

28 January 2021

Financial Regulator Assessment Authority  
The Treasury  
Langton Cres  
Parkes ACT 2600

via email: [FRAA@treasury.gov.au](mailto:FRAA@treasury.gov.au)

Dear Treasury

## **Effectiveness and capability review of the Australian Securities and Investments Commission**

Thank you for the opportunity to provide a submission to the Financial Regulator Assessment Authority (**FRAA**) to assist with its assessment of the Australian Securities and Investments Commission (**ASIC**).

The Australian Institute of Company Directors' (**AICD**) mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership reflects the diversity of Australia's director community, with 47,000 members drawn from directors and leaders of not-for-profits, large and small businesses and the government sector.

The AICD strongly supports the objectives of the FRAA's first independent effectiveness and capability review of ASIC (**Review**). We have previously participated in ASIC's periodic self-assessment reviews, the ASIC 2015 Capability Review (**2015 Capability Review**), and more recently, the Hayne Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Hayne Royal Commission**) consultation on its Interim Report.

ASIC plays an important role in Australia's overall corporate governance framework. The FRAA's Review presents a valuable opportunity to consider ASIC's overall effectiveness, and in particular, how ASIC uses its current governance and operational structure, resources and processes to carry out its strategic decision making, surveillance and licensing activities.

### **1. Executive summary**

We have concentrated our response on those areas of focus that are particularly relevant to AICD members. We note that an important element of ASIC's mandate, such as enforcement, are beyond the scope of the current review, and hence we do not offer comment on those aspects.

#### **(a) Strategic prioritisation, planning and decision making**

- The AICD considers that ASIC's mandate is clearly articulated, communicated and understood by its stakeholders. Its ability to deliver on this mandate and apply an effective framework for strategic prioritisation, planning and decision making could however be enhanced.
- ASIC's remit is extensive and appears broader than any other conduct authority globally. Its workload has only continued to expand since the Hayne Royal Commission with increased activity in corporate governance and market conduct issues. This will broaden further with the joint administration of the Financial Accountability Regime (**FAR**) and its application to all APRA

regulated entities. It is critical that ASIC's resourcing and funding increases commensurately to account for the breadth and depth of its regulatory activities, including greater investment in data and technology solutions to ensure its systems and processes are fit for purpose.

- The AICD has previously advocated for a change to ASIC's governance model. The introduction of a corporate board structure comprising a majority of non-executive, independent directors, including the existing ASIC Chair, would enable a clearer delineation between the Commission's existing executive and non-executive responsibilities.

## **(b) Surveillance**

- The AICD supports ASIC's surveillance of regulated entities and markets. It is a critical regulatory activity for ASIC and its thematic assessments into corporate governance practices of large listed entities undertaken by its Corporate Governance Taskforce provide valuable insights into the regulator's view of better practice. Learnings from these assessments are applied widely by directors in all sectors. It is important that organisations are encouraged to continue participating in thematic reviews and are not deterred by perceptions this may lead to enforcement action.
- The AICD has regular engagement with ASIC on key governance issues facing company directors. This two-way dialogue is constructive and allows learnings to be shared between our organisations with the common goal of maintaining strong corporate governance market practices. In recent times, bilateral engagement has facilitated a broad range of relief measures to assist companies navigate their governance requirements under COVID-19 pandemic conditions. We remain committed to working openly and collaboratively with ASIC.
- ASIC's financial reporting surveillance and audit inspection program helps investors and consumers have confidence in the integrity of financial reporting and disclosure in directors' reports and the Operating and Financial Review (**OFR**). However, directors and their advisors have concerns about how this program operates and is resourced. The AICD encourages consideration of recommendations to address these concerns as part of the FRAA's review.

## **2. Strategic prioritisation, planning and decision making**

The AICD considers it important that ASIC's role is well understood and the Government's expectations of the regulator clearly articulated.

Reflecting on the Government's Statement of Expectations for ASIC (August 2021), ASIC's Statement of Intent (August 2021) and ASIC's Corporate Plan 2021 – 2025, the AICD is of the view that ASIC's mandate and priorities is effectively outlined while at the same time, allowing sufficient flexibility to respond quickly to emerging issues such as the ongoing impact of COVID-19.

