FSR, CLERP 9 and surveillance programs: ASIC priorities over the next 12 months

An address by

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Thank you for inviting me to speak to you today.

I will discuss ASIC's priorities generally and how we set those priorities.

Apart from our ongoing activities in enforcement, consumer protection and policy development, today, I intend to pay particular attention to:

- the work we have done and that which remains to be done in relation to FSR Act implementation;
- the numerous tasks surrounding the CLERP 9 reform program; and
- our various surveillance and monitoring activities in identified areas of regulatory and consumer risk.

The background to all of these activities of ours is one of constant and continuous change. You have seen that the evolution of financial and corporate regulation in Australia over the last decade has been rapid and dramatic. Reform – legislative, common law, self-regulatory, industry-driven – seems to have been constant and will certainly not stop or really even pause in 2004. But that reform has been necessary, simply to try and keep pace (if indeed it has done that), with the growth and evolution of the markets in Australia that rely on effective regulation.

International influences on our markets are significant, diverse and constant: for example, the indirect impact that a US law such as the *Sarbanes-Oxley Act* can have on us, the implications of the introduction of international accounting standards in 2005, the growth and development of regulatory regimes in many of the Southeast Asian economies – all these are factors that combine with myriad others to make it imperative that Australia, its laws and its regulatory system keep pace with the rest of world, and stay in the forefront if we possibly can. Developments in Australia must reflect, complement – and lead if we can – developments overseas, if we are to maintain our place at international forums and our credibility as a destination for investment.

Our market has been growing apace. In just the last 13 years, since ASIC (and its predecessor, the Australian Securities Commission) began operating, the growth of Australia's markets and financial services industry has been rapid and sustained. The financial services industry has grown more than 60 per cent in that time and now employs well over 350,000 people. Simultaneously, access to our markets has been made far easier, resulting in a substantial increase in the level of participation, and in particular, rapidly growing consumer involvement.

For example - a statistic that may be familiar to many of you - nearly one in two Australian adults now directly own shares, which is the highest proportion in the world. We rank ahead of the US, UK, Canada, Germany and New Zealand in both direct and indirect share ownership. Similarly to the US, where the involvement of so many "moms and pops" contributes greatly to the liquidity of their market, our market profile is increasingly skewed towards retail investors. This is markedly different from Europe, where the market profile remains predominantly institutional. In Australia, millions of new investors are proving eager to help fund their own retirement. Three out of four working Australians invest in superannuation. Over five million Australians use financial advisers.

This growth in market size and coverage inevitably also means that many investors are participating for the first time in financial markets that they may not entirely or adequately understand. Many of these new financial services consumers are relatively inexperienced, yet they are buying a wider and far more complicated range of products and services than was ever available before. The expansion of the financial services industry has also increased the number and impact of fringe operators: and consumers have been caught out, many losing their life savings and now depending on public pensions.

Increased responsibilities for ASIC

ASIC's core responsibilities, as set out in the opening sections of the ASIC Act, have always been wide-ranging and impressively worded. As well as enforcing the law (a large and crucial part of our mandate) ASIC is to receive, process, store and make available information given to it by companies, promote the confident and informed participation of investors and consumers in the financial system, and – perhaps the key responsibility (and not accidentally, the first mentioned in the Act): maintain, facilitate and improve the performance of the financial system and the entities within it, in the interests of commercial certainly, reducing business costs and the efficiency and development of the economy. I quote these words from the ASIC Act today to remind you of the foundation upon which the Government builds, each time it adds to our responsibilities or refines them.

The growth in the size of our market, in its complexity and the level of participation per head of population has had enormous ramifications for ASIC, with a new ‘wave' of responsibility seemingly breaking over us every couple of years.

Back in 1998 there was the new managed investments legislation, which required a whole new system of licensing operators of managed investment schemes, and the registration of an ever-expanding range of managed investment products. Indeed, the number of registered schemes has risen more than nine times since 1991.

In addition, in July of 1998, Parliament hugely extended our responsibilities so that we were responsible for protecting consumers in superannuation, life and general insurance and deposit taking. This meant that for the first time, some sectors of industry felt an effective regulatory presence. Law reform has continued apace in the years since then, with the Government adding to and refining our responsibilities.

