Essential legal and regulatory update

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Introduction

Thank you for inviting me to speak at today's update.

I think you will all agree that we're experiencing a time of rapid change, with innovation and disruption reshaping almost every industry.

With that in mind, I'll begin today looking to the future, outlining ASIC's focus for the year ahead and how we're evolving to face our challenges. I'll then discuss key work from 2017 and share some thoughts on lessons to be learned.

Focus for 2018

Our focus for the year is shaped by our fundamental vision of allowing markets to fund the economy and, in turn, economic growth.

Our vision is reflected in our strategic priorities of:

- promoting investor and consumer trust and confidence
- ensuring fair and efficient markets, and
- providing efficient registration services.

We are focused on being proactive and forward-looking to achieve our goals. However, as detailed in our Corporate Plan, we see five long-term challenges. These are:

- aligning conduct in a market-based system with investor and consumer trust and confidence
- building financial capability
- digital disruption to existing business models and channels, and cyber resilience
- globalisation of financial markets, products and services, and
- structural and demographic changes.

I'll take some time to talk about each of these challenges and our strategy to address them.

Culture and conduct

It can take a long time to build investor trust and confidence and that trust and confidence can be quickly lost when misconduct happens. In times of technological change, firms that don't have a good culture risk losing their customers to firms that do. We're addressing this risk by focusing on the conduct of gatekeepers. A positive gatekeeper culture driving good conduct is central to trust and confidence and fair markets.

We're incorporating culture and incentives into risk-based surveillances. We're focusing on:

- improving financial advice quality by targeting high-risk advisers
- analysing the effectiveness of life insurance remuneration reforms
- improving consumer outcomes in the credit sector by continuing our work in areas such as mortgage broker remuneration and responsible lending practices
- reviewing disclosure practices in the superannuation and managed funds sector, and
- addressing illegal phoenix activity and other small business issues.

Poor culture often leads to poor outcomes for investors and consumers, impacts on market integrity and erodes trust and confidence. Good culture should be at the heart of industry practice, both to improve conduct and outcomes and to promote firm reputation and brand loyalty, which are vital to long-term business success. We think there are still improvements to make here, and we're committed to assisting our regulated population to foster good culture.

Building financial capability

Our second focus is improving the financial capability of investors and consumers. This is a key piece of ASIC's toolkit, complementing our regulatory activities by empowering investors and consumers to make good financial decisions. Our comprehensive financial capability program includes:

- leading the National Financial Literacy Strategy – a framework for strengthening Australians' financial capabilities

- providing impartial and trusted guidance and tools to support informed financial decision-making – predominantly through ASIC's MoneySmart website, and
- delivering ASIC's MoneySmart teaching program to support financial literacy in schools.

Building financial capability requires a long-term commitment to lay foundations for behavioural change. We'll continue to focus on building behaviours that support better financial outcomes for Australians.

Digital disruption and cyber resilience

It's been said that we're moving towards a digital future. Increasingly, financial products and services are delivered using technology, with limited human involvement. Fintechs and start-ups are seeking to disrupt the status quo by providing new products or services, or finding new ways to deliver existing ones.

To address this, we'll focus on:

- monitoring emerging technologies, business models and delivery channels in financial markets
- facilitating initiatives to improve cyber resilience
- continuing to foster innovation and help fintechs navigate the regulatory framework through our Innovation Hub, and
- engaging with the fintech community and regulators to keep abreast of market developments.

We'll continue to support the role that innovative businesses and fintechs have in reshaping financial services and markets. At the same time, we're managing the risks of new products and services to ensure investor trust and confidence is maintained.

Globalisation

Looking internationally now, it's clear that our modern financial system is global in nature. Markets are increasingly interconnected with greater cross-border activity, competition and integration. By contrast, we see increased global political and economic uncertainty and protectionist sentiment, which may lead towards fragmentation in the global system – for example, because of differences in regulatory approaches.

We're focused on fostering cross-border trade and capital flows, while managing uncertainty. Global challenges often require global solutions and global regulatory coordination is critical to prevent fragmentation from becoming a reality. We'll continue to:

- contribute to the work of international bodies like IOSCO
- support key initiatives, including the Asia Region Funds Passport and corporate collective investment vehicles

- support equivalence assessments and exchange enforcement information with international regulators
- implement bilateral and multilateral agreements, and
- prepare for changes to international financial market regulatory requirements.