That said, the AICD considers there remains fundamental structural limitations facing ASIC, that if addressed, would enhance its ability to deliver on both government and community expectations.

### **(a) ASIC's remit and resourcing**

As noted in the AICD's submission to the Hayne Royal Commission on its Interim Report, ASIC's remit is extensive and appears to be unparalleled by any other conduct regulator globally, being the only authority to administer both investor and consumer protection within one agency.<sup>1</sup> ASIC not only enforces laws, it also, amongst other things, publishes a wide range of guidance material, engages in

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<sup>1</sup> AICD submission, *The Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, October 2018, available [here](#).

education and policy development, licenses financial services entities, is charged with lifting financial literacy and manages relief applications to exempt (or modify the application of) laws to entities.

In the two years since the Hayne Royal Commission, ASIC's workload has continued to grow considerably as a consequence of increased sophistication of financial products and global trends (for example, the growth of crypto-assets); superannuation growth and a broader range of non-financial risks within the purview of corporate governance (for example, environmental, social and governance (**ESG**) issues). New to ASIC's mandate is the joint administration of the FAR with the Australian Prudential Regulation Authority (**APRA**). This is a particularly significant expansion given it will apply to all APRA regulated entities.

If ASIC's remit is to remain as extensive, it is critical that resourcing – from both a financial and personnel perspective - is commensurately increased. We acknowledge that all regulatory funding is necessarily finite. To alleviate this, a key recommendation of the 2014 Murray Financial System Inquiry was to establish an industry funding model to enable ASIC greater independence and discretion to determine how its funding is used.<sup>2</sup> While this cost recovery mechanism provides greater predictability in funding, the Government continues to provide the overall funding envelope for the regulator. Resourcing should not constrain ASIC in delivering on its strategic priorities and ultimately, its mandate. Public trust in the corporate regulator requires it to be, and to be seen to be, an effective body.

We make further comments in section 3 below regarding ASIC's personnel resourcing for the purposes of its financial reporting surveillance function. However, from an operational resource allocation perspective, the AICD has heard specific concerns from directors regarding ASIC's document management and record-keeping processes. Directors report that their organisations can receive multiple requests for the same information in different formats and sometimes, by different functions of ASIC. The AICD would encourage greater investment in technology and data solutions for centralised information gathering and storage systems. This would not only aid security of sensitive information and ensure cross-departmental efficiencies, but also make it easier for business and market participants to interact with ASIC. These efficiencies will be critical, in particular, for ASIC's joint administration of the FAR with APRA.

## **(b) ASIC's governance**

The AICD has previously advocated for a change in ASIC's governance structure to improve accountability, culture and strategic oversight.<sup>3</sup>

Under its current structure, ASIC is led by a Chair who is supported by two Deputy Chairs and three Commissioners.<sup>4</sup> Uniquely, according to ASIC itself, all hold full-time regulatory (executive) and governance (non-executive) positions with ASIC, and together form the Commission. While the Commission is responsible for the exercise of ASIC's functions and powers, ASIC's strategic direction and its priorities, the Commission does not formally operate as a board of directors. External perspectives are instead provided through its external panels, which meet on a relatively infrequent basis and without any decision-making authority.

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<sup>2</sup> Financial System Inquiry: Final Report, November 2014, available [here](#).

<sup>3</sup> AICD submission, *Capability Review of the Australian Securities and Investments Commission*, September 2015, available [here](#); AICD submission, *The Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, October 2018, available [here](#).

<sup>4</sup> See <https://download.asic.gov.au/media/4wbc1j5v/asic-corporate-structure-updated-4-january-2022.pdf>.

In their regulatory role, the Commissioners perform day-to-day line management functions in relation to business activities of ASIC. In this role, they lead groups of business lines with direct reporting from executive directors to individual Commissioners, and make decisions on regulatory and/or operational matters. At the same time, in their non-executive role, the Commissioners have ultimate decision-making authority as to the strategic oversight and direction of the organisation.

