for business particularly small to medium business and, just as important, will add to improved service levels and efficiency.

ASIC's priorities (as I said earlier) extend to the Financial Economy as well. Here we outlined three priorities.

First, the growth in direct retail investment has increased significantly and we are seeing more sophisticated products aimed at retail investors. The retail investor has become, with the increase in personal wealth, a significant sector in our financial markets.

A special team, under the leadership of our deputy chairman, Jeremy Cooper (who is well known to you), is examining the risks for the retail investor and will respond with projects to help address these risks and to develop a more investment-wise retail sector, with better access to quality advice and better equipped to protect their wealth. I will be making a more detailed statement on the work of this taskforce at the FPA Conference in Sydney this week.

Secondly, for all investors, ASIC will continue to maintain and improve confidence and integrity in Australia's capital markets. While we have had some successes in deterring insider trading and market manipulation, we feel we can improve.

A special team has been established to determine what additional actions ASIC, in cooperation with ASX, can take in the areas of continuous disclosure, market manipulation and insider trading.

This team is headed by ASIC's new commissioner, Belinda Gibson, and will cover both exchange-traded products and the over-the-counter market. Belinda is well suited to this role with her mergers and acquisitions and corporate law background. She is senior and experienced.

Thirdly, ASIC is looking at ways where it can facilitate the inward and outward flow of capital. ASIC will seek to ensure there are only the necessary minimum roadblocks to investment flows, commensurate with adequate protection.

Closer international cooperation is in Australia's interest with the increasing globalisation of capital markets.

An example of this increased cooperation is the audit oversight arrangements between ASIC and the Public Company Accounting Oversight Board in the United States.

This will deliver a joint audit inspection process for companies operating in both jurisdictions between ASIC and the US regulator. This first joint review is in progress.

In June, the Securities and Exchange Commission in the United States indicated it would develop proposals for mutual recognition. Treasury and ASIC have had preliminary discussions with their US counterparts about the SEC's plans. Mutual recognition could permit Australian financial service providers to offer services concerning Australian products to US investors. Similarly US service providers could provide the products into Australia. For example, brokers could invest directly into the US and US brokers could invest directly into Australia (ie, because compliance with one would be seen as adequate to operate in both jurisdictions).

These priorities (two in the 'real economy' and three in the 'financial economy') are complimented by a sixth, and most important, priority; an overall review of ASIC's strategies to identify areas where we need to improve.

The review is being conducted within the existing legislative framework and is looking at where ASIC needs to be in three to five years. In other words, looking out to where the pressures may come from – as our markets continue to evolve.

A key feature of this strategic review will be an extensive survey of external stakeholders to help us assess what we do well and where we need to do better. A new strategy unit within ASIC has been created with a new Executive Director (Malcolm Rodgers) and a newly appointed Chief Economist Alex Erskine.

We are well advanced. Our objective is to deliver results by May so that we can include changes into our financial year 2008/09 plan.

Our approach with these six priorities is similar to approaches which new CEO's adopt: that is to identify the immediate priorities and get on with those and, while doing so, to conduct a review of the organisation using a 'fresh set of eyes', and to develop scorecards to measure and report on outcomes achieved.

I have, since taking office as Chairman, attended some 20 industry stakeholder meetings. I am gratified by the feedback that our priorities are the right ones and received positive feedback on our engagement through the stakeholder meetings and survey.

It is important to add that these priorities build on the good work of the Commission under the leadership of my predecessor, Jeffrey Lucy. He is an exemplary example of commitment to public service. As I recorded with Senate Estimates on 30 May, 3 achievements stand out:

- diligence in pursuing those companies and individuals who breached the law (e.g. HIH)
- laying the foundations for a more proactive ASIC in compliance (e.g. audit regulation team)
- establishing the foundation for greater international cooperation

Jeffrey's legacy is that he left the organisation in a much better state than the one he found.

Impact on You

Let me now take those priorities and what I have said to try and make them more relevant to issues you and AICD may be concerned about. What are those issues and how do they fit in those priorities?

The first of these, for the AICD, is in the area of continuous disclosure. There is a broad support that our system of continuous disclosure is the right model for Australia. The concerns which have been raised are:

- The Infringement Notice Regime. With specific concern around the complexity and time consuming nature of the regime and that the regime does not achieve its legislative purpose.[1]
- The particular operation of the continuous disclosure regime around takeovers – the application of the exemptions in Rule 3.1 of the ASX rules and companies being required to respond to market rumours.

[1] AICD Submission to the Review of the Operation of the Infringement Notice Provisions of the Corporations Act, 28 May 2007.

- The operation of the continuous disclosure regime for companies operating in jurisdictions where a similar regime does not apply. Where there is business competition when it comes to needing to strike a partnership with a foreign company, there is a concern that foreign companies may chose to partner with non Australian companies not subject to the same disclosure rules. This is particularly relevant to our mining sector.

- An overlay to the concerns on continuous disclosure is the liability for damages to persons who traded when the market has not been fully informed. There are a number of class actions on foot claiming damages. Indeed ASIC, late in 2006 agreed to accept an enforceable undertaking with a commitment to compensate some buyers of Multiplex securities in the period the market was under informed.

