

BCA

Business Council of Australia

Assessment of the Australian Securities and Investments Commission

Submission to the Financial
Regulator Assessment Authority

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Overview

This is the submission of the Business Council of Australia to the review of the Australian Securities and Investments Commission (ASIC) by the Financial Regulator Assessment Authority (FRAA).

The BCA welcomes the opportunity to assist with the FRAA's assessment of the effectiveness and capability of ASIC. The submissions prepared by the BCA respond to some but not all of the questions raised by the FRAA, focussing on the issues of most relevance to the BCA members.

The BCA also wishes to make the following general observations concerning the effectiveness and capability of ASIC.

General observations

The BCA strongly supports the role of ASIC as a strong regulator of Australian business. It should adopt the orthodox role of a regulator within its statutory jurisdiction and a clear and consistent approach to enforcement.

ASIC's effectiveness peaked over the period of the financial crisis in 2008, when ASIC took decisive steps to steady markets. Since that time ASIC's performance has been mixed and its priorities and enforcement policies went through a period of change and uncertainty.

Approach to enforcement

ASIC's approach to enforcement has varied in many areas, for a range of reasons, over time. At one stage it became too reliant on enforceable undertakings as an "efficient" regulatory tool, which generally failed as a deterrent. It then went too far the other way, following the Financial Services Royal Commission, with its "*Why not litigate*" strategy, which caused a significant amount of resources to be dedicated to investigations and prosecutions that should have been resolved by other means, together with excessive delays in resolving matters, often many years. In some cases, it simply chose the wrong cases to prosecute – resources were expended on unsuccessful cases when a balanced approach through negotiated and enforceable undertakings would have resolved the issues.

In our view, ASIC should be able to utilise both enforceable undertakings and litigation, with a focus on proper selection of the most effective and appropriate measure in the circumstances.

ASIC has, however, continued to be effective in the enforcement of market misconduct, utilising sophisticated market surveillance tools to achieve a high level of success in insider trading prosecutions in particular.

The BCA hopes that ASIC will manage to strike a balance in its general enforcement strategy, resolving matters without litigation where appropriate but ensuring that ASIC remains effective in prosecuting criminal and other serious non-compliance.

The protection of retail investors and consumers of financial products are two areas in which ASIC was criticised by the Financial Services Royal Commission, which recommended the establishment of the FRAA as a consequence. Since that time, the Commonwealth Government has introduced a range of new legislation and regulations to better protect retail investors and consumers of financial services, including the financial product "design and distribution obligations" and new breach reporting obligations.

Involvement in policy matters

There are also areas in which ASIC, in our view, ventured beyond the role of a regulator and into areas of policy that should be the preserve of Government. By way of example, after the Royal Commission, ASIC established a "*Corporate Governance Taskforce*". The Taskforce conducted two investigations, one into management of non-financial risks and the other into executive remuneration. This project imposed a massive cost burden on about twenty large Australian enterprises (including many members of the BCA), with no obvious benefit in respect of outcomes.

The organisations that were targeted in these investigations were forced to produce a huge volume of documents at enormous expense because ASIC used its enforcement powers to compel production, when there was never any suggestion that any of those organisations had breached the law or would fail to co-operate with reasonable requests from ASIC. Failure to comply was an offence.

ASIC also retained an industrial psychologist who sat in on meetings of the participating companies. It is unclear how this was of benefit to the participants.

The Taskforce only reported on the investigation into management of non-financial risks: it did not publish a report on executive remuneration. The report on non-financial risks¹ was of limited value – it covered only seven companies; all in financial services; all of whom were regulated by the Australian Prudential Regulation Authority (APRA), which has extensive expertise in this area; and all of whom had been the subject of investigation by the Royal Commission; and all of whom had already undertaken a self-assessment of management of non-financial risks required by APRA.

The ASIC report made no findings that had not already been identified by APRA and the Royal Commission; identified no contraventions of the law; and unlike the APRA Report into the Commonwealth Bank, made no substantive recommendations.

In relation to executive remuneration, the only outcome of the review of 21 enterprises was the publication of an “information sheet”², which was of questionable value, particularly when compared to the process that APRA has undertaken to prepare and issue its remuneration standard.³

Finally, we believe it would be helpful to have a simplified and clarified structure for ASIC and the subsequent cultural change to allow it to have a clearer and more consistent approach to its role as a regulator.