We note that the 2015 Capability Review Final Report to government commented on ASIC's governance arrangements (in particular, Commissioners having both an executive and non-executive role), stating that the model results:<sup>5</sup>

*"...in a number of challenges and tensions, with the risk that it can erode the strength of internal accountability, and that it may leave insufficient time for Commissioners to focus on strategic decision making, holding executives accountable for delivery, external engagement and strategic communications. The Panel believes that a dual governance and executive line management role inherently undermines accountability."*

The Final Report further reflected:<sup>6</sup>

*"The Panel is also of the view that the volume and urgency or time sensitivity of operational matters distracts the Commission away from focusing on higher priority strategic questions and challenges, strategy development and organisation capacity and capability needs. There is likely to be a natural tendency for people in blended executive and governance roles to prioritise some of the more immediate issues and short term challenges compared with long term strategic requirements."*

Moreover, a further key finding of the 2015 Capability Review Panel identified was that ASIC's culture was variable, overly defensive, inward looking, risk averse and reactive.<sup>7</sup> In the Panel's view, this was contributed to, in part, by the internal governance arrangements which blur responsibility and accountability and limit the empowerment of staff and senior executive leaders.

ASIC did not adopt the 2015 Capability Review recommendation to realign its structure to achieve clear separation of the non-executive and executive roles.<sup>8</sup> Instead ASIC identified three initiatives: enhanced management information and performance reporting; a review of the mandate, membership, effectiveness and role of committees; and a review of Commissioners' engagement with stakeholders.

Commissioner Hayne commented on changes made to ASIC's management structure in 2019 in the Hayne Royal Commission Final Report. Specifically, Commissioner Hayne referred to the creation of a group of executive directors immediately below the Commissioners, who are to manage components of ASIC's activities and enable Commissioners to better deal with higher-level strategic issues.<sup>9</sup> Ultimately, Commissioner Hayne acknowledged it was for ASIC to decide what organisational structure would best fulfil its remit. Nevertheless, caution was urged regarding the process by which matters are elevated to the Commissioners and the quality of

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<sup>5</sup> Fit for the future: A capability review of the Australian Securities and Investments Commission, A Report to Government, December 2015, p. 61, available [here](#).

<sup>6</sup> Ibid, p. 62.

<sup>7</sup> Ibid, p. 76.

<sup>8</sup> Ibid, p. 66.

<sup>9</sup> Final Report, Royal Commission into Misconduct in the Banking Superannuation and Financial Services Industry, Volume 1, (2019), p. 444, available [here](#).

the information presented. Commissioner Hayne further noted that the new management structure would inevitably result in more matters of significance being determined by staff rather than Commissioners. Hayne was further concerned that the longer and more attenuated the chain of responsibility, the harder it would be to challenge the views that are expressed along the way.<sup>10</sup>

Commenting on ASIC's governance structures, Commissioner Hayne also observed that there was "no obvious reason" why ASIC would not benefit in the same ways that listed entities do from the inclusion of non-executive directors on their boards. However, he stopped short of such a formal recommendation, noting the "radical changes" which ASIC already had to undertake.

The AICD accepts that the current composition of the Commission provides significant knowledge and a deep understanding of the organisation. However, in our view the introduction of a board comprising a majority of non-executive, independent directors could improve performance and accountability; bring important external perspectives to the regulator; and a higher degree of executive oversight than its current arrangements.

### Comparative structures

We note that ASIC's current governance model is unlike many other conduct regulators internationally. For example, in the United Kingdom, both the Financial Conduct Authority (**FCA**)<sup>11</sup> and the Financial Reporting Council (**FRC**)<sup>12</sup> have traditional board structures comprised of a majority non-executive directors and a non-executive Chair who has no responsibility for the day-to-day running of the FCA. Similarly, the Financial Markets Authority (**FMA**) in New Zealand has a board with a majority of non-executive directors as its governing body.<sup>13</sup>

In Australia, we note there is also precedent for government agencies to have a board structure in place for its governing body. The Reserve Bank of Australia (**RBA**) has a board that comprises three ex officio members – the Chair, Deputy Chair and Secretary of the Australian Treasury – and six non-executive directors who are appointed by the Treasurer.<sup>14</sup>

### AICD recommendation

As an alternative to ASIC's existing governance structure, the AICD encourages consideration of either:

- **RBA model:** retaining some or all of the Commissioners as executive directors supplemented by a majority of practising non-executive directors with the appropriate knowledge, skills and experience to form a 'board of the Commission'. Under this model the current ASIC Chair would be the Chair of the new board. This would be consistent with the board structure of the RBA; or
- **FCA model:** establishing an independent board, separate from the Commission, comprised of the current ASIC Chair and practising non-executive directors. Under this model, Commissioners would remain on the Commission and retain their executive role with oversight of day-to-day management functions, regulatory decisions and executive

<sup>10</sup> Ibid, p. 445.