Most recently, the Government enacted the Financial Services Reform Act, which commenced on 11 March 2002 and has just reached the end of its two-year transition period. The FSR Act has simplified how consumers use financial services, but has further increased ASIC's regulatory reach, in licensing a larger number of participants and in supervising markets. I will return to the FSR Act and our priorities in a post-transition environment in a few moments.

The Government has of course also continued to shore up and strengthen Australia's financial architecture with its ongoing series of so-called CLERP (Corporate Law Economic Reform Program) reforms; and I will also return later to a consideration of the implications for us of the latest Bill in this series, CLERP 9.

So, as you see from that extremely brief traverse of the changing legislative landscape over the last few years, ASIC has been faced in that time with enormous increases in its jurisdiction and regulatory reach, as well as in the size, complexity, diversity and sophistication of the markets it regulates.

In that environment, what should our priorities be? Well, in a sense our first and absolute priority must always be the ability to swiftly and accurately prioritise. That may sound odd, but with such a vast jurisdiction and growing market, we need to always retain an acute sense of where the risks are in the market; we must be able to quickly identify them, resource those areas, and make our responses swift, effective and lasting.

When setting our priorities we also understand that flexibility is important; that is, an ability to shift our focus quickly, not only to address the issues that emerge from different points in the economic cycle (which each generate different types of transactions, for example, from floats and fundraising, to mergers and acquisitions – both friendly and hostile - to financial reporting problems, to insolvency) but to allow us to readily move our resources to areas where we *anticipate* risk and potential regulatory exposure.

Greater expectations of regulators

Setting priorities and responding to risks is made even more challenging for an organization like ASIC by the increased weight of expectation on regulators, not just in Australia but worldwide.

As you know in recent years there has been ever greater pressure internationally on standards of corporate governance, audit and disclosure, with consequent scrutiny of the reactions and performance of regulators and law enforcement agencies whose task it is to encourage, facilitate, enforce and police compliance with these standards.

We also have increased political, public, industry and business expectations, that we will respond quickly when misconduct is detected; but also that we will prevent the misconduct – or at least minimise it - as well as punish.

The collapses or difficulties of entities like HIH, Enron, Worldcom and Parmalat have moved regulatory issues higher up on the public agenda, particularly as they relate to disclosure and audit. Reform of standards, standard setting and regulatory structures are under active public discussion, here and in many other countries.

Quite appropriately, the public demands a proper accounting for major corporate collapses such as these; and this in many cases involves not just the regulator and receivers or liquidators cleaning up after the mess is made, but also the legislature and industry resetting the standards and tightening the rules so that the same mess cannot be made again, or at least not with the same ease.

Such ‘clean-ups’ in various industries or sectors can and often do also involve a degree of self-regulatory input; but self-regulation by itself cannot, I think, deliver on the high expectations about protection of their interests and their money that consumers and investors now have, and which I think they are entitled to have.

I think most of the companies and people we regulate want effective, responsive and consultative regulation that maintains Australia's competitiveness and relevance in a global market. They watch our performance closely, particularly now, in the post-FSR environment. They expect regulators such as (but not only) ASIC to know where the risks are, and if the regulators cannot eliminate the risks, they expect at the very least to be told about those risks, or have them minimised by the removal of habitual fraudsters.

So one of our fundamental priorities is to be able to recognise and measure regulatory risks, and respond to them by the efficient allocation of resources.

I will talk more in a moment about some of the specific risks we have identified for the current year and the priorities that these have dictated for us; but before I do, let me reflect briefly on one of our overriding priorities for the last two years: the transition to the FSR regime.

Transition to the FSR regime

It will be no surprise to you that managing the transition to the FSR Act regime has been an absolute priority for a large percentage of ASIC's staff since March of 2002.

With the introduction of the FSR regime Parliament in effect set new standards in particular parts of the financial services industry, so that the entire sector is now subject to broadly consistent regulation. FSR gave the financial sector a harmonized licensing, disclosure and conduct framework, and a single regime for financial product disclosure. It gave consumers streamlined and simplified access to a range of financial services. But from a regulatory perspective its introduction was a massive undertaking – it substantially increased both our jurisdictional reach and our workload.