Structural and demographic changes

Our final focus area is structural and demographic change. For Australia, an ageing population and increasing number of retirees is a demographic reality, and the pool of funds in superannuation continues to grow.

We're committed to addressing issues affecting older Australians when they access financial products and services, including:

- making complex financial decisions
- vulnerability to financial exploitation, and
- lacking familiarity with the technology used to deliver financial services and products.

We've established an Older Australians Coordination Group to oversee and implement ASIC's strategy to address the fundamental and strategic challenges our ageing population experiences in the financial services sector.

One ASIC

For ASIC, we are focused on strengthening our capabilities to respond to these long-term challenges.

We're committed to transforming our regulatory business by more effectively capturing, sharing and using our data. We're building an integrated platform with a single repository of internal and external regulatory information and the ability to search across this information easily. We call this 'One ASIC' and it's part of our strategy of using data to connect the dots to achieve better regulatory outcomes.

We've also established a Chief Data Office to support ASIC to be a data-driven and forward-looking regulator. For example, we're developing our predictive data analytics capabilities, piloting technology-assisted evidence reviews and using relationship pattern matching. We're also employing behavioural insights to understand how investors and consumers make decisions.

These changes coincide with the industry funding arrangements, under which those who create the need for, or benefit from, ASIC's regulation bear the costs.

Update from 2017

Now that we've covered 2018, I'd like to revisit 2017. I thought it would be timely to begin with recent work in the space of annual general meetings, before moving to our work on cyber resilience and fundraising.

Annual general meetings

AGMs are an important tool for companies and shareholders. AGMs give directors an opportunity to engage with shareholders about their company's performance and strategies. For shareholders, it's a chance to ask questions or comment on management and have a say on the company's board and corporate actions.

We recently published observations from monitoring the 2017 AGM season of ASX 200 companies in Report 564, available on our website.

Remuneration reports

Overall, the 2017 AGM season was significantly less tumultuous than the previous season. There were fewer strikes on remuneration reports in the ASX 200 this year, with only one ASX 200 company incurring a second strike. Company boards appeared to have learnt from 2016, proactively engaging with shareholders and pre-emptively reforming remuneration structures, including by reducing complexity and withholding executive bonuses.

We encourage directors to approach remuneration reporting with the objective of arming shareholders with simple, transparent and comprehensive information. A remuneration report should explain how the company's remuneration structure and policies incentivise executives to achieve the company's objectives. Where remuneration reports aren't transparent, are overly complex or don't embrace 'pay-for-performance', boards risk a rebuke from shareholders.

Shareholder engagement

In keeping with these findings, shareholder engagement was a key feature of the last AGM season. Although voting outcomes were generally consistent with the previous season, significant votes against director elections noticeably increased. Commentary suggested that shareholders were voicing dissatisfaction with company performance by holding individual directors accountable.

Shareholders also exercised their rights to requisition resolutions, principally on environmental, social and governance matters. Gender diversity on boards was a hot topic, with some large institutional investors taking a stand on companies without female board representatives.

Shareholder engagement enhances a company's long-term performance and value for all investors. We recommend that companies continue actively engaging with shareholders to understand their concerns and maintain that dialogue throughout the year. Boards should also consider and manage material and emerging risks, including environmental or sustainability risks where these may affect current or future performance.

Proxy advisers

Another topic attracting attention in 2017 was the role of proxy advisers. Proxy advisers play an important role by assisting shareholders – typically large institutional investors such as super funds – in making voting decisions and scrutinising governance practices.

This AGM season, we analysed data provided by three major proxy advisers. We observed that resolutions proxy advisers recommended voting against received a higher 'against' vote on average; however, on average the size of the 'against' vote was insufficient to alter the outcome of the resolution.

We encourage boards to engage proactively with proxy advisers as a natural extension of shareholder engagement processes. We recommend that companies reach out to proxy advisers early if they have concerns.

