


ASIC

Australian Securities & Investments Commission

# Monitoring the activities of companies in Australia

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***CHECK AGAINST DELIVERY***

## Introduction

Thank you to the Australian Mining Association for the invitation to speak to you this afternoon on ASIC's role in monitoring the activities of companies operating in Australia.

Today, I'd like to discuss four topics:

- ASIC's approach to regulation of companies
- our recent observations with respect to emerging market companies
- the importance of good corporate governance, and
- the role of gatekeepers.

## ASIC's approach

ASIC is Australia's corporate, market and financial services regulator.

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.

Markets cannot achieve their purpose if investors, financial consumers and companies do not have trust and confidence in them.

We are committed to ensuring that investors and financial consumers can have trust and confidence in the integrity of our markets, and we do this by:

- assessing whether our financial markets are operating with integrity
- analysing whether participants in those markets are acting efficiently, honestly and fairly, and
- taking action to detect wrongdoing, to understand the nature of it and to respond to it – for example, by stopping the wrongdoing or punishing the people involved.

### Legal and regulatory framework

A large portion of our work is carried out under the *Corporations Act 2001* (Corporations Act), which covers companies at every point – from cradle to grave, from incorporation to winding up.

To prioritise and manage the risks and misconduct that we identify, we need to make the best use of our resources and the powers provided by the

Corporations Act, *Australian Securities and Investments Commission Act 2001* and Australian law in general.

Globalisation – and the increase in integration, competition and complexity of the global financial system – brings with it new issues for our financial markets, and ASIC is committed to ensuring that our regulatory framework can deal with the technical changes and innovations that arise.

Our regulatory framework allows us to detect, understand and respond to misconduct and market issues.

We undertake rigorous analysis of the market and review market issues thematically. Our work in identifying challenges for emerging market companies is an example of one of our thematic reviews.

## Emerging market companies

In 2013, as part of detecting and understanding our markets, we conducted a high-level review of emerging market companies in Australia.

We consider emerging market companies to be listed entities with significant operations or assets in Eastern Europe, Africa, South America, the Middle East and parts of Asia, including China.

Our review noted that not all entities listed on our major stock exchange, ASX, operate in Australia, and around one-third of ASX entities have significant operations or assets outside of Australia. Additionally, many entities listed on Australian markets have connections to emerging markets. This reflects the growth in emerging markets and the significance of mining and resources markets in our economy.

ASIC encourages cross-border activity and integration of international markets, as this can deliver significant economic benefits to Australian financial markets, investors and financial consumers and it aligns with our fundamental objective to allow markets to allocate capital efficiently. However, we are mindful that increased cross-border activity may pose new challenges and risks.

During our review, we noted that we were not alone in taking this view. For example, in 2012, the Ontario Securities Commission and the Toronto Stock Exchange undertook a review of emerging market companies and, as a result, released guidance on the risks associated with doing business in emerging markets and satisfying disclosure and governance obligations.

A particular observation from reviewing the work of overseas regulators was the use of ‘back door’ listings, or reverse mergers, to facilitate the listing of emerging market companies. This was a key area of focus for them, given

 

these arrangements were being used to facilitate listings that may not have otherwise achieved a listing through an initial public offering of the company.

ASIC's review in 2013 did not identify any areas of systemic concern in emerging market companies, but it did identify specific challenges or areas of risk that ASIC continues to monitor.

The specific areas of risk included:

- poor corporate governance and internal control and risk management systems
- being reliant on one or two key individuals located outside of Australia
- operating with complex ownership structures or contractual arrangements, which creates challenges for ensuring title and control over assets, and
- the difficulty in accessing or verifying reliable information or opinions about an overseas entity's operations and performance.

To address some of these areas of risk, ASIC suggests the following, where applicable, should be adopted by emerging market companies:

- structure the board to add value – for example, by appointing independent directors
- implement robust internal controls and risk management policies to mitigate preventable difficulties in operating in foreign jurisdictions
- adequately consider the extent of the entity's and board's legal obligations in both the Australian and their overseas market, and manage the associated risks where laws between countries are different
- address potential conflicts of interest and related party transactions – for example, by providing adequate disclosure to shareholders and seeking their approval, and
- for share offers made available to the public, ensure the disclosure used is an accurate reflection of the business undertaken by the entity and the risks associated with the business. For example, it may be particularly important that adequate verification of assets and ownership is undertaken as part of a due diligence process in preparing an offer. It is also important that emerging market companies not incorporated in Australia clearly disclose any differences in legal and regulatory requirements between Australia and the jurisdiction of incorporation, and explain the risks this may present to shareholders or investors.

