The Future of the Corporation: The Regulator's Perspective

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Supreme Court of New South Wales, Banco Court

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Thank you.

Your Excellency, Chief Justice, Honoured Guests.

Before I commence, I'd like to acknowledge the Gadigal people of the Eora nation as the traditional custodians of the land on which we meet today and pay my respects to their Elders past and present. I extend that respect to Aboriginal and Torres Strait Islander peoples here today.

I would also like to thank my fellow speakers for their thought-provoking presentations this afternoon.

A. Australian and Securities and Investments Commission - A Conduct Regulator

1. The Australian Securities and Investments Commission (**ASIC**) is the conduct regulator of a wide range of industries including Financial Services, Credit, Markets, Corporations, Insurance and is soon to be the conduct regulator of Superannuation.

2. ASIC's mandate is to supervise, investigate and pursue court outcomes with respect to misconduct engaged in both by individuals and entities in these sectors. It may pursue civil penalties against individuals and entities. It may seek orders disqualifying an individual from being a director of corporations. It may pursue criminal prosecutions with the Commonwealth Department of Public Prosecutions of individuals and entities. ASIC conducts joint investigations with the Australian Federal Police, most recently into alleged complex cybercrime. ASIC does not have general rule-making powers (except where legislation confers such a power[1]) or the power to issue penalties itself.

3. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission**) shone a powerful

[1] See, for example, ss.798G and 908CA of the *Corporations Act 2001* (Cth)

light on the financial services sector throughout 2018. The hearings dominated the media cycle and the Interim Report (delivered on 27 September 2018)[2] and the Final Report (delivered on 1 February 2019)[3] contained many case studies of misconduct in these sectors.

4. The Final Report contained 76 recommendations for legislative reform and other changes to the regulation of the sector.

5. The Royal Commission made some criticism of ASIC and its regulatory responses to misconduct in the past.

6. On 13 March 2019, the Act containing provisions effecting penalties reform received royal assent[4]. This Act was responsive to recommendations contained in the ASIC Enforcement Review Taskforce Report dated December 2017[5], predating the commencement of the Royal Commission. Thereafter, contraventions of provisions that contain cornerstone obligations owed by Financial Services Licensees and Credit Licensees to those to whom they provide services have attracted significant potential civil penalties.

7. The *Penalties Act* also increased maximum civil penalties very significantly and increased maximum terms of imprisonment significantly for criminal conduct.

8. Much of the misconduct examined by the Royal Commission in its case studies arguably amounted to contraventions of these key provisions. That is the mandatory obligation on licensees to:

   (a) do all things necessary to ensure that the financial services covered by the licensee are provided efficiently, honestly and fairly (s.912A(1)(a) of the *Corporations Act* 2001 (Cth)); and

   (b) do all things necessary to ensure that the credit activities authorised the licence are engaged in efficiently, honestly and fairly (s.47(1)(a) of the *National Consumer Credit Protection Act* 2009 (Cth)).

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[2] Hayne K., Commissioner, 27 October 2018, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission): Interim Report,*
[3] Hayne K., Commissioner, 1 February 2019, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission): Final Report*, https://financialservices.royalcommission.gov.au/Pages/reports.aspx#final.
[4] *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019* (Cth) (*'Penalties Act'*).
[5] https://treasury.gov.au/review/asic-enforcement-review

9. Unsurprisingly, perhaps, the regulator historically (prior to 13 March 2019) entered into enforceable undertakings with firms it suspected of contravening these key provisions rather than pursue bare declarations of contravention from the court. Typically, these undertakings contained no admission of contravention but merely an acknowledgement of the regulator's concerns.

10. The Royal Commission expressed some scepticism as to the efficacy of enforceable undertakings in effecting enduring deterrence.

11. Where the regulator's role in administering the key duty provisions of s. 912A and s. 47 may once more comfortably have resided in the protective aspects of its regulatory responses to misconduct, with the introduction of significant civil penalties, the regulator's role is clearly more punitive or litigation-orientated. That is, the regulator is far more likely to respond by utilising enforcement and litigation where it takes the view that significant misconduct has been engaged in by a licensee contrary to these cornerstone obligations.

12. These important reforms introducing penalties for contraventions of these cornerstone obligations may go some way to the exploration of the scope and dimension of these duties such that the "purpose" of a corporate licensee may in some way inform an examination of whether or not such a licensee has breached it duty to act "efficiently, fairly and honestly". I will elaborate shortly.

13. So too, a stated "purpose" of a company may, for example, increase its chances of accessing certain species of capital. The "purpose" and the benefit derived from it may inform an examination of whether or not a director as steward of a company possessing that particular design may not have discharged their duties with due care and diligence within the meaning of s.180 of the *Corporations Act* in circumstances where the "purpose" is ignored or not observed.