Responses to the FRAA review questions

Assessment of the effectiveness and capability of ASIC’s strategic prioritisation, planning and decision making

Question 1: Does ASIC have a clear and effective framework for setting strategic priorities and making decisions consistent with those strategic priorities?

When viewed from outside the organisation, ASIC appears to have an effective framework for setting strategic priorities, through the annual publication of a four-year “ASIC Corporate Plan”. The 2021 Corporate Plan was issued in late 2021, following the appointment of a new Chair and the issue of a new Statement of Expectations by the Treasurer.

Whether the internal framework for developing the Corporate Plan is clear and effective is difficult to assess from outside, but ASIC continues to use the “*Threats, Harms and Behaviours Framework*”, first adopted in 2018. In addition, the strategic priorities articulated in the current Corporate Plan are identical to those described in the 2020 plan.

The 2021 Corporate Plan removed the focus on responding to the COVID-19 pandemic, and the Implementation Plan involves greater consultation with government, other regulators and regulated entities than has been the case in the past.

¹ ASIC Report 631, October 2019: <https://download.asic.gov.au/media/5290879/rep631-published-2-10-2019.pdf>

² Information Sheet 245: <https://asic.gov.au/regulatory-resources/corporate-governance/executive-remuneration/board-oversight-of-executive-variable-pay-decisions/>

³ Prudential Standard CPS 511: https://www.apra.gov.au/sites/default/files/2021-08/Final%20Prudential%20Standard%20CPS%20511%20Remuneration%20-%20clean_O.pdf

While most of the “Actions” for 2021/2022 are continuing, there are a significant number of welcome “new” initiatives, including social media advice and influence on retail investment decisions, intervention on retail OTC derivatives, an enhanced “regulatory sandbox” (because the current arrangements have not been well utilised), and regulation of crypto-assets.

In a long-overdue development, the Plan adopts a more balanced enforcement policy and the “Why not litigate” policy has been dropped.

Question 3: How effective is ASIC in implementing its strategic priorities and decisions, and allocating resources to give effect to them?

A review of past Corporate Plans is one way of assessing how effective ASIC has been in implementing its strategic priorities. The BCA has taken the 2017 and 2018 Corporate Plans by way of example.

2017-2021 Corporate Plan

This was the last plan published before the Financial Services Royal Commission.

The Plan identified five “challenges” to be addressed over the following four years, and seven “key risks” to be addressed in 2017/2018. These were as follows:

Challenges for 2017 - 2021:

- *culture and conduct – aligning conduct in a market-based system with investor and consumer trust and confidence*
- *building financial capability*
- *digital disruption and cyber resilience in financial services and markets*
- *globalisation of financial markets, products and services*
- *structural and demographic change in our financial system enhancing the role of market-based financing.*

Key risks for 2017/2018 reflected these “challenges”:

- *poor culture and conduct in financial services and credit resulting in poor outcomes for investors and consumers*
- *poor culture and conduct in markets undermining market integrity*
- *financial vulnerability of consumers at key decision points*
- *misalignment of retail product design and distribution with consumer needs*
- *digital disruption*
- *inadequate risk management of technological change, including cyber threats*
- *cross-border businesses, services and transactions in an uncertain environment.*

2018–2022 Corporate Plan

ASIC issued its 2018–2022 Corporate Plan in September 2018, during the Financial Services Royal Commission.

In 2018 ASIC adopted a new “Threat, Harm and Behaviour Framework”, and established an “ASIC Emerging Threat and Harm Committee” to assist in identifying matters of priority to be addressed by ASIC and allocating resources. This framework was still in place in 2021.

Further, the six “focus areas” identified in the plan for 2018/2019 were identical in substance to the “key risks” for attention in 2017/2018, despite the adoption of a new planning framework and the concerns identified during the Royal Commission.

This suggests that progress had not been made in implementing the previous year's Plan, and that ASIC did not respond strategically to significant change in the regulatory environment.

The three "regulatory priorities" for 2018 – 2022 were new, departing from the "challenges" for 2017 – 2021. However, implementation is still underway.