Our review also identified a number of instances where emerging market companies appeared not to be sufficiently aware of their legal obligations.

 

Generally speaking, emerging market companies not incorporated in Australia are still subject to significant regulatory requirements under the ASX Listing Rules and the Corporations Act.

For those unfamiliar with these requirements, we strongly recommend you seek appropriate advice from advisers and other professional experts who will assist you in understanding and complying with your regulatory obligations.

Our expectation is that emerging market companies need to understand their Australian regulatory requirements, and tailor their compliance arrangements so that they take into account the risks and issues they face.

Since our 2013 review, Australia has also begun to see emerging market companies using the reverse merger or 'back door' process to gain Australian listings. This process may be seen as favourable by emerging market companies because requirements about having a minimum number of investors are generally already met and the process allows for the issue of capital to a controlling entity.

In the past where 'back door' listings or reverse mergers have been used we have sometimes been concerned that:

- shareholders are not complying with their substantial shareholder disclosure obligations under the Corporations Act. This obligation applies when an investor obtains an substantial interest in a company
- company auditors may not be sufficiently reviewing the work of overseas auditors and experts, and
- there may not be sufficient evaluation by directors of the competence and independence of experts or auditors.

To ensure that investors and financial consumers can have trust and confidence in the integrity of Australian markets, ASIC will continue to closely monitor these types of issues.

## Corporate governance

We consider that some of the challenges faced by emerging market companies can be mitigated by good corporate governance.

In Australia and overseas, there has been an increased focus on corporate governance in recent years.

Corporate governance practices and expectations will always evolve, and it is important for capital markets and society more generally that there is continuing discussion about what good corporate governance means. However, the fundamental concepts of good governance – such as integrity,

transparency, accountability and acting for proper purpose – will always remain. This is because it is not only regulators who are interested in how companies are governed. Investors also have basic expectations about how a company should be governed and they will not invest unless those expectations are met.

Good governance practices are not like legal obligations set by governments, but they do go hand in hand with fulfilling legal obligations and are central to achieving trust and confidence in our markets.

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.

ASIC encourages directors not to regard corporate governance as a mere compliance or 'box ticking' exercise. Rather, good governance should be part of a director's mindset when discharging his or her functions. In short, directors and gatekeepers should ensure that their stewardship drives the right governance practices and compliance culture in their organisation.

## The role of gatekeepers

Many aspects of our corporate, financial services and market laws are self-executing, relying on people we refer to as 'gatekeepers' – such as directors, auditors and other professional experts – to comply with their regulatory obligations.

Gatekeepers perform an important role in promoting market integrity and maintaining investor confidence, and we expect directors to discharge their duties diligently and in accordance with the Corporations Act.

Under the Corporations Act, directors are entitled to delegate to others; however, a director is also required to take a diligent and intelligent interest in the available information, to understand that information, and to ask questions about it if needed.

It is a director's responsibility to ensure that any advice obtained and relied upon is provided by someone who is suitably qualified, has an appropriate level of expertise and knowledge, and that the advice they give is unbiased and objective.

To ensure directors of emerging market companies fulfil these responsibilities, ASIC will continue to closely monitor gatekeeper conduct and when we detect misconduct, depending on our resources and powers, we may respond by:

- disrupting harmful conduct
- taking enforcement action
- educating investors
- providing guidance to gatekeepers, and
- providing policy advice to Government about possible changes to the law.

## In closing

ASIC's view is that our markets are currently in good shape and are well regarded at home and abroad. We are committed to ensuring that investors and financial consumers can have trust and confidence in the integrity of our markets. We look to companies and corporate advisers to ensure that when they conduct business within Australia they do so in a way that will comply with Australian law and support market integrity, transparency, and accountability.