14. So too, disclosure requirements may include or extend to non-financial risks such that regulatory risks that are peculiar to a particular industry or endeavour are disclosable. A publicly listed exploration company may, for example, be subject to the strictures of particular state-based environmental or remediation lease or licence requirements or conditions.

15. ASIC released a report in September 2018 on climate risk disclosure by Australia's listed companies which discusses possible disclosure issues in this regard.[6]

16. Beyond those types of possible outcomes or at least the application of legal theory and argument within its remit, under the current legislative framework in Australia, the regulator's interest in a company's "purpose" beyond compliance with the law it administers and generally, could best be described as agnostic.

17. In this paper, I will discuss recent developments in Australia that may shed light on the role of corporate "purpose" in the current and emerging legislative framework in which ASIC operates.

B. Fairness - a Legal Obligation in Australia (and Elsewhere)

18. As a starting premise, existing law in Australia already require good corporate conduct. Good corporate citizens are unlikely to attract the regulator's attention.

19. As set out above, Financial Services Licensees and Credit Licensees are legally obliged to act "efficiently, honestly and fairly".

20. Whether societal norms and concepts of value-driven corporate "purposes" will be capable of residing within the regulator's remit will necessarily in part await the development of jurisprudence arising from this and other obligations.

21. Treating customers fairly is the third of six key norms of conduct outlined in the Royal Commission final report.

22. The Royal Commission acknowledged that fairness "may lie at, or at least close to, the heart of community standards and expectations about dealings with consumers".[7]

[6] https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-593-climate-risk-disclosure-by-australias-listed-companies/

[7] Financial Services Royal Commission first hearing, 12 February 2018, transcript at https://financialservices.royalcommission.gov.au/public-hearings/Documents/transcripts-2018/12-february-2018-initial-public-hearing.pdf, see p8, para 45.

23. There is an emerging body of law with the respect of the content of the "efficiently, honestly and fairly" obligation. In *ASIC v Westpac Banking Corporation* Justice Beach observed that:

> *"The meaning of the "efficiently, honestly and fairly" standard in s 912A(1)(a) is not in doubt".*[8]

24. Justice Beach then referred to Justice Foster's construction of the statutory obligation in *ASIC v Camelot Derivatives Pty Ltd (in liq)* (2012), which were that the phrase 'efficiently, honestly and fairly' must be:

> "*read as a compendious indication meaning a person who goes about their duties efficiently having regard to the dictates of honesty and fairness, honestly having regard to the dictates of efficiency and fairness, and fairly having regard to the dictates of efficiency and honesty*".[9]

25. Justice Foster further noted that the words connote a requirement of competence in providing advice and complying with the law, of evenhandedness in dealing with clients, and sound ethical values and judgment in matters relevant to a client's affairs. [10]

26. Justice Foster also noted that "honestly" can include conduct that is not criminal but is morally wrong. When combined with the word "fairly", it connotes a "*person who not only is not dishonest, but [is] also… ethically sound*".[11]

27. Most recently, indeed yesterday, the Full Federal Court handed down a decision in which it had cause to examine the scope of the s.912A obligation in *Australian Securities and Investments Commission v Westpac Securities Administration* Limited.[12] I won't comment on the judgment but will refer you to Chief Justice Allsop and Justice O'Bryan's observations as to the operation of s.912A(1)(a).

28. Chief Justice Allsop made the following observations:

> "*The phrase has been held to be compendious as a single, composite concept, rather than containing three discrete*

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[8] *Australian Securities and Investments Commission v Westpac Banking Corporation* (No 2) [2018] FCA 751, Beach J at 2347, https://www.judgments.fedcourt.gov.au/judgments/Judgments/fca/single/2018/2018fca0751

[9] *Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (In Liquidation)* [2012] FCA 414, Foster J at 69-70, https://www.judgments.fedcourt.gov.au/judgments/Judgments/fca/single/2012/2012fca0414

[10] *Ibid*.

[11] *Ibid*.