The FSR regime has meant a much larger pool of industry participants requiring licences and ASIC supervision. Over the two-year transitional period just ended, we licensed or re-licensed thousands of financial system participants, dealt with hundreds of applications for relief from the law and answered thousands of enquiries by phone and by way of our Frequently Asked Questions on the ASIC website. We also issued and varied a large number of Policy Statements, Information Releases and other guidance, to ensure the new law can deliver in a way that is not too burdensome on business.

But now that March 11 has come and gone, and we are committed to the FSR regime, we can pause a little, draw breath and turn our minds to some new priorities.

Some of these, but not all, will inevitably still concern the bedding down of the FSR regime. We certainly expect that new regime to result in improved standards - of advice, conduct and disclosure, as well as complaints handling - otherwise the huge changes and efforts required by the reform process will not have been worth it for the parties involved.

Firstly, we will continue to consult with industry and consumer groups over the next 12 months, and where required will give further guidance and relief.

But one of our immediate major priorities will be what we are calling, in a shorthand way, the FSR 'wrap-up'.

This will involve, firstly, identifying all those in the industry who are carrying on business but have not transitioned, did not become licensed or do not hold authorizations from licence holders (and once identified, taking targeted action addressing unlicensed activity); and secondly, checking what systems and procedures financial services licensees actually have in place against what they said at the time they applied for their licenses. In effect we will be continuing the licence verification surveillance activity that we have already begun, but on a larger scale.

Our initial approach will be to give priority to activities where consumers' funds are most likely to be at risk. As our risk identification processes become more precise and reliable, we will visit those entities that we regard as being high risk in terms of consumer impact more frequently and more intensively; and will make follow-up visits to ensure that improvements have been made.

In addition, our campaign work in this upcoming year will involve more of a balance between product manufacturers and distribution arms, whereas traditionally we have focused only on the issuers. It will probably come as little surprise to you that ‘good advice’ will be a theme of most campaigns.

However, we will also have other priorities this year that are not directly related to the FSR legislation; and clearly one of these is the implementation of the reform package that we know as CLERP 9.

Responses to concerns about governance and disclosure

The CLERP 9 package has emerged as at least a partial solution (in Australia) to the disquiet about governance and disclosure issues that has characterized the last few years, both here and internationally.

After some years of perhaps complacency and even cynicism, corporate governance again became a topic of some international interest as a result of a series of corporate failures of a magnitude not seen for some years. Before those recent high-profile collapses (Enron, Worldcom, HIH, One.Tel, etc) it might be argued that the business community was becoming a little wearied by the concept of corporate governance, seeing it as somewhat irrelevant, even passé: a 1990's response to the wave of corporate collapses that had characterised the 1980's.

In Australia, some years of sustained economic growth and our remarkable survival of the financial crisis in Asia had also perhaps contributed to the complacency. Over time, corporate governance became more process-driven, compliance focused and institutionalised - driven by legalistic liability management rather than by any true notion of investor wealth creation and protection.

But then, along with the new millennium came the new wave of large-scale corporate scandals, which reminded everyone that governance is a serious matter, with implications and consequences that are too important to be the subject only of lip service or rubbery principles with no real teeth.

I am not, incidentally, suggesting that there has been a systemic collapse of good governance in this country, or that there are endemic problems. But events in the US in the last five years surely must have taught us that we can never again become complacent about our market environment.

Proper corporate governance cannot be a fad, or a mantra to be invoked when potential liability needs to be managed. It is a necessary component of any sound and developed economic system. Even more than that - there is a real and positive correlation emerging between good corporate governance and the growth performance of public companies.

One of the foundations of good governance is the provision of adequate, timely and reliable information about corporate performance. This is the responsibility of those who direct and control the corporation, and of the experts brought in under the law as independent judges – that is, the auditors.

So, while over the last few years quite a notable gap had opened up between what the market required in terms of effective disclosure, and what company boards and auditors were delivering, there are now steps being taken to bridge that gap - in many jurisdictions.

It was clear from an examination of the circumstances of some of the corporate failures I mentioned that not all those in charge of companies or responsible for their financial reporting had fully embraced the culture of continuous disclosure; and it was recognized internationally that both the legislature and the regulators needed to make a greater impact in this area.

The US responded by adopting what some are calling a quite rigid and prescriptive approach to corporate governance: in July 2002 President Bush signed into law the *Sarbanes-Oxley Act*, introducing reforms relating primarily to corporate disclosure and auditor independence.