The following table summarises the strategic priorities from the 2017 and 2018 Corporate Plans, and sets out the BCA's assessment of ASIC's success or otherwise in achieving its strategic priorities:

Strategic priorities 2017	Strategic priorities 2018	BCA Comment
2017 – 2018 Key risks	2018 – 2019 Focus areas	
Digital disruption and risk management of technological change, including cyber threats	Potential harm from technology, particularly crypto currencies and cyber-resilience	<ul style="list-style-type: none"> • ASIC's regulatory role in these areas has been limited over the last five years. Whilst it has encouraged companies to enhance their cyber-security, it has taken little enforcement action against hackers and ransomware attackers. • The challenge of potential harm from new technologies is an issue that may require legislative amendments. This should be a policy question for Government
Poor culture and conduct in financial services and credit resulting in poor outcomes for investors and consumers	Poor culture and professionalism in financial services and credit	<ul style="list-style-type: none"> • ASIC's focus has been on improving the qualifications of financial advisers and the standard of financial advice for consumers. The increased focus has led to many providers, especially large credible advisory businesses, leaving the market. • It has also led to greater costs for advisors. The net result has been that financial advice for consumers is now more expensive, harder to find, and provided by entities that are less well-resourced on an industry-wide basis. • The costs and benefits of this approach are currently imbalanced.
Poor culture and conduct in markets undermining market integrity	Culture, governance and incentives that can harm markets	<ul style="list-style-type: none"> • ASIC has been effective in reducing incentives that can lead to harmful market behaviours.
Financial vulnerability of consumers at key decision points	Practices that target vulnerable consumers	<ul style="list-style-type: none"> • ASIC has been successful in developing and providing tools to assist retail investors and consumers of financial services, including warnings about scams.
Misalignment of retail product design and distribution with consumer needs	Misalignment of retail product design and distribution with consumer needs.	<ul style="list-style-type: none"> • ASIC has assisted Treasury to develop new "Design and Distribution Obligations" legislation

Strategic priorities 2017	Strategic priorities 2018	BCA Comment
Cross-border businesses, services and transactions in an uncertain environment	Increased global uncertainty – focus on domestic compliance and market impacts in cross-border transactions.	<p>and regulations, although it has taken five years.</p> <ul style="list-style-type: none"> ASIC is now focussing effectively on “pump and dump” schemes utilising social media platforms.

Strategic priorities 2017	Strategic priorities 2018	BCA Comment
<p>2017 – 2021 Challenges</p> <ul style="list-style-type: none"> culture and conduct – aligning conduct in a market-based system with investor and consumer trust and confidence building financial capability digital disruption and cyber resilience in financial services and markets globalisation of financial markets, products and services structural and demographic change in our financial system enhancing the role of market-based financing. 	<p>2018 – 2022 Regulatory priorities</p> <p>Accelerating enforcement outcomes</p> <p>Implementing new regulatory approaches, including:</p> <ul style="list-style-type: none"> Placing ASIC monitors onsite in major financial institutions Strengthening supervision and enforcement in superannuation Establishing a corporate governance taskforce focussing on large listed companies Other supervisory priorities (whistleblowers, financial advice, unfair contracts, co-operation with other regulators) 	<ul style="list-style-type: none"> These “challenges” were generally reflected in the “Key risks” for 2017/2018, listed above. The opposite occurred, due mainly to the “Why not litigate” policy Monitors in banks and insurers have been of questionable benefit Increased supervision of superannuation entities has been mixed, with some having to deal with an increased regulator focus, including litigation. The Corporate Governance Taskforce was not an appropriate task for ASIC. Other priorities have generally been effective.

Promoting Australia as a world leader in the development and adoption of Regtech solutions

- ASIC’s role as a regulator should not encompass attracting certain types of business to Australia. The Regtech sector in Australia remains a virtual cottage industry, with very few exceptions.
 - There are no Australian Regtech “unicorns”. Global Regtech companies have succeeded in penetrating the Australian market.
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Although it does not fit into any of the strategic priorities listed above, the 2018–2022 Corporate Plan also included references to reviewing the “Buy Now Pay Later” sector. That sector remains largely unregulated.

The 2018 Corporate Plan published in September 2018 made no reference to the “*Why not litigate*” strategy, which was first promulgated only one month later, in October 2018, in response to criticism by the Royal Commission. The strategy failed and has now been dropped.