<sup>11</sup> See <https://www.fca.org.uk/about/fca-board>.

<sup>12</sup> See <https://www.frc.org.uk/about-the-frc/structure-of-the-frc/frc-board>.

<sup>13</sup> See <https://www.fma.govt.nz/about-us/governance-and-board/>.

<sup>14</sup> See <https://www.rba.gov.au/about-rba/boards/rba-board.html>.

leaders. However, the Commissioners would be separate from the non-executive governance function provided by the independent board. The current ASIC Chair would become the CEO of the regulator and a new, independent non-executive Chair would be appointed. This would be consistent with the board structure of the FCA.

The AICD considers that the addition of practising non-executive directors under either model would help introduce external perspectives and impartiality where the remainder of the Commission hold executive positions with ASIC.

We recognise that non-executive directors whether appointed to the 'Board of the Commission' (RBA model) or a wholly independent board (FCA model) will have directorships with other companies and organisations outside of their role on the ASIC board. Accordingly, conflicts of interest would need to be dealt with by any non-executive directors appointed to the ASIC board in the usual manner. That is, existing conflicts of interest would need to be declared at the commencement of their appointment and any conflict arising during their appointment being immediately declared to the Chair. Appropriate steps would then need to be taken to ensure the conflicted director is not involved in the decision-making process going forward.

### 3. Surveillance

#### (a) ASIC's thematic assessments

The AICD agrees that surveillance of regulated entities and markets is a critical regulatory activity for ASIC and supports, in particular, ASIC's thematic assessments into corporate governance practices of large listed entities. Since the Hayne Royal Commission, these assessments have been conducted into a number of key governance areas, including the governance of non-financial risk and remuneration; audit quality; financial reporting during COVID-19; and market disclosure (including climate risk disclosure by ASX listed companies).

The AICD's mission is to build the capability of our community of leaders to ensure world-class governance within Australian organisations. Consistent with this objective and our education programs for directors, ASIC's thematic assessments enable real-world insights into governance practices and the AICD regularly encourages our members to consider how they might apply these key learnings to their own organisations.

The AICD considers that ASIC's assessments are targeted, efficient and proportionate. That said, we have heard from directors and their advisors that there can be a general reticence to disclose requested information to ASIC due to concerns this may prejudice their position in any future enforcement action by ASIC. It is critical therefore that the purpose and conduct of these assessments, as a regulatory tool, are not seen to be punitive so that organisations and their officers do not take an overly defensive approach. Rather, they must remain focused on highlighting better practice and areas for improvement.

The AICD regularly engages with ASIC on governance issues facing directors. In recent times, this engagement has predominantly centred around challenges that company directors have faced, and continue to face, in the wake of the COVID-19 pandemic. ASIC has been particularly effective in recalibrating regulatory settings that accommodate continued pandemic disruption. Recent examples include relief (or 'no action' positions taken) for the convening of virtual annual general meetings (**AGMs**) and sending meeting materials electronically; extensions to deadlines for holding AGMs; and extensions to financial reporting deadlines.



Outside of pandemic-related issues, we note that ASIC has also recently conducted important work in rapidly evolving areas of governance practice such as cyber resilience; legislative whistleblower policy requirements; and climate change disclosure.

The AICD considers the two-way dialogue with ASIC assists greatly in meeting our common objectives to maintain high standards of corporate governance practices in the Australian market.

### **(b) ASIC's surveillance of financial reporting and audit inspection**

ASIC operates a [Financial Reporting Surveillance Program](#) whereby they review the annual and interim reports of ASX listed companies. The results are aggregated and [published](#) after each review. The financial reporting surveillance program is an important and legitimate part of ASIC's statutory role to maintain, facilitate and improve the performance of the financial system and entities in it as well as to promote informed participation by investors and consumers. ASIC's surveillance undoubtedly helps investors and consumers have confidence in the integrity of financial reporting and disclosure in directors' reports and the OFR.