Here in Australia we have, of course, CLERP 9: in full, the *Corporate Law Reform Economic Reform Program (Audit Reform and Corporate Disclosure) Bill* - the latest plank in our Government's ongoing rebuilding of Australia's financial architecture.

It is fair to say that the US legislation contains far more in the way of specific rules for specific situations than our approach does – that it delves into levels of particularity that are rarely ventured into by our own Parliamentary draftsmen. (For example, where in Australia the law reform proposed in CLERP 9 contains a general independence test for auditors, in the US the law prohibiting provision of non-audit services by auditors contains a list of specific preclusions.)

The Australian approach – in CLERP 9 and more generally in our approach to corporate law reform over the last few years – is based on principles and is dependent more on – arguably - flexible concepts such as eg. materiality or reasonableness.

Some would say that having a list of principles only, as opposed to specific and enforceable rules, is not enough. Indeed, I recently had the pleasure of hearing Commissioner Roel Campos of the US SEC speak at ASIC's 2004 Summer School in Brisbane, and he made the point – perhaps unsurprisingly – that he sees clear danger in having too many principles without specific rules, and that if you do that, you risk ending up with 'marshmallow' – that is, principles that are open to misinterpretation and very difficult to enforce.

However, I understand that the US is moving to review its position to also include, alongside its specific rules, an underlying set of principles by way of a safety net; and that these principles would in fact 'trump' the rules should the two conflict, or be in any way inconsistent.

There is an interesting debate to be had about whether the current US rules-based approach is the right or even the best one. It could be argued that having numerous specific instances of prohibited conduct inevitably leaves open the possibility of some specifics being omitted; or that it drives market participants to devise avoidance behaviour and look for or create loopholes. This can be solved, of course, to an extent by having a general safety net as well.

In any event, in a sense we are now beyond the stage of public debate in Australia – we have a Bill that is progressing through Parliament. ASIC's job will be to administer it effectively and efficiently from Day 1.

The CLERP 9 Bill

Tabled in Parliament in December 2003, and passed by the House of Representatives on 16 February this year, the CLERP 9 Bill was formally introduced in the Senate on 1 March. Further debate in the Senate will await the outcome of the Parliamentary Joint Committee inquiry into the provisions of the Bill. The Committee has begun its public hearings this month and will continue into April.

As you know, the Bill is a response to recommendations in the Ramsay Report about the independence of Australian company auditors, and also takes account of some of the recommendations made in the report of the Joint Committee of Public Accounts and Audit (Report 39: Review of Independent Auditing by Registered Company Auditors). The Bill also incorporates recommendations from both the HIH and Cole Royal Commissions. It does not, however, as I noted earlier, follow the strict rules-based approach of *Sarbanes-Oxley.*

We at ASIC welcome its introduction, as it strengthens the law in the areas of corporate governance, disclosure and regulation of audit and financial reporting. It promotes transparency, accountability and shareholder participation. In doing so it addresses one of our core responsibilities under the ASIC Act, which I referred to earlier: market confidence.

We face a tremendous administrative task in preparing to implement the Bill in the time between now and its intended start date – assumed to be 1 July 2004 – and we are working very hard to develop policy and processes so that we are ready as of Day 1, as we have to be.

Before turning in more detail to some of the provisions that may be of most interest to you, I will briefly remind you of the most important measures contained in the Bill.

Paraphrasing and very much in summary, CLERP 9:

- expands the role of the Financial Reporting Council, and among other things makes the Council responsible for the oversight of the AUASB;

- gives audit standards made by the AUASB the force of law;

- strengthens standards for auditor independence, including by requiring rotation of auditors of listed companies after five years;

- enhances the operational capacity of the Companies Auditors and Liquidators Board;

- establishes a Financial Reporting Panel to deal with disputes between ASIC and companies over the application of accounting standards to financial reports and whether the financial statements give a true and fair view;

- provides greater protection for those who report suspected breaches of the law to ASIC;

- strengthens the obligations of auditors to report breaches of the law to ASIC;

- allows auditors to incorporate;

- enhances disclosure and accountability to shareholders, including on executive and director remuneration;

- increases the penalty for breaches of the continuous disclosure provisions, as well as other financial services penalties;

- allows ASIC to issue infringement notices containing a financial penalty for relatively minor contraventions of continuous disclosure obligations; and

- introduces a new duty for financial services licensees to manage conflicts of interest.

