# What ASIC expects of directors

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***CHECK AGAINST DELIVERY***

## Introduction

Thank you, Lindsay, for that introduction, and the Australian Institute of Company Directors (AICD), for inviting me to speak to so many of our corporate leaders today.

Today, I would like to discuss four topics:

- ASIC's role and the environment in which we operate
- our expectations of directors
- overseas developments in corporate governance, and
- ASIC's deregulatory agenda.

Afterwards, I understand Lindsay will be facilitating a Q&A session.

## ASIC and our environment

Moving on to our first topic – ASIC and our environment.

We are living in a time of rapid innovation and change, and this is only likely to increase. Change brings opportunity, but it also brings risk.

For example, in our financial services and markets:

- Market-based financing is seen as a key source of funding economic growth in the coming decades.
- The growth of superannuation, digitisation of the economy and globalisation are also driving changes – creating new opportunities and risks for business and regulators alike.

All businesses must be alive to the opportunity change brings. Evolution is necessary for survival.

As Alan Kohler commented in an article over the weekend 'disruptions' to business are inevitable and many 'old' businesses will die. However, not all 'disruptions' succeed. Kohler uses a number of interesting examples to illustrate his point.

### Tesla and Better Place

Shai Agassi's electric car charging business, Better Place, was meant to be the first big disruptor to the motor industry. However, the business failed to take off, and filed for bankruptcy in 2013.

On the other hand, Tesla is disrupting the motor industry with its unique battery technology. Its share price has gone from US$18 to around US$230.

### iTunes

iTunes is an example of how a disruptor can become the one being disrupted. Kholer pointed out that iTunes disrupted the music industry and now digital music services like Spotify and Pandora are disrupting iTunes.

Innovation is constant and management must be both astute and responsive in adapting to future developments. At the end of the day, your company's success rests on your shoulders and the direction in which you take it.

## ASIC's challenges

In this age of innovation, the key external challenges I see for ASIC are:

- balancing free markets and investor protection with a particular focus on de-regulation
- structural change in our financial system through the growth of market-based financing and super;
- financial innovation-driven complexity in products, markets and technology, and
- globalisation.

While these are all challenges – they also present opportunities to fund economic growth. We need to continue working together to harvest the opportunities while mitigating the risks.

So how does ASIC carry out our role in the face of these challenges?

### Our people and our work

People work at ASIC for good reason. Our work makes a positive difference to the well-being of Australians.

Our fundamental objective is to allow markets to allocate capital efficiently to fund the real economy and, in turn, economic growth. This contributes to improved standards of living for all Australians.

We do this through our strategic priorities of:

- confident and informed investors and financial consumers
- fair, orderly and transparent markets, and
- efficient registration and licensing for those that participate in our markets.

In achieving our strategic objectives, a key aspect of what we do is identifying and dealing with those that break the law.

We do this to the best of our ability through our ‘detect, understand and respond’ approach. Let me unpack each of these.

We ‘detect’ misconduct by gathering intelligence through:

- surveillance
- breach reporting, and
- reports from whistleblowers.

We ‘understand’ by analysing the intelligence we receive.

And, depending on our resources and powers, we ‘respond’ by:

- educating investors
- providing guidance to gatekeepers
- disrupting harmful behaviour
- taking enforcement action, which can be;
  - punitive
  - protective
  - preservative
  - compensatory
  - corrective, and/or
  - a negotiated outcome, and
- providing policy advice to Government.

We do the best we can with our resources and powers to catch those who break the law. For those who intentionally break it – we will do all that we can to ensure that the ramifications are severe.

Of course, the vast majority of you here today comply with the law and have nothing to worry about. As gatekeepers in our financial system, directors – such as many of you in this room – play an important role in helping to ensure that markets function correctly and investors are confident and informed.

## Our expectations of directors

So, what does ASIC expect of directors?

On this topic, I would like to talk about:

- the role of directors as gatekeepers, and

- director liability.

## Gatekeepers generally

Many aspects of our corporate, financial services and markets law are self-executing – relying on gatekeepers, such as directors, to comply with their regulatory obligations.

To maintain investor confidence and fair, orderly and transparent markets, it is important that we monitor gatekeeper conduct closely. If a gatekeeper fails in their role, it can have serious consequences for investors and our market. This is why we hold gatekeepers – including directors – to account. This has and will continue to be an ongoing area of focus for ASIC.

## Directors as gatekeepers

Directors should ensure that their company has strong internal audit and compliance functions. A compliance function is meaningless if it is not backed up by supervision and review, and reflected in the company's culture.

It is this last point, culture, that I consider is the most important.

Directors should ensure that their stewardship drives the right compliance culture in their organisation.

Both ASIC and directors have oversight roles. We must detect, understand and respond to the conduct we see:

- for ASIC, it is in the financial services and markets we regulate, and
- for directors, it is in the companies they are fiduciaries to.

