Towards best practice in corporate governance


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TOWARDS BEST PRACTICE IN CORPORATE GOVERNANCE

A SPECIFIC MEMORANDUM OF UNDERSTANDING BETWEEN TWO KEY CORPORATE REGULATORS COULD TAKE THE REGULATION OF CORPORATE GOVERNANCE IN AUSTRALIA BEYOND INTERNATIONAL BEST PRACTICE. BY DR JAMES MCCONVILL AND PROFESSOR MIRKO BAGARIC
There are various legislative and non-legislative mechanisms in place to regulate the corporation. Collectively, these mechanisms provide a framework by which good governance can be achieved within the corporation. This body of mechanisms forms part of what has been described recently as an emerging "law of corporate governance".

Focus on regulation

Recently, in response to spectacular corporate collapses in the US, Australia and the European Union, there has been a renewed focus on corporate governance regulation in the form of the formalisation of best practice "benchmarks", which has resulted in a shift from an essentially self-regulatory approach to a heavily prescriptive approach. It is generally considered to be crucial that companies be perceived to be operating according to best practice corporate governance standards in order for the international money market to maintain confidence in the companies in question and the economies in which these companies operate. However, it is not sufficient for a regulatory movement to be one dimensional and focus only on how the targets of regulation (companies and their participants) can perform more effectively (i.e. the "form" of regulation). It is also important to ensure that the corporate governance regulatory framework itself (i.e. the "manner" of regulation) is effective. So much was recognised in the Organisation for Economic Co-operation and Development's (OECD's) recently revised OECD Principles of Corporate Governance (OECD Principles). Australia is a member country of the OECD, and the OECD Principles are:

"intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance".

In this article, we discuss the criteria for an effective corporate governance regulatory framework as stated in the OECD Principles, and assess whether Australia's regulatory framework meets the criteria for effectiveness that have been set out in the Principles. We also outline what we believe to be an important proposal – a specific memorandum of understanding (MOU) on corporate governance between the Australian Securities and Investments Commission (ASIC) and the Australian Stock Exchange (ASX) – which, if adopted, would mean that corporate governance regulation in Australia would better meet the criteria for effectiveness contained in the OECD Principles.

OECD Principles and Australia's performance

"Ensuring the Basis for an Effective Corporate Governance Framework" is one of the key principles of the OECD Principles. For a regulatory framework to be effective, the OECD Principles state that:

"The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities" (emphasis added).

Thus, according to the OECD Principles, whether a corporate governance regulatory framework is effective or not depends on whether the following three criteria are satisfied:

- the promotion of transparent and efficient markets;
- consistency with the principles of the rule of law (namely accountability, accessibility and clarity); and
- clear articulation of the division of responsibilities among different supervisory, regulatory and enforcement authorities.

In our view, Australia's regulatory framework for corporate governance easily satisfies the first two criteria. Most developed economies with strong democracies do so as a matter of course. That is why Australia is considered to be an attractive place for international investment, and is also why it has enjoyed a long period of strong economic growth. By comparison, countries in Asia such as Indonesia and Malaysia, which have regulatory frameworks that have not traditionally been consistent with the principles of the rule of law and which generally do not allow markets to operate free of unnecessary controls, have struggled in relative terms over the past decade.

We believe, however, that the third criterion articulated above highlights a weakness in Australia's existing regulatory framework with respect to corporate governance. We believe there are some issues in relation to the dual roles of the ASX and ASIC in regulation of corporate governance (for example, information-sharing arrangements between these two bodies and the role, if any, that ASIC has in the enforcement of the ASX's Principles of Good Corporate Governance and Best Practice Recommendations (ASX Best Practice Recommendations)) that make it important for the role of, and relationship between, the ASX and ASIC in corporate governance to be expressed in clear, written form and to be made publicly available. As contemporary corporate governance further matures into a sophisticated area of corporate regulation, it is crucial that the key regulators have a clear vision as to how they contribute to good corporate governance practices in Australian corporations. This challenge is almost unique to Australia, as we are one of the only jurisdictions to have dual regulators with a wide ranging mandate in relation to corporate governance.

The lack of formality to date in the relationship between the ASX and ASIC is perhaps due to a belief that
the respective roles of each regulator are already clearly defined, with ASIC being responsible for enforcement of the Corporations Act 2001 (Cth), and the ASX being responsible for overseeing and promoting compliance with the ASX Listing Rules and the ASX Best Practice Recommendations. However, we believe that the clear potential for the roles of the ASX and ASIC to overlap in the regulation of corporate governance, due to a lack of guidance on the relationship between the two regulators, justifies a formalisation of their respective roles. This lack of a formal understanding between the ASX and ASIC inhibits the fulfilment of an effective corporate governance regulatory framework in Australia.