As you know, public confidence in levels of corporate disclosure, and in particular perhaps the audit process, has been dramatically undermined after One.Tel, HIH, Enron – and more recently, NAB. That confidence needs restoring, and CLERP 9 is a step in that direction.

Auditors in particular have always faced the dilemma of trying to reconcile a commercial service provider/client relationship with the responsibility of a watchdog or a 'contracted regulator' of corporate financial reporting. The two roles conflict and are not equally supported - all the commercial incentives support the service provider role, and very little if anything has supported the public responsibility role. CLERP 9 tries to redress the balance a little, in supporting the public responsibility or ‘watchdog’ aspect of auditing. In that sense, it should make it easier for auditors to do their job well.

You will be aware of the view expressed in some quarters that in fact, auditors ought not be just ‘watchdogs’, but in fact should be closer to 'bloodhounds' – a term which clearly calls for greater vigilance and an even more robust attitude to the job at hand and the entity being audited. I would say that there is, in fact, now a clear market expectation to this effect - that is, that auditors are bloodhounds not just watchdogs. Simply put, the market expects auditors to pick up instances of fraud. It expects auditors to take the initiative where they discern something amiss; to find and reveal what is hidden. That expectation has, if anything, increased over recent years.

I should note that when the CLERP Bill was read in the Lower House for the second and third time, the Federal Opposition signaled that they may be moving a number of amendments to the Bill in the Senate. Interestingly, these potential amendments (which I will refer to in a moment) go more to what is *not* currently in the Bill, rather than any debate about what *is* in it; in other words, they reflect a desire to add further provisions to strengthen the Bill rather than remove or dilute any existing provisions.

This may reflect the fact that the current version of the Bill is, as you know, already the end result of enormous and exhaustive consultation on the part of the Government draftsmen. It may also acknowledge the reality that in a dynamic and fast-moving international marketplace, Australia simply cannot afford to lag behind in any way; and that this is an opportunity for the Parliament to ensure that our laws are truly internationally credible and can respond to the high expectations about regulation that investors and consumers now have.

For example, the Bill currently introduces a mandatory cooling off period of 2 years before former partners or professional members of the audit team can become officers of that client. Labor has foreshadowed a possible amendment to this provision, extending the cooling off period to 4 years.

Labor has also foreshadowed possible amendments that would prohibit a company's auditor from providing certain non-audit services which compromise the independence of the auditor. This proposed amendment, if successful, would bring the Australian reforms more into line with the US and Canada. That is, the US already conditionally prohibits services such as: bookkeeping services related to the accounting or financial statements of the audit client, financial information systems design and implementation, appraisal or valuation services, fairness opinions, actuarial services and internal audit outsourcing services by the auditor.

On the issue of financial reporting, I understand that the Federal Opposition may also want to flag for the major accounting bodies a proposal that auditors specifically report to shareholders and to the audit committee on alternative treatments of financial information that have been discussed with management, as well as the ramifications of those treatments and the treatment that is preferred by the auditor. These would form part of the audit opinion. This proposed amendment is also based on a similar requirement in the US *Sarbanes-Oxley Act*, albeit that *Sarbanes-Oxley* requires that the report be made only to the audit committee.

Infringement notices

I want to say a few words in particular today about the so-called 'fining power' – that is, the proposals in the CLERP 9 Bill giving ASIC the ability to issue an infringement notice where we have reasonable grounds to believe that a disclosing entity has breached the continuous disclosure provisions of the Corporations Act.

The proposals have been controversial and much debated. They are designed to provide a quicker, cheaper and more flexible outcome in cases of less serious contraventions of the continuous disclosure regime, and to fill a gap in the currently available remedies, which focus far more on the consequences of more serious breaches, as well as being expensive, time-consuming and often disproportionate to the conduct.

Infringement notice schemes already operate in Australia in many areas of federal regulation including transport, communications, environmental protection, migration, quarantine, defence and customs.

The proposed power for ASIC to issue an infringement notice specifying a financial penalty is also not dissimilar to the power of the UK Listing Authority (UKLA), a division of the Financial Services Authority (FSA), to directly impose financial penalties for breach of the UK Listing Rules. The UK Listing Rules include continuous disclosure obligations, and the sanctions available for breach of the rules include private warnings, public censures, financial penalties, and suspension or cancellation of listed securities.