These examples demonstrate that over the past five years, ASIC’s approach to its strategic priorities and decisions around resource allocation have been mixed. This has, in part, been due to uncertainty about its core purpose and priorities.

Question 5: Is ASIC’s strategic prioritisation and decision-making framework clearly communicated to and understood by ASIC staff and external stakeholders?

The BCA cannot speak for ASIC staff, but communications by ASIC with external parties about its strategy and decision-making framework have been reasonably well communicated, at least in the formal publications such as the Corporate Plans and Annual Reports.

ASIC’s public communication of its priorities and approach through speeches and other means has been less successful.

Assessment of the effectiveness and capability of ASIC’s surveillance function

Question 2: To what extent are ASIC’s surveillances targeted, efficient, and proportionate? Are those surveillances effective?

ASIC’s market surveillance function is technically sophisticated, and technically capable. It has been effective to identify unusual trading activity, and support insider trading prosecutions by private traders.

However, the BCA would encourage ASIC investigators to have greater market experience and understanding to interpret trading activity undertaken by professional portfolio managers. The BCA would be supportive of ASIC following the lead of US regulators and allocating resources to an effective programme to attract young financial services professionals to take medium-term placements with ASIC.

Question 3: To what extent does ASIC have the appropriate data, technology, and systems to allow it to detect risk, harm and misconduct, prioritise issues, and conduct surveillances?

As noted above, ASIC's market surveillance function is technically sophisticated, and technically capable. It has been effective to identify unusual trading activity.

ASIC has also been very active in identifying retail investment products that carry a high risk for retail investors and has acted successfully to ban a number of high-risk products. The financial product design and distribution obligations have also been introduced recently, with ASIC's support.

That said, ASIC cannot and should not be responsible for eliminating investment risk for retail investors. If it is too harsh in enforcing existing and new regulations applicable to "risky" investment products, rather than encouraging education of retail investors about investment risk, there is a risk that the retail investment community will come to expect, and rely on, ASIC to prevent investment failure, which sets too high a bar for a regulator. A balance must be found.

Question 4: How effectively does ASIC use data and technology to reduce the regulatory impost of its surveillance activities?

Under ASIC's "Why not litigate" enforcement strategy, many matters were the subject of interminable investigations involving multiple document production notices and examinations, as ASIC utilised its investigatory powers to gather evidence under compulsion. In many instances, production notices requested information that had already been provided, but which ASIC's data technology was inadequate to identify.

For example, there are instances of ASIC seizing servers, containing all of the data of the target company, and then spending two years issuing notices to produce information that was on those servers.

These investigations have been at great cost to the target companies, which could have been avoided if ASIC had the capability to analyse the data it had already collected.

Assessment of the effectiveness and capability of ASIC's licensing function

Question 2: Are licensing and registry application decisions timely and consistent? Does ASIC ensure that clear guidance for applicants is made available and that stakeholders are engaged appropriately?

The BCA believes that ASIC's decisions in response to Australian Financial Services Licences (AFSLs) are not timely. It usually takes over 6 months for an application to be considered, even for run-of-the-mill applications. More complex applications can take over 12 months.

The regulatory burden has also recently increased under opaque new breach reporting obligations. We note, however, that these obligations are matters of law, which may be a matter for the Government to revisit. The growing prevalence of regulations that make it an offence to fail to confess breaches upends the basic presumption of innocence. While Australian financial services institutions have made large investments in internal compliance functions and systems designed to ensure that breaches do not occur, there remains the risk of technical breaches in view of the complexity of the rules.

There are numerous recent examples of an AFSL holder reporting a breach, often trivial, disciplining the employees involved, and voluntarily remediating clients for any loss, only for ASIC to prosecute the breach years after it occurred and was reported and remediated. There is no purpose to be served by ASIC prosecuting these

cases: the fact that they are self-reported and that any harm has been redressed means that prosecution achieves no compensatory, deterrent or rehabilitative objective.

The BCA would encourage ASIC to take a more focussed approach to enforcement action against AFSL holders, which will hopefully be a consequence of dropping the “*Why not litigate*” policy. Prosecutions of self-reported breaches should only proceed where there is a clear objective to be achieved by the litigation, consistent with well-established principles by which prosecutions are justified.

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