These issues on continuous disclosure are not just within ASIC's jurisdiction. They involve Government policy and the ASX. In the priorities which I outlined, ASIC will progress its review of these issues with industry and the ASX through the Capital Markets taskforce headed by our new Commissioner, Belinda Gibson.

As part of the process of identifying the issues we are, at the ASIC Summer School in February 2008 bringing together speakers and presenters to assist us to better understand and discuss these issues on continuous disclosure. This and other consultations will enable us to form views on whether and what changes may be needed and whether those changes are for Government or for ASX and ASIC.

The next issue which AICD has raised is to question the <u>balance between corporate liability (i.e. relying on the corporate veil) and directors (individual) liability</u>. The concern is that able and experienced women and men are shying away from the listed environment because of higher liability risks. It is argued that even if claims are not successful, the potential of reputation damage is too much risk to accept board positions.[2]

From ASIC's perspective, we have run a series of court cases where we have said that it is in the public interest to pursue directors (i.e. individual liability). Examples are HIH where we were concerned that behaviour fell short of what the law expected.[3] In OneTel, in the Greaves case, to ensure directors were across the company's financial position.[4] In Water Wheel we wanted to send the message that insolvent trading would be treated seriously and directors would be held personally liable.[5]

We recognise, however, that it may be time for a stocktake in this area of personal liability – to assess this balance between ensuring our boards take risks (so that our economy keeps growing) with protection of shareholders and creditors and consumers where individual liability may be appropriate.

Our Capital Markets taskforce will, for the Summer School in February 2008, commission a study on the current state of the law on this important issue. It will present its report at the Summer School. This will be our initial contribution on this important debate. How the debate will unfold from this will depend on the outcome of research and the debate which we hope will follow.

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[2] AICD Submission to the Review of Sanctions for Breaches of Corporate Law, 8 June 2007.
[3] ASIC Media Release MR03/217.
[4] ASIC Media Releases MR 01/441 and MR 03/099.
[5] ASIC Media Release MR00/500.

A third issue is the shareholder primacy rule (i.e. directors must act in the best interests of shareholders). There is increasing pressure for Boards to examine what's in the best interests of shareholders in the context of employees and other stakeholders. Issues such as climate change are increasing pressure on boards.

Our capital markets taskforce, to assist Boards with issues such as these, will as part of the Summer School in February 2008 convene a panel of leading directors to promote discussion on this issue, building on the work CAMAC has done in this area.

[And, if you would like to come to our Summer School, you should visit our website at www.asic.gov.au.]

Another issue is the area of conflicts of interest in management buyouts - cases such as Qantas and Alinta have provoked a lot of discussion in the past 18 months. Essentially conflicts of interest remain an area for Boards. The guidelines provided by the Takeovers Panel will assist Boards.[6]

What is pleasing here is that Boards and the market are sorting out the issues through the use of protocols. For the present, ASIC will monitor the situation and does not see the need to become actively involved.

In going through these examples, I have simply wanted to highlight that the capital markets priority will have very specific application in a number of areas which are relevant to you. This is in addition to the taskforce focusing on market manipulation and insider trading.

Each of the other 5 priorities will also have issues which will impact on you. For example, cost reduction for the priorities in the Real Economy. In the area of international flow of capital, mutual recognition may assist in dealing directly in other markets (e.g. US). Overall however, the Capital Markets taskforce is probably the most important for you.

Measuring Success

So far I have identified a number of initiatives. What may be going through your mind is what will be the outcomes of these initiatives? How will success be measured?

With a corporate, success translates into the share price and the market will sort successful strategies out from less successful ones. The measure of return to shareholders is generally understood. With a regulator, measures such as returns to shareholders' wealth are not possible. Yet the community does invest in a regulator like ASIC. Indeed, the investment is, in the case of ASIC, $280m - $300m per year.

The challenge for the regulator is to be able to demonstrate a return on this investment to the community/taxpayer. ASIC's Annual Report has a number of measures which we report against to show this value.

We will, as part of the strategic review, review and improve our measures. To see if we can more clearly show, for example, how projects such as the ones I have outlined in capital markets, will lift integrity in the markets. Or, for the real economy initiatives, how they will lower the costs of doing business.

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[6] Takeovers Panel: Guidance Note 19 *Insider Participation in Control Transactions*.

On the subject of measures, the AICD has endorsed, in its submission to the Banks inquiry[7], a set of key principles for a good regulator.[8] These were also set out in a letter to ASIC from AICD in August 2005. Those measures are, if you like, suggested benchmarks.

In thinking about what to say on measures today, I thought I would run through those AICD benchmarks to see how we have been doing against these in the last 6½ months.

Creating ownership and commitment

The first of these is creating ownership and commitment. For ASIC what we understand AICD to be saying is we should, wherever possible, let business know where we stand on specific matters. We should be transparent as to the process and status of matters between ASIC and those it regulates. We should communicate with our stakeholders what those stakeholders can expect as normal behaviour from ASIC.