In deciding which form of action to take, the UKLA considers the seriousness of the breach, any profit or loss made and a poor compliance history to favour imposition of a financial penalty, whereas cooperation and confession favours a public censure. Importantly, the imposition of a financial penalty by the UKLA does not then prevent the FSA taking action under other relevant statutory powers, nor does it prevent disciplinary action being taken by relevant professional bodies.

As the CLERP 9 Bill is currently before Parliament, the proposals in it may of course still be subject to change. However, with the Bill in its current form, the consequences of ASIC issuing an infringement notice will be that:

- the entity may either ignore it completely, in which case no legal consequences flow directly; or
- it can pay the penalty, provide any information to the market operator that is required, and put the matter to rest.

Payment of the penalty will not be an admission of guilt or culpability, and no contravention will be recorded. Life will go on. Such payment will prevent the regulator from taking further enforcement action (civil or criminal, but not administrative) in relation to the alleged contravention; but would not prevent third parties (such as ASX or shareholders) taking action, although the absence of an admission would mean that the third party would have to prove that a contravention had occurred.

In cases where the infringement notice is not satisfied, it will be open to ASIC to take other enforcement action, such as civil penalty proceedings, but this is no different to the current powers that ASIC has in this area. It is also the same in other federal schemes.

If court action is commenced, the court would consider all matters afresh. However, the restrictions in the Bill relating to 'publicity' of infringement notices are very wide; and may arguably include referring to a notice in Court. Thus, while ASIC could submit evidence of the facts and matters underlying an infringement notice, it is at least arguable that, on the current drafting of the Bill, we may be precluded from mentioning the notice itself. In any event, an infringement notice would not be conclusive evidence of the matters alleged in it. (Note: by contrast, under the Trade Practices Act, a competition notice issued by the Australian Competition and Consumer

Commission (ACCC) is accepted as prima facie evidence of the matters alleged.)
As you may be aware from a recent Parliamentary Committee hearing, one area where there appears to be some controversy is the timing of any publicity associated with an infringement notice. Another aspect that has been publicly debated is the manner in which ASIC will decide that an infringement notice should be issued.

We have already publicly stated that we will be releasing in a few months guidelines on how we will issue infringement notices. The debate that has been occurring since the proposal was first floated has been useful and instructive for us in deciding how best to sensibly give effect to the Parliament's intention in relation to this remedy.

ASIC implementation of CLERP 9

ASIC's CLERP 9 implementation work generally is now in full swing – we are establishing policies, processes and systems to make sure we are ready for the assumed start date of 1 July.

Early last month we released a major framework document, called *Building the CLERP 9 administrative framework; policy to implement the CLERP (Audit Reform and Corporate Disclosure) Bill 2003; an ASIC Guide.* This document set out our approach to the CLERP 9 Bill, and explained how we will develop our administrative policy and processes for implementation.

We have identified several topics that seem to require ASIC policy and process and guidelines (such as infringement notices, which I referred to a few moments ago), and we propose to deal with these topics in separate publications that will together form a complete package. I will briefly give you an idea of what we are concentrating on in relation to each topic.

Some of the most important issues we are currently examining in relation to **audit and financial reporting** are:

- the registration process for auditors and audit companies under the new regime;

- our approach to approving auditor qualifications or experience as being equivalent to those required under the Act;

- when we might approve a competency standard for auditors;

- when we might extend the period for lodgment of annual statements by an auditor;

- what are adequate and appropriate PI insurance arrangements for audit companies; and

- what will be the ongoing registration requirements for auditors.

In relation to **disclosure**, we are looking at:

- how the 'clear, concise and effective' disclosure obligation will apply to prospectuses and other disclosure documents;

- how we will administer the transaction-specific product disclosure statement requirements; and

- what relief we will give from the provisions requiring disclosure for the secondary sale of securities and other financial products.

In relation to **licensee obligations**, we are looking at:

- how we will administer the obligation for AFS licensees to have in place adequate arrangements to manage conflicts of interest; and

- what specific guidance we can give to providers of research reports about managing conflicts of interest.

Finally, as I noted earlier, in the area of **continuous disclosure**, we are considering what guidance we can give about our processes for issuing infringement notices for breaches of the continuous disclosure requirements.