However, directors have raised specific concerns about the financial reporting surveillance program (which apply similarly to the audit inspection program which ASIC also runs as part of its surveillance program). While the AICD agrees that these surveillance programs are an important part of ASIC's work, the following comments are aimed at making the program more effective and lifting its standing amongst the regulated population.

#### Skills, knowledge and experience of review team

Directors report concerns about ASIC's review team having access to the skills, knowledge, and experience necessary to perform this function. Accounting treatments inevitably involve estimates and fine judgments over the likelihood of future events. They are matters on which professionals can and do hold different opinions. It is possible that the opinions reached by ASIC staff may be those of professionals with less experience and knowledge than the persons within the entity or the entity's auditor. We note that this does not extend to all ASIC staff, for example, ASIC senior executives are highly regarded by directors and auditors. The challenge is the relatively limited depth of expertise within the organisation.

Directors encourage ASIC to consider the resourcing of this function, including more senior, experienced accountants and auditors to ASIC to work within the review team. This might require ASIC to review pay and team composition to ensure that it is able to attract suitably qualified candidates. This would undoubtedly assist those managing the teams to more effectively carry out their duties.

#### Lack of clear process to resolve disagreements

Relevant to the issues regarding the skills, knowledge, and experience of ASIC staff is the lack of a clear process to resolve differences of opinion between ASIC and an entity in respect of findings from the review of financial reports. As noted above, financial reporting often involves fine judgments. Where disagreements arise over the correct interpretation of accounting standards there is no clear process in place by which those disagreements can be resolved.

Directors report that the way these matters are generally resolved is through escalation to senior ASIC staff. The process of debating the interpretation of accounting standards with ASIC can be a lengthy and costly exercise for entities, with substantial risks if they are unable to resolve the matter.

It is our view that ASIC should seek to formalise a review process where there is a dispute between ASIC and an entity in respect of a finding. This might include for example, the ability for an entity to request an independent, third party assessment.

#### Reporting and publication of results

The publication of the results from the financial reporting surveillance programs fails to distinguish between major and minor reporting issues and potentially overstates problems with Australia's reporting system.

Likewise, publication of both the financial reporting surveillance program and the audit inspection program could create the perception of systemic issues which are not supported by the limited data set and review. Both surveillance programmes are undertaken on a risk basis where ASIC prioritises areas which may be 'hot topics' or where there may be a particular reason to hold concerns about the entities. In other words, ASIC's surveillance and inspection (understandably) looks in the areas where it is expected there will be problems. Consequently, the results of those programs tend to overstate the number of concerns and findings than an inspection and surveillance program taken at random.

We believe that publication of results should place a greater emphasis on the risk-based nature of the surveillance and inspection, as well as note the inability of ASIC or any other regulator to draw conclusions about the state of the financial reporting or audit market.

#### Broader thematic reviews on financial reporting and audit inspection

In the AICD's view, there is scope for the financial reporting surveillance program to be conducted in a more proportionate manner, with greater consideration of the potential effect that a negative finding can have on an entity's market position.


As advisors to reporting entities have raised with us, it could be more effective for the overall quality of corporate reporting if ASIC were to conduct broader reviews on thematic issues (similar to the abovementioned) than the very targeted and in-depth reviews on highly subjective matters.

For example, thematic reports on the accounting and reporting of taxation and uncertain tax positions; asset impairment and OFR disclosures may be more beneficial than significant staff time and resources being invested in resolving differing opinions on accounting treatments – particularly on what are ultimately relatively minor matters or which are highly subjective, complex reporting or commercial matters.

#### **4. Next steps**

We hope our submission will be of assistance to the FRAA's review. If you would like to discuss any aspects further, please contact Christian Gergis, Head of Policy, at [cgergis@aicd.com.au](mailto:cgergis@aicd.com.au), or Laura Bacon, Senior Policy Adviser, at [lbacon@aicd.com.au](mailto:lbacon@aicd.com.au).

Yours sincerely,



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