[12] [2019] FCAFC 187 (28 October 2019)

behavioural norms. That said, if a body of deliberate and carefully planned conduct can be characterised as unfair, even if it cannot be described as dishonest, such may suffice for the proper characterisation to be made." (at 170)

"*The provision is part of the statute's legislative policy to require social and commercial norms or standards of behaviour to be adhered to. The rule in the section is directed to a social and commercial norm, expressed as an abstraction, but nevertheless an abstraction to be directed to the "infinite variety of human conduct revealed by the evidence in one case after another." (See Gummow WMC, "The Common Law and Statute" in Change and Continuity: Statute, Equity and Federalism (Oxford University Press, 1999) at 18-19.) By the phrase itself, emphasis must be given to substance over form and the essential over the inessential in a process of characterisation by reference to the stated norm: Attorney-General (NSW) v The Perpetual Trustee Co (Ltd) [1940] HCA 12; 63 CLR 209 at 226–227 (per Dixon and Evatt JJ); and Gummow WMC, ibid. Care needs to be taken that phrases used by judges in individual cases, in which they explain and articulate their views as to the success or failure in satisfying the norm in s 912A(1)(a), do not become rules to apply as defaults for the proper process of characterisation by reference to the words used by Parliament as to whether a body of conduct satisfied or failed to satisfy the norm.*" (at 174)

"*The word "fair" in its adjectival form, directed to conduct, includes a meaning of "free from bias, dishonesty, or injustice; that which is legitimately sought, pursued, done, given etc.; proper under the rules": Macquarie Dictionary. It could hardly be seen to be fair, or to be providing financial product advice fairly, or efficiently, honestly and fairly, to set out for one's own interests to seek to influence a customer to make a decision on advice of a general character when such decision can only prudently be made having regard to information personal to the customer. For one's own interests, one is advising generally (on this hypothesis) to bring about a result which may not be in the interests of the customer. The general advice is given to reinforce an assumption that fewer fees (in number) will mean less fees (in amount). There was a degree of calculated sharpness about the practice adopted in the QM Framework. At best, the aim was to get a customer to make a decision after only general advice, being a decision that could only prudently be made by a consideration of the personal circumstances of the customer and his or her funds and their characteristics.*" (at 175)

29. Justice O'Bryan made the following observations as to the s.912A obligation:

> *"Although not the subject of argument on this appeal, I have considerable reservations about the view that the words "efficiently, honestly and fairly" as used in s 912A(1)(a) of the Act should be read compendiously in the manner suggested by Young J in Story. His Honour gave two reasons for interpreting the phrase in that manner. The first is that it is impossible to carry out all three tasks concurrently. His Honour explained that conclusion by reference to the following example (at 672):*
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> *To illustrate, a police officer may very well be most efficient in control of crime if he just shot every suspected criminal on site. It would save a lot of time in arresting, preparing for trial, trying and convicting the offender. However, that would hardly be fair. Likewise, a judge could get through his list most efficiently by finding for the plaintiff or the defendant as a matter of course, or declining to listen to counsel, but again that would hardly be the fairest way to proceed."* (at 424)
>
> *The second is the use of the conjunction "and" rather than the disjunctive "or" in the phrase "efficiently, honestly and fairly".* (at 425)
>
> *With respect, it is not apparent that either reason provides a sound basis for reading the phrase, as it appears in s 912A(1)(a) of the Act, compendiously in the manner suggested by his Honour. In particular, it is not apparent why a licensee cannot comply with each of the three obligations, efficiently, honestly and fairly, applying the ordinary meaning of each word. One of the meanings of the word "efficiently", and the meaning well adapted to the statutory provision, is competent, capable and having and using the requisite knowledge, skill and industry: cf ASIC v Camelot at [69(c)]. The word "honestly" includes dishonesty in the criminal sense but may also comprehend conduct which is not criminal but which is morally wrong in the commercial sense: R J Elrington Nominees Pty Ltd v Corporate Affairs Commission (SA) (1989) 1 ACSR 93 at 110. The word "fair" as used in s 912A(1)(a) has not received detailed judicial consideration. However, it seems to me that there is no reason why it cannot carry its ordinary meaning which includes an absence of injustice, even-handedness and reasonableness. As is the case with legislative requirements of a similar kind, such as provisions addressing unfair contract terms, the characterisation of conduct as unfair is evaluative and must be done with close attention to the applicable statutory provision: cf*

Paciocco v Australia and New Zealand Banking Group Ltd (2015) 236 FCR 199 at [364]. It seems to me that the concepts of efficiently, honestly and fairly are not inherently in conflict with each other and that the ordinary meaning of the words used in s 912A(1)(a) is to impose three concurrent obligations on the financial services licensee: to ensure that the financial services are provided efficiently, and are provided honestly, and are provided fairly." (at 426)

United States

30. Under the *Dodd-Frank Act*, it is unlawful for providers of financial products and services to engage in unfair, deceptive, or abusive acts or practices.

31. The *Act* establishes a three-limbed test for unfairness, which captures an act or practice where:

    (a) It causes or is likely to cause substantial injury to consumers;

    (b) The injury is not reasonably avoidable by consumers; and

    (c) The injury is not outweighed by countervailing benefits to consumers or to competition.