We expect to have policy proposals ready and released about most of the topics above by late March, with the final policies to be issued by June.

There are some exceptions to this timetable, firstly, our policy proposal paper on insurance requirements for authorized audit companies, which we expect to issue in May, to allow a report on the topic to be prepared by external consultants; but we will hold informal discussions with key stakeholders about the issues before May.

Secondly, our guide on the administration of the infringement notice regime, including how hearings will be conducted and notices issued, will be released in April or May.

In addition, as the auditor rotation obligation (whereby rotation is required after five years, or up to seven where relief has been granted by ASIC) applies only to financial years commencing on or after 1 July 2006, we do not plan to commence our policy work until 2005.

We have already issued, in October 2003, a policy proposal paper on conflicts management by financial services licensees, in which we say that in order to meet the conflicts management obligation, we expect them to:

- control, disclose and avoid conflicts of interest; and
- have measures, processes and procedures to identify conflicts, assess and evaluate them, appropriately respond to them and ensure that

regardless of any conflicts, the quality of financial services they provide is not significantly compromised.

Responding to regulatory risk

So – against a background where FSR has just recently been introduced and we are continuing to work to ensure it is bedded down, and where CLERP 9 is almost upon us and we are making sure we are ready, what other priorities could ASIC have this year?

In short - as I adverted to earlier - our priorities will be wherever the risks are. We will turn our attention to those practices, those products, those industry sectors where we currently perceive there to be the greatest risks for consumers and investors.

We have a dedicated risk analysis unit which monitors and prioritises issues in the external environment that impact on ASIC and the markets we regulate.

Among other things, we consider external issues such as – and these are a sample only – economic pressures, global developments, competition, jurisdictional scope and gaps, growth in consumer credit, new product innovations, demographic changes, international and local regulatory reforms, and cycles in fundraising and takeover activity.

We use this information and subsequent risk analysis to set our work priorities and plan our regulatory responses accordingly.

One of our work priorities is always, as I have said earlier, the effective introduction and administration of new legislation – be it FSRA, CLERP 9, or any other major piece of reform, such as the introduction of international accounting standards.

Other priorities tend often to be either industry-specific (eg. we might focus on issues we have identified in the superannuation industry, which I will touch upon further in a moment) or conduct-specific (eg. improving disclosure and transparency generally, or looking at insolvent trading).

Surveillance programs

One of our major regulatory tools, once we have identified a risk area, is surveillance. This means, in short, monitoring of compliance by financial system participants; and it becomes particularly important where the laws and regulations to be complied with have been recently reformed or are even entirely new to sectors of an industry.

Our goal is to influence the behaviour of – ideally – all participants in the financial system, and so reduce the incidence of unlawful activity. To do this, we have to maintain an effective compliance monitoring presence in all key industry sectors: superannuation, life insurance, general insurance, managed investments and securities. So we look at, for example, the disclosure of information to investors right across the spectrum – IPOs, continuous disclosure, auditing, whatever it may be.

Our monitoring and surveillance activities can be broadly categorised as responses to notifications of breaches, detailed reviews of disclosure documents, and compliance visits and campaigns, which might examine various aspects of, for example, licence holders' compliance procedures and activities.

But, we are inevitably and necessarily selective as to where we devote the most resources. We develop and tailor our surveillance programs in response to risk areas, and we have adopted a strategy of tackling patterns of misconduct, not just individual cases.

For example, we might – as we have done in a recent year – review a couple of hundred or so companies in a particular sector such as high technology or 'dot.com' businesses, and ask them where required to clarify their financial reporting and disclosure.

Turning now to a couple of specific priority areas – superannuation, a topic of relevance to (at least) every employed Australian, and financial reporting, a topic of relevance to (at least) the audience in this room.

Superannuation

You will not be surprised to hear that superannuation is one of the areas we are targeting. I noted at the outset that consumers are every year more actively participating in the financial markets in Australia – and the funds flowing into superannuation represent a large part of this increased participation.

The Investment and Financial Services Association's (IFSA) website tells us that Australia's funds management industry manages more than $691 billion for over nine million Australian investors, in superannuation and managed investments (unit trusts) and life insurance products. This ranks Australia as the fourth largest funds management market in the world.