There are 2 examples which, in the past 6½ months illustrate our performance against this.

- In the wake of the failures in the market for unlisted and unrated debentures (Fincorp and ACR), we announced a 3-point plan to deal with the existing debentures, new issues and past problems. We combined the expertise of industry specialists (property experts, ratings agencies, and trustees) with our own resources to prepare a consultation paper on how to improve disclosure in the unlisted, unrated debenture industry using 8 benchmarks against which issuers what report on an "if not, why not basis". We reported back the results of the submissions we received from industry, and, with the benefit of our own resources, outside expertise, and industry's viewpoints we developed a policy response in the form of RG69.

- We recognised that the application by both AXE and Liquidnet to operate markets for trading in securities listed on the ASX would be significant development in Australian securities markets. The applications raised policy issues that our regulatory regime had not dealt with before. While we prepared a consultation paper to take to the market, we also sought an economic assessment of the issues by CRA International. Both documents were exposed for comment and we have recently published a further consultation paper setting out the submissions we have received in response to our original consultation paper.

Relating these examples to the benchmark, we have been clear and communicated with our stakeholders and been transparent.

Setting appropriate requirements

The AICD has noted that regulators unnecessarily add "layers of 'red tape' over and above the actual legislative or regulatory requirements".

[7] Taskforce on Reducing the Regulatory Burden on Business, Chaired by Gary Banks.
[8] AICD Submission to the Taskforce on Reducing the Regulatory Burden on Business, 25 November 2005. The key principles were based on *Grey Letter Law*, Report of the Commonwealth Interdepartmental Committee on Quasi-regulation, 1997.

An example of where we are removing, or reducing layers of, 'red tape' is with our documents. On 5 July 2007, we launched our regulatory document consolidation program. It harmonised the various forms of policy documents ASIC produces to create clearer, simpler documents, with fewer manifestations (statements, guides, practice notes, information releases etc). Our new type of document "the regulatory guide" consolidated 14 types of policy documents. A good clear examples of removing layers and red tape.

Another example is our e-charges (i.e. charges over company assets) project, which commenced on 1 July this year. I provided details of these earlier.

So, a couple of examples on how we are meeting this benchmark.

<u>Understanding the Industry and minimising costs to industry and consumers</u>

AICD says that a regulator needs to understand the nature of the business they regulate. This may be achieved through good consultation, better training of staff, and working groups.

On that, in the last 6½ months we have established a good record:

- Started an external stakeholder survey of all our stakeholders as part of the strategic review;

- Participated 20 industry stakeholder meetings;

- Set the principles of a secondment program to bring more external expertise into ASIC;

- appointed Chief Economist (Alex Erskine) and research unit to assist us to better understand our markets;

- And, in competition for market services (the applications of AXE and Liquidnet), we recognised that the significance of the issue was such that an external economic expert needed to be brought in.

<u>Monitoring and reviewing arrangements</u>

The AICD suggest that good practice for regulators involves regular and thorough reviews of regulation (and its enforcement). These reviews should occur as part of an ongoing external consultation process. Part of this process involves understanding the gaps and duplications between regulators.

Again we are doing a number of things to meet this benchmark. By way of example:

- We released on 4 October 2007 a discussion paper with APRA proposing a system for online breach reporting for entities like banks and insurance companies that are regulated by both organisations. The purpose of which is to remove duplications of process between APRA and ASIC.
- We have set up regular consultation processes between ASIC and APRA and ASIC and ATO.

So at least against these 4 AICD benchmarks we are delivering. I recognise, however, that what I have given are examples and we need to do more detailed work across the whole of ASIC.

Measures

We will, as part of our strategic review, focus more closely on benchmarking and reporting against them. On measures let me make 2 other comments:

- **First**, the AICD's benchmarks are one stakeholder's benchmarks. We have many stakeholders such as other industry brokers, consumer brokers and Government. Not all their benchmarks will be consistent.

- **Secondly**, when we go back to the core functions of ASIC which I outlined earlier – in the Real Economy and in the Financial Economy, the performance measures for the Real Economy are likely to be around operational effectiveness and stakeholder service and cost reduction for business. For the Financial Economy, the measure are going to be very much around what we contribute to integrity of our markets and the protection of investors.

What do I mean by these two comments? They illustrate the need for us to develop benchmarks more clearly around our priorities and report against those as well as reporting against those suggested by industry groups.

The important point is ASIC's commitment to delivering outcomes and subjecting itself to being measured.

Conclusion

Let me conclude … You can see from what I have said that it has been a busy 6½ months. When it is all boiled down, however, it has been a time of laying the foundations. There is more work to do to achieve meaningful outcomes from the priorities outlined.

It is pleasing that against our own benchmarks and against benchmarks such as the ones AICD has set we are doing reasonably well although it is early days for the 6 priorities and we are in good economic markets.

I also recognise that a lot of what I have outlined is about what we are going to do. I am happy to come back next year and report to you on what we have set as our benchmarks, how they relate to AICD's benchmarks, and what we have achieved against both.

Thank you.