32. Guidance issued by the Consumer Financial Protection Bureau (**CFPB**) provides additional information on the interpretation of those three elements of unfair practice, and examples of enforcement action to demonstrate how the standard of unfairness might be applied.

    (a) That substantial injury generally infers monetary harm, can include a small amount of harm to a large number of consumers, and that actual injury is not requited in each case. Example: economic injury suffered when a mortgage servicer did not release a security interest in a property after the borrower had repaid the total amount due on the mortgage.

    (b) That avoidance of injury does not mean that a consumer could have made a better choice, but rather whether the act or practice hinders a consumer's decision-making, including changes to the nature of a product without the consumer's knowledge. Example: where costs to the consumer arise from transactions that the consumer has not consented to, such as fraudulent withdrawals.

(c) That an act or practice must be injurious in its net effects, and not outweighed by any offsetting consumer or competitive benefits produced. This determination includes consideration of costs incurred for measures to prevent the injury. Example: where the net effect of a policy or practice is to lower prices for consumers or increase availability of products and services due to competition may offset limited injury to certain consumers.

33. This three-pronged test reflects the Federal Trade Commission's definition of "unfairness", contained in its *Policy Statement on Unfairness* published in 1980 and later codified into the *Federal Trade Commission Act* (Section 5(a)). Prior to that publication, United States courts had typically identified that a practice was unfair where it "offends established public policy" and is "immoral, unethical, oppressive, unscrupulous, or substantially injurious to consumers"[13]

34. The CFPB has often pursued cases against entities for unfair practices at the same time as deceptive practices, reflecting a view that deception of consumers is likely to satisfy criteria of unfairness[14].

35. In *LabMD, Inc. v. Federal Trade Commission*, No. 16-16270 (11th Cir. 2018), the Court considered an appeal against a cease and desist order against LabMD Inc made on the basis that its failure to design and maintain a reasonable data-security program invaded consumers' right of privacy, constituting an unfair act or practice.

36. While ultimately finding that the FTC's cease and desist order was unenforceable, the Court made a number of useful observations about determining unfairness by linking the test with established legal standards of fairness.

> *"Put another way, an act or practice's "unfairness" must be grounded in statute, judicial decisions—i.e., the common law—or the Constitution. An act or practice that causes substantial injury but lacks such grounding is not unfair within Section 5(a)'s meaning.*
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> …
>
> *Section 5(n) now states, with regard to public policy, "In determining whether an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence. Such public policy*

[13] *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972)
[14] Christopher L. Peterson, Consumer Financial Protection Bureau Law Enforcement: An Empirical Review, 90 *Tulane Law Review* 1057 (2016)

considerations may not serve as a primary basis for such determination." We do not take this ambiguous statement to mean that the Commission may bring suit purely on the basis of substantial consumer injury. The act or practice alleged to have caused the injury must still be unfair under a well-established legal standard, whether grounded in statute, the common law, or the Constitution"[15].

United Kingdom

37. UK financial services legislation contains a number of provisions that impose a standard of fairness on firms when dealing with consumers in relation to contracts, including:

    (a) The *Unfair Contract Terms Act* 1977 (UK)

    (b) The *Unfair Terms in Consumer Contracts Regulations* 1999 (UK)

    (c) The *Consumer Credit Act* 1974 (UK)

38. The *Consumer Protection from Unfair Trading Regulations* also place on traders, including financial services firms, a general prohibition on unfair commercial practices. A practice is deemed to be unfair if it is found to be misleading or aggressive, or otherwise where:

    (a) It contravenes the requirements of professional diligence; and

    (b) It materially distorts or is likely to materially distort the economic behaviour of the average consumer with regard to the product.

39. These provisions are supplemented by a principles-based regulatory model, which sets out 11 principles outlining the fundamental obligations for firms, including that 'A firm must pay due regard to the interests of its customers and treat them fairly'.

40. Under this Principle, the FCA has implemented a long-standing 'Treating Customers Fairly' initiative (TCF), which requires senior management of regulated firms to give consideration to the meaning of Principle 6 in the context of their firms.

41. In *Director General of Fair Trading v. First National Bank [2001] UKHL 52*, the House of Lords considered the meaning of fairness in the context of the *Unfair Terms in Consumer Contracts Regulations,* which deem a

[15] *LabMD, Inc. v. Federal Trade Commission*, No. 16-16270 (11th Cir. 2018)

term to be unfair where it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer in a manner or to an extent which is contrary to the requirement of good faith.