According to the Australian Prudential Regulation Authority's (APRA) statistics, in September 2003 there were over 250,000 separate superannuation entities in Australia, managing nearly $550 billion in assets on behalf of over 25 million member accounts. In January last year, Treasury estimated the following growth projections: $1.0 trillion by June 2012, $1.2 trillion by June 2015 and $1.6 trillion by June 2020. And while consolidation across corporate, industry, public sector and retail superannuation has resulted in a decline in the number of large funds in recent years, the numbers of small funds have grown. Superannuation is also an area where consumer and investor expectations about the safety and protection of their money are at their highest.

So we will be turning our attention to the superannuation industry, and the quality of advice. Addressing risks in these areas is critical, given the level of funds involved, the coverage across the population, and the rate at which that level is increasing.

Over the next six to twelve months we want to look systemically at the issue of advice and consider what the long-term structure might be for the industry, particularly given the possible implementation of choice legislation or at least portability of superannuation, which will again bring the competence and practices of advisors under scrutiny. We will also examine selling and disclosure practices, in particular how superannuation is sold and how fees, charges and returns are disclosed.

Financial reporting surveillance

As most of you know, for some years now, ASIC has undertaken a regular semi-annual targeted surveillance program focusing on different aspects of financial reports of listed entities. We review them in relation to specific accounting issues and for compliance with particular standards.

Thus we have, for example, in recent memory turned our attention to areas of accounting abuse of the types uncovered in a number of high profile cases in the US; that is, deferred expenses, recognition of revenue and recognition of controlled entities and assets. These areas of focus change each year.

You may recall that in December of last year, we released the Stage 1 results of our most recent financial reporting surveillance project, whereby we reviewed the audited full-year financial reports of about 400 listed companies with balance dates between 30 June and 31 July 2003, for their general compliance with accounting standards, and undertook a review of more than 1000 listed Australian entities to check their compliance with section 300A disclosure obligations (relating to the value of options issued to directors and senior executives) and the accounting policy applied by corporate sponsors of defined benefit superannuation plans to actuarial deficits in those superannuation funds.

That surveillance project has resulted – so far – in a number of matters being referred for further investigation, 22 orders made prohibiting companies from using a short form prospectus, and 21 cases where additional information was disclosed about s300A option valuations.

However, encouragingly, the review did not reveal any significant systemic weaknesses in accounting disclosure. Most of the concerns we had related to issues where the application of accounting standards is less prescriptive (for example the valuation of non-current assets, and the appropriateness of audit report qualifications).

We are currently considering what areas we will concentrate on in our upcoming financial reporting surveillance projects. We will review another 400 or so companies for general compliance with all accounting standards, but we will also make some decisions about, for example, our responses to compliance with some new accounting standards (eg. AASB 1046 on Remuneration; possibly ED 129, disclosing the impact of the transition to international accounting standards).

Our planning and priorities in this regard will also be influenced by the adoption in Australia of International Accounting Standards for the years after 1 January 2005. Some of these differ quite markedly from current Australian standards, and we will be taking into account the impact of these changes, as well as the requirements to prepare comparative information by those applying the international requirements for the first time, when deciding on our surveillance priorities for the coming years.

Conclusion

So – as I have tried to illustrate for you today, to an extent our priorities are set for us, by a market that is growing and changing apace and a government that is assiduously reforming the law to keep up with that pace.

FSRA and CLERP 9 implementation – or indeed any such reform programs - are imperatives we cannot ignore or postpone, and our other priorities are then set by what the market, and our own risk analysis, tells us is putting – or can potentially put - consumers and investors most at risk.

I referred earlier to the talk that Commissioner Roel Campos of the US SEC gave at ASIC's 2004 Summer School in Brisbane last month. Commissioner Campos said that in his view investment in a liquid market (like the US) was a privilege, not a right; and that if one wanted to participate in a market like that, one had to play by its rules.

I would like to think we do not flatter ourselves too much if we say that, despite our smaller size, participation in the Australian market is also a privilege, not a right, and that the almost continuous law reform that we are experiencing will indeed improve, tighten up and clarify the rules by which our market participants can operate.

In any event, one of ASIC's jobs is to ensure that all those who need to understand those rules can do so; another is to use all the tools at our disposal to identify and deal with those who bend or break those rules. As ever, this will leave us with no shortage of work to do.

Thank you for your attention today.