Cyber resilience

Cyber resilience was another focus in 2017, with increasing recognition that cyber threats are a key risk facing the financial sector. We think that cyber resilience is vital to all organisations operating in the digital economy. Because we see cyber risk as a key threat to our strategic priorities, we're seeking to assist our regulated population in their efforts to improve cyber resilience.

We recently asked over 100 financial market sector participants to self-assess their cyber resilience. The results, published on our website in Report 555, indicated that large enterprises demonstrated a high degree of cyber resilience compared to their small or medium counterparts, some of whom were only beginning to develop cyber resilience.

Companies need to implement appropriate systems and controls for managing cyber risk. We've published a set of good practices that enable organisations to operate adaptive and responsive cyber resilience processes. To assist boards in taking ownership of cyber strategy, we've identified key questions that boards should ask of their executives. Although we know that complete cyber security can't be achieved, a comprehensive and long-term commitment to cyber resilience is essential.

Investors in IPOs

In 2017, we enhanced our understanding of how investors decide to invest in initial public offerings (IPOs). We play an active role in the IPO market and we closely review a significant proportion of prospectuses. To build our understanding, we conducted qualitative research and interviews with investors to identify the information they rely on when investing in IPOs.

Our research, published in Report 540 on our website, confirmed that prospectuses are a key information source for retail and institutional investors, although some retail investors find prospectuses to be challenging documents to read. Retail investors reported that financial media were influential in both alerting them to potential investments and in guiding their decision-making; while for institutional investors, access to management was very influential.

We'll continue to review a significant proportion of prospectuses, given their importance to investors. We'll also gather information from external sources when reviewing prospectus, including investment websites, advertising and forums. We encourage those preparing prospectuses to focus on producing clear and effective disclosure.

Examples from 2017 of 'what not to do'

As outlined in our Corporate Plan, underpinning our vision for each sector we regulate is our view of 'what good looks like'. For example, we consider that 'good' public companies:

- treat investors fairly, including when undertaking fundraising or control transactions,
- are accountable to investors, by ensuring disclosure is accurate, complete and timely, and
- adopt sound corporate governance practices that support market integrity and good investor outcomes.

Show of hands voting

One example of missing the mark on 'what good looks like' is in choosing voting methods for resolutions. We identified 20 ASX 200 companies that relied on show of hands voting during the 2017 AGM season. This included instances where proxies received before the vote indicated that a remuneration report might receive a strike or that a resolution might not pass.

The Corporations Act doesn't require a resolution to be put to a poll. Many company constitutions give the chair discretion as to which voting method to use. But in making this choice, chairs should carefully consider whether circumstances exist that mean a poll should be called. Chairs have a duty imposed on them at common law to give effect to the true will of the members. Polls more democratically reflect the principle of 'one share, one vote' and ensure that the votes of all shareholders are taken into account, whether they attend the meeting or vote by proxy. We strongly encourage companies to adopt a poll on all resolutions as a matter of good corporate governance.

Financial reporting

We also noted that some companies' financial reporting in 2017 wasn't up to scratch. We reviewed the 30 June 2017 financial reports of 220 listed and other public interest entities, publishing our findings in ASIC Media Release (17-437MR). Key areas where financial reporting fell short were:

- the impairment of non-financial assets, with reliance on unrealistic assumptions in testing recoverable value
- applying inappropriate accounting treatments in areas such as revenue recognition

- the adequacy of income tax expense accounted for, and
- the quality and completeness of disclosures regarding estimation uncertainties and significant judgements in applying accounting policies.

A financial report is crucial in communicating a company's financial position and performance to shareholders and stakeholders. Directors are primarily responsible for the quality of the financial report and companies should have appropriate processes and records to support the information it contains. We're calling on companies to focus on providing useful and meaningful information for users of financial reports.

Conclusion

As I said earlier, we're experiencing a time of rapid change. Change brings both opportunities and challenges – it may challenge investor and consumer trust and confidence but it can also enhance financial wellbeing if it's well managed.

From a corporate governance perspective, the fundamentals – such as integrity, transparency, accountability and acting for a proper purpose – haven't changed. So, in facing change, we encourage directors and governance professionals to focus on these fundamentals and ensure they're acting in a way that safeguards the continued trust and confidence of investors and financial consumers.

Thank you. I look forward to the panel discussion.