42. In his judgment, Lord Bingham, considered relevant considerations in determining whether a contract term could be found to be unfair, by reference to standards of fair dealing:

> "*Appropriate prominence should be given to terms which might operate disadvantageously to the customer. Fair dealing requires that a supplier should not, whether deliberately or unconsciously, take advantage of the consumer's necessity, indigence, lack of experience, unfamiliarity with the subject matter of the contract, weak bargaining position or any other factor listed in or analogous to those listed in Schedule 2 of the regulations. Good faith in this context is not an artificial or technical concept; nor, since Lord Mansfield was its champion, is it a concept wholly unfamiliar to British lawyers. It looks to good standards of commercial morality and practice*".[16]

Canada

43. In 2018, the Financial Services Commission of Ontario (FSCO – now incorporated into the Financial Services Regulatory Authority of Ontario [FSRA]) released guidance on the fair treatment of customers "to ensure there is common understanding between FSCO and its Licensees as to what it means to treat consumers fairly".[17]

44. The Guideline sets out standards of conduct and product design that are required to meet licensee obligations to treat customers fairly, including those that are covered by existing statutory requirements. Under the guidelines, licensees are expected to:

(a) engrain fairness into their company culture;

(b) act with due diligence always;

(c) promote its services clearly and honestly;

[16] *Director General of Fair Trading v. First National Bank* [2001] UKHL 52.
[17] Financial Services Commission of Ontario - Superintendent's Guideline No. 03/18

(d) recommend products that are suitable for the consumer based on their specific needs;

(e) disclose and manage potential conflicts of interests;

(f) keep consumers appropriately informed;

(g) have policies in place to handle complaints in a timely manner; and

(h) protect the private information of consumers.

45. Statutory provisions of the *Ontario Insurance Act* prohibit persons from engaging in any unfair or deceptive act or practice, with a detailed list of activities deemed to be unfair or deceptive included in Regulations. Examples of acts that are prescribed under the Regulations include:

(a) Unfair discrimination between individuals of the same class and same expectation of life in relation to premiums, rates or dividends;

(b) Incomplete, false or misleading statements in relation to a product;

(c) Financial inducements to a prospective insured;

(d) Conduct resulting in an unreasonable delay to the settlement of claims; and

(e) Hidden fees in relation to commission payments.

46. The concept of "fairness" as a legal obligation is not therefore confined to Australia but is found at least in the jurisdictions of the United Kingdom, United States and Canada.

47. This concentration on the concept of "fairness" in the legislative framework in which ASIC regulates the commercial activities of the providers of financial services and credit will no doubt throw up a significant body of jurisprudence. This should go a long way to addressing the British Academy's position at least as to the importance of a "purpose" consistent with the proper treatment of customers. That is, the adherence to a "purpose" that is consistent with acting in such a way to customers that is fair. That is, the corporation does not prefer

shareholder primacy or profit to the detriment of the interests of the customer.

C. Shareholder Primacy, Corporate Social Responsibility and Social Licence to Operate

48. In Australia, the concepts of Corporate Social Responsibility and Social Licence to Operate have been widely debated in the regulatory context.

49. In 2014, the Governance Institute of Australia (**GIA**) published a discussion paper, entitled "Shareholder Primacy; Is there a need for a change?"[18]

50. The paper examines case studies of societal expectations with respect to a number of identified issues such as hydraulic fracking, poker machines, obesity and plastic beverages.

51. In the paper, the authors refer to two inquiries, one by the Corporations and Markets Advisory Committee and the second undertaken by the Parliamentary Committee on Corporations, both in 2006.

52. In summary, those enquiries found that there was no need for change in the Corporations law in Australia in circumstances where the current law was sufficiently flexible to ensure that corporations and directors are able to be held to account for actions that affect stakeholders beyond shareholders.

53. There are well known criticisms of the shareholder primacy concept as not being consistent with the law. In his 2002 paper, Professor Stout observed:

> "… *the shareholders do not own the corporation. Rather they own a type of corporate security commonly called "stock". As owners of stock, shareholders rights are quite limited. For example, stockholders do not have the right to exercise control over the corporation's assets …*".[19]

[18] https://www.governanceinstitute.com.au/advocacy/thought-leadership/shareholder-primacy-is-there-a-need-for-change/

[19] Stout, Lynn A, 'Bad and Not-so-Bad Arguments for Shareholder Primacy' (2002) 75 *Southern California Law Review* 1189.

54. Shareholders rights are set out in Chapter 2F of the *Corporations Act* and are limited to actions arising from the oppressive conduct of affairs and derivative actions.[20] Shareholders can of course, act in concert to alter the composition of the board contrary to the recommendations of the board.

55. The GIA paper poses the question: "should stakeholder interest be dealt with in corporations law or by social policy intervention?"

56. The authors note that some precedent exists for impacts of corporations on stakeholders through laws other than corporations law. For example, workplace, health and safety laws which protect the important stakeholders, the employees.