It is not only ASIC that looks to directors to act as gatekeepers. Shareholders and institutional investors have expectations about the role of directors, including their role in shaping and policing corporate governance practices.

In 2011, ASIC won a big case in the Federal Court against former directors of the property company Centro. The case provided valuable principles, which I think can be applied to all public company directors.

These lessons are:

- *Scepticism*: Directors must question the information provided to them. There is no defence for wilful blindness.
- *Accounting knowledge*: Directors are expected to have financial literacy and basic accounting knowledge. That is, be able to read a balance sheet and profit and loss statement.

- *Accountability and control*: It is up to directors to ensure the executive has systems, protocols and controls to ensure sound corporate governance. It is about having the right level of effective risk management.

I would like to add a fourth principle to this list. It is something I mentioned earlier – culture.

A director's stewardship should drive a culture of compliance within the company. If we find that a company's culture is lacking, it is a red flag that there may be broader regulatory problems in the company. This means we are more likely to investigate and gather intelligence on that organisation.

## Director liability

I know that director liability is a topic of keen interest to the AICD and its members. Directors have a range of obligations under the Corporations Act, including:

- general duties
- specific obligations
- and even liability if a director is involved in the contravention of another person.

The consequences for breaching a provision in the Corporations Act (*Corporations Act 2001)* are diverse, including:

- fines
- disqualification from being a director, and
- imprisonment.

On top of this, there is the reputational damage that accompanies a finding of wrong doing.

It is also worth mentioning that the Corporations Act has very few strict liability offences for directors. This means that for enforcement action to be commenced – even in civil penalty proceedings – there must generally be a failing of either:

- honesty
- due care
- diligence, or
- proper purpose.

Whether a director has failed in their duties will depend on the circumstances. This includes the economic climate at the relevant time.

In carrying out our own responsibilities, ASIC is mindful of ensuring that our approach to director liability is not affected by knee-jerk reactions to a tough economic climate.

The economy is cyclical and tough economic times are often followed by a period of prosperity.

## Overseas developments on corporate governance

My third topic is overseas developments relating to corporate governance.

This is something that has received a renewed global focus in the aftermath of the GFC. In fact, it was the area of focus at the industry roundtable of the International Organization of Securities Commissions (IOSCO) Board meeting in Madrid earlier this month.

There have been many reports into corporate governance failures and recommendations for improvements. In particular, the focus so far has been more on the implementation of good corporate governance, particularly by financial institutions.

Key areas of focus for improving the implementation of corporate governance are in the areas of culture and risk governance.

### Culture

Culture has been a recurring theme in my speech today.

Effective corporate governance relies on both:

- ‘hard’ structural elements – such as specific legal obligations, and
- ‘soft’ behavioural factors driven by directors and management faithfully performing their duty of care to the company.

Directors should also ensure that their stewardship drives the right compliance culture in their organisation. They should also go beyond what the law requires.

As the David Jones share trading incident highlighted – perception matters. We suggest applying a ‘front page’ test to proposed share trading

### Risk governance

The 2013 review, commissioned by the Organisation for Economic Co-operation and Development (OECD), on risk management and governance in financial services firms found that the cost of risk-management failures is often underestimated. This includes the estimate of management time needed to rectify a failure.

We consider that corporate governance arrangements should ensure that risks are understood, managed and, where appropriate, communicated.

It is also essential that corporate governance arrangements – particularly for listed companies – emphasise the need to proactively identify risks. Risk governance standards can help – they can be specified in formal procedures that are supervised, reviewed and reflected in an organisations culture.

## ASIC's deregulatory agenda

My fourth and final topic for today is ASIC's deregulatory agenda.

Consistent with the Federal Government's focus on removing unnecessary regulation, ASIC has committed to cutting red tape and reducing compliance costs for individuals and companies.

We will do this provided it does not undermine our strategic priorities of ensuring investors and financial consumers are confident and informed, and markets are fair, orderly and transparent.

Cutting red tape is also consistent with our mandate under the ASIC Act, which includes business facilitation. In fact, we spend a lot of time and resources facilitating business every year. For example, in 2013 we granted 52 class orders and received over 2,700 individual applications for relief. Around 85% of the individual applications received were approved.

We aim to cut red tape through both our business-as-usual work and specific deregulatory initiatives. The outcome of all of this work will be reduced regulatory burden and compliance costs for business. That is, the companies you are directors for can conduct business more efficiently.

## Conclusion

Let me conclude by saying that as directors your actions affect more than just the companies you act for and their shareholders. You are integral gatekeepers in our financial system and, through the proper performance of your role, you help ensure that:

- investors are confident and informed, and
- our markets are fair, orderly and transparent.

This is important in helping to ensure that markets work to fund the real economy and, in turn, economic growth and wellbeing.

From your position at the head of your company, you set the direction and are vital to driving a culture of compliance in your organisation. Such a culture is beneficial for companies, markets and the community as a whole. After all, we all benefit from economic growth.

Thank you.