57. One case study as to how corporations may be subject to a panoply of legal obligations that stand outside of the corporations law is the mining industry.

58. As with the Toronto Stock Exchange and the Johannesburg Stock Exchange, the Australia Stock Exchange has a significant number of junior explorer companies listed.

59. The "purpose" of a junior explorer is to identify assets and attain access to them.

60. In Australia, in order to attain access to the assets for the purposes of exploiting them and thereby producing profit, the junior explorer must satisfy a number of legal conditions to be entitled to that access. For example, the company must comply with laws that relate to:

    (a) Environmental Impact;

    (b) Remediation; and

    (c) Indigenous land use and Native Title.

61. In one sense, the junior explorers in Australia are well versed in having a "Social License to Operate" or a regulatory framework in which they must take account of ESG issues and obligations.

[20] *Corporations Act 2001* (Cth) ss 232–41.

62. Some of the British Academy's concerns therefore relating to the environment, social expectations and employees are probably addressed in existing current Australian legislation.

63. It is not for this regulator to opine as to whether the current legislative framework in which it operates is sufficient for regulating any particular "purpose". Rather this paper hopefully illustrates some ways in which the existing legal framework might relate to a corporation's "purpose" that transcends the pursuit of profit.

D. Directors' Duties – The Stewards of the Corporation

64. In Australia, company directors are required to act with due care and diligence and in the best interests of the company: ss.180 and 181 of the *Corporations* Act.

65. When taking a long-term view, factoring in the interests of a multitude of stakeholders as well as the company's reputation is arguably consistent with considering the best interests of the company.

66. If a director fails to act in the best interests of the company with respect to non-financial risks, environmental, social and governance (**ESG**) issues might impact future cash flows, asset values, intangible assets such as reputation and, ultimately, the longevity of the company.

67. Mismanagement of these non-financial risks may readily become a financial risk over time.

68. Our society has also come to expect much more from companies than short-term shareholder returns. Investors are placing more emphasis on considerations that can have a long-term impact such as environmental impact, employee rights and other issues than perhaps they have in years past.

69. Internationally, there is also recognition that a range of factors can affect the long-term interests of a company. The UK Financial Reporting Council's July 2016 report 'Corporate culture and the role of boards' noted that intangible assets – such as reputation, IP and customer base – today account for 80% of total corporate value.[21] Forty years ago, that figure was under 20%. With figures such as those, behaviour that

[21] Financial Reporting Council (UK), July 2016, *Corporate culture and the role of boards*, https://www.frc.org.uk/getattachment/3851b9c5-92d3-4695-aeb2-87c9052dc8c1/Corporate-Culture-and-the-Role-of-Boards-Report-of-Observations.pdf at p8.

compromises customers – behaviour that is unfair – certainly has the potential to impact on a company's long-term interests.

70. Taking an example, a board may spectacularly fail to meet a "purpose" that relates to a societal expectation or an ESG issue such that the corporation is disentitled to have access to capital that is dependent on the company's maintenance of and meeting that "purpose". That might give rise to a derivative action under Chapter 2F.2 of the *Corporations Act* for breaches of ss.180 and/or 181 of the *Act*. That is, the shareholders might be given leave to sue the directors in the name of the company for failing to act in the best interests of the company.

71. One might imagine that the work of the British Academy might be more relevant to the power of market forces and questions of access to capital rather than law enforcement *per se*.

72. The flexibility of the directors' duties provisions will no doubt continue to be tested by the regulator and private parties before the court.

73. That flexibility may, in time, address some of the British Academy's concerns particularly when a company self identifies a non-financial purpose and adherence to that purpose provides a benefit to the company itself such as access to capital.

E. Corporate governance: businesses are responsible for improving their practices

74. In 2019, ASIC established its Corporate Governance Taskforce – one of its new enhanced supervisory initiatives – to gain better insights into the governance practices of our largest listed companies.

75. The Taskforce has recently completed a comprehensive review on how the boards of seven of the country's largest financial services companies oversee the management of non-financial risk.[22] It is currently completing its next review regarding the oversight of decisions regarding variable remuneration for executives.

76. ASIC's review found that firstly whilst boards were setting risk-appetites for non-financial risks, often management was operating outside of

[22] ASIC, October 2019, *Corporate Governance Taskforce: Director and officer oversight of non-financial risk report*, https://asic.gov.au/regulatory-resources/find-a-document/reports/corporate-governance-taskforce-director-and-officer-oversight-of-non-financial-risk-report/

these approved appetites.[23] Boards need to actively position themselves to hold management accountable to operate within their stated appetites.

77. A second key finding was that monitoring of risk against appetite put broadly, often did not enable effective communication of the company's risk position.[24] Boards need to take ownership of the form and content of information they are receiving to better inform themselves of the management of material risks.

78. ASIC's third key finding was that material information about non-financial risk was often buried in dense board packs, hundreds of pages long.[25] Boards should require management make reports using a clear hierarchy and prioritisation of non-financial risks.

79. A fourth finding was that board risk committees are not operating as effectively as they could be.[26] Meetings should be regular, long enough to enable proper discussion and resolution, and attendees need to be actively engaged. Without these things, board risk committees become an exercise in box checking, instead of an important element of governance and risk-management.

80. Above all, ASIC's report highlighted one key lesson that all directors need to take to heart – this is that ultimately, all risk is likely to have financial consequences.[27]

81. If not well managed, non-financial risks carry very real financial implications for companies, their investors and their customers - particularly if not identified and prioritised early enough.

82. With the global financial crisis as a catalyst, businesses have had more than a decade to examine and improve their approach to managing

[23] As above, Risk Appetite Statements, 1. Boards need to hold management to account when companies are operating outside appetite, https://asic.gov.au/regulatory-resources/find-a-document/reports/corporate-governance-taskforce-director-and-officer-oversight-of-non-financial-risk-report/risk-appetite-statements

[24] As above, Risk Appetite Statements, 8. Reporting to the board should be aligned with risk appetite and metrics, https://asic.gov.au/regulatory-resources/find-a-document/reports/corporate-governance-taskforce-director-and-officer-oversight-of-non-financial-risk-report/risk-appetite-statements/#3-risk-appetite-needs-to-be-clearly-expressed-reflecting-actual-appetite

[25] As above, Information Flows, 1. Material information should not be buried in lengthy board packs or reports, https://asic.gov.au/regulatory-resources/find-a-document/reports/corporate-governance-taskforce-director-and-officer-oversight-of-non-financial-risk-report/information-flows/#1-material-information-should-not-be-buried-in-lengthy-board-packs-or-reports

[26] As above, Board Risk Committees, https://asic.gov.au/regulatory-resources/find-a-document/reports/corporate-governance-taskforce-director-and-officer-oversight-of-non-financial-risk-report/board-risk-committees

[27] As above, Foreword, https://asic.gov.au/regulatory-resources/find-a-document/reports/corporate-governance-taskforce-director-and-officer-oversight-of-non-financial-risk-report/foreword

financial risks. This effort has resulted in mature approaches to financial risk. It is time for businesses to pay the same attention to non-financial risks. It is in the company's best interest to do so.

83. The Royal Commission has demonstrated the impact that poorly managed non-financial risk can have. Australians have lost hundreds of millions of dollars because of this mismanagement of risk.

84. Non-financial risks result in financial costs if they are not managed properly. Our message to firms is to take these risks seriously and ensure they are managed effectively and transparently.

F. Deterrence: Increased Penalties

85. The regulator was identified by Commissioner Hayne as the fourth line of defence. The first was public policy, second, the consumer, and third, the firms.

86. ASIC now has a greater range of powers and penalties as a result of the legislative reform referred to earlier. 10 of Commissioner Hayne's 76 recommendations relate to strengthening and expanding ASIC's remit. Further legislative reform is currently afoot.

87. As referred to above, one area that we have already seen strengthened is penalties. From March this year, we saw a much-needed boost to a range of existing penalties:

(a) Maximum prison penalties for the most serious offences have increased to 15 years including for contraventions of:

(i) s.184; and

(ii) s.1041G,

of the *Corporations Act*. These sections relate to dishonest and reckless conduct.

(b) Civil penalties for companies significantly increased, now capped at $525 million; and

(c) Maximum civil penalties for individuals have increased to $1.05 million.

88. In addition to increasing existing penalties, civil penalties applied to a greater range of misconduct, including the licensee's failure to act efficiently, honestly and fairly, failure to report breaches and defective disclosure.

89. In ASIC's view a primary purpose of penalties in relation to the misconduct we regulate is deterrence both general and specific. Two aspects of effective deterrence are the perception of being caught and the perception of being meaningfully punished.

90. Once again, the thrust of these reforms addresses primarily the British Academy's concerns as to the treatment of customers to their detriment in the interests of shareholder primacy and profit.

91. But for reasons discussed earlier, the scope of the obligations of fairness and directors acting in accordance with their statutory obligations may develop jurisprudentially to address some other of the British Academy's concerns also.

92. And thirdly and lastly, as discussed earlier with the junior miner example, there exists a panoply of legal obligations that address many of the ESG concerns which may or may not be relied upon by private citizens or the regulator in bring actions under the Corporations Law.

93. Beyond that analysis, any public policy issues are not in the purview of the regulator.

G. Intervention – Addressing Harmful yet Legal Conduct

94. ASIC has also been given new powers that allow for a more strategic approach to addressing harmful conduct. In particular, the new product intervention power and the design and distribution obligations

95. The product intervention power gives ASIC a proactive legislated power to intervene where a product has resulted, will result or is likely to result in significant consumer detriment. A breach of the law is not required for ASIC to exercise the product intervention power.

96. It is important to note that when a regulator is stepping into areas where there is no legal breach, ASIC must have clear guardrails for the exercise of our powers. In this case, that guardrail is the "significant consumer detriment" caused by the product. If ASIC is not satisfied that the test for significant detriment is met, the regulator cannot exercise

the power. In light of this, ASIC will also be consulting with relevant stakeholders on any proposed use of the power.

97. In considering whether a product has resulted, will result or is likely to result in significant consumer detriment, ASIC will take into account relevant factors. ASIC is required to take into account:

(a) the nature and extent of the detriment;

(b) the actual or potential financial loss to consumers resulting from the product; and

(c) the impact that the detriment has had, will have or is likely to have on consumers.

98. ASIC will also need to take into account any other matter prescribed by regulations.

99. The meaning of detriment is intended to take its ordinary meaning in the context of the new provision. However, it is intended to cover a broad range of harm or damage that may flow from a product. The harm or damage may arise from any number of sources associated with the product, including the product's features, defective disclosure, poor design, or inappropriate distribution[28].

100. The legislative design in using these new powers is to effectively and comprehensively address significant consumer detriment.

101. Already, ASIC has exercised the power or commenced consultations on:

(a) a short-term credit model – with an intervention order made on 12 September[29]

[28] *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019* (Cth), Revised Explanatory Memorandum, https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fems%2Fr6184_ems_8006c124-21ef-4334-bf20-8c28d0a22214%22 at 2.33.

[29] Consultation Paper 316 *Using the product intervention power: Short term credit* (CP 316), https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-316-using-the-product-intervention-power-short-term-credit/, released 9 July 2019, comments closed 30 July 2019. ASIC Corporations (Product Intervention Order—Short Term Credit) Instrument 2019/917 made 12 September 2019, https://www.legislation.gov.au/Details/F2019L01183

(b) over-the-counter binary options and contracts for difference to retail clients[30]

(c) and the sale of add-on financial products through caryard intermediaries.[31]

102. The product intervention power complements the intent of the obligations introduced by the Design and Distribution Act, which is another reform that will shape the future of the financial services corporation.

103. From April 2021, providers of financial products will be obliged to design products to meet the objectives, financial situation and needs of their targeted customers. They will also need to introduce distribution controls that direct sales to that group of consumers.

104. ASIC expect to consult on draft guidance for the regime by the end of this year.

105. ASIC's guidance will be principles-based and is not intended to supplement the regime with detailed or prescriptive rules.

106. The regime is designed in such a way that it places responsibility on businesses to consider their products in light of their customers' objectives, financial situation and needs.

H. ASIC's expectations for corporations, now and in the future

107. In summary, ASIC's vision for the future of Australian corporations is one that is fair, compliant and not causing consumer harm. We want to see Australia's corporations contributing to a fair, strong and efficient financial system that works for all Australians.

108. As a conduct regulator, ASIC expects that the corporation will:

(a) obey the law;

[30] Consultation Paper 322 *Product intervention: OTC binary options and CFDs* (CP 322), https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-322-product-intervention-otc-binary-options-and-cfds/, released 22 August 2019, comments closed 1 October 2019.
[31] Consultation Paper 324 *Product intervention: The sale of add-on financial products through caryard intermediaries* (CP 324), https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-324-product-intervention-the-sale-of-add-on-financial-products-through-caryard-intermediaries/, released 1 October 2019, comments close 12 November 2019.

(b) act fairly, in accordance with law;

(c) work to create corporate governance structures that guard against non-financial risk and lead to positive outcomes;

(d) review products considering the design and distribution obligations, and ensure their products meet the objectives, financial situation and needs of their customers;

(e) be prepared for ASIC to use its expanded remit and strengthened powers to take action when corporations break the law or sell products that cause significant harm to customers.

109. If companies fail in their task, regulation and more interventionist reforms become more likely. And if companies break the law, they can expect court-based outcomes.

110. How corporate "purposes" that transcend the pursuit of profit inform the enforcement of the law by the regulator will depend upon the legal framework in which the regulator operates. I have endeavoured to identify some illustrative examples where a corporation's "purpose" might be relevant to the regulator and ultimately to a court's adjudication.

111. Whether or not any of this analysis addresses some of the British Academy's concerns probably warrants further discussion which I understand will take place shortly.

112. Thank you.