Achieving such a framework according to international standards is not merely an exercise of adding more red tape to an already burdensome framework of corporate governance regulation. It is also about ensuring that Australia maintains a positive reputation in international money markets, thereby providing strong benefits for the economy. To ensure that Australia satisfies the third criterion, and can therefore be said to have in place an effective corporate governance regulatory framework, we propose that a formal MOU specifically dealing with corporate governance regulation be negotiated between the ASX and ASIC.

Proposed MOU between the ASX and ASIC

There is already an MOU between the ASX and ASIC. However, this MOU is limited to increasing cooperation and minimising overlap with respect to market supervision. ASIC has also entered into MOUs with a number of other regulators and organisations, including the Australian Competition and Consumer Commission (ACCC). In December 2004, the ACCC and ASIC revised their MOU to take account of the closer relationship resulting from their respective actions in addressing misconduct in debt collection and problems with wealth creation seminars and "get rich quick" schemes. Although this MOU between the ACCC and ASIC provides a useful template, a more specific corporate governance MOU between the ASX and ASIC would be desirable, given the emphasis of late on ensuring good corporate governance.

Traditionally, the role of the ASX has been limited to market surveillance and supervision, with ASIC also having some responsibility in this area as part of its general role of enforcing the Corporations Act. It is therefore understandable that market surveillance and supervision were the focus when the ASX and ASIC last came together to develop an MOU on how the two regulators would cooperate. But there have been major changes in the dynamics of corporate regulation in Australia, with the recent elevation of corporate governance as a discrete field of regulation. The ASX, as the regulator of the largest companies in Australia, is now taking an active role in the area of corporate governance—principally through its Best Practice Recommendations.

The growing sophistication and complexity of corporate governance as a discrete area of regulation, and the key roles of ASX and ASIC in both promoting and potentially enforcing good corporate governance practices, provide the potential for unnecessary confusion and uncertainty as to the role required of each regulator in particular contexts. This confusion and uncertainty could produce inefficiencies, a lack of transparency and a general lack of confidence in the market. Accordingly, we believe that—just as an MOU on market surveillance and supervision was considered necessary—a discrete MOU on corporate governance is now required.

A common theme in the recent corporate governance reform movement has been the desire to instil a culture of transparency and accountability in the governance practices of Australian companies. We believe that the parameters should naturally be extended so that the regulators of these companies themselves set in place guidelines for a transparent and accountable approach to the regulation of corporate governance. Indeed, they should set the lead. Corporate governance regulation should be directed at both manner and form.

The OECD Principles make this point very strongly: a "clearly defined" division of responsibilities between corporate governance regulators constitutes one of the three key criteria that underpin an effective corporate governance regulatory framework. The OECD Principles express the importance of this clear division of responsibilities as follows:

"Effective enforcement also requires that the allocation of responsibilities for supervision, implementation and enforcement among different authorities is clearly defined so that the competencies of complementary bodies and agencies are respected and used most effectively. Overlapping and perhaps contradictory regulations between national jurisdictions is also an issue that should be monitored so that no regulatory vacuum is allowed to develop... and to minimise the cost of compliance with multiple systems by corporations."

The proposed corporate governance MOU would relate mainly to the activities of listed companies, given that the jurisdiction of the ASX does not extend beyond these companies. Rather than being an addition to the existing MOU between the ASX and ASIC, the MOU on corporate governance would be a separate document. This is because, with corporate governance being such a high profile area of public policy, the MOU would be equally important as:

- an educational document (to inform corporate participants and the general community of what corporate governance regulation involves, and of the role of each regulator);
- a policy document (to demonstrate Australia's commitment to international best practice on corporate governance regulation); and
- a functional document used as part of the day to day relationship between the ASX and ASIC.

Features of the proposed MOU

The existing MOU between the ASX and ASIC provides guiding principles in relation to:

- the respective roles of the ASX and ASIC in market supervision and surveillance;
• referral of cases between the two regulators;
• consultation between the two regulators;
• the sharing of information;
• compliance by the two regulators with statutory obligations; and
• agreement on strategic objectives.

This MOU also provides for the formation of a National Coordination Committee as a forum for the exchange of information and to ensure that both parties discharge their roles as efficiently as possible. Importantly, the present MOU between the ASX and ASIC is a document that is available to the public.

We believe that this MOU provides a useful template for the proposed MOU between the ASX and ASIC on corporate governance.

**Delineation of roles**

The proposed corporate governance MOU would provide guiding principles in relation to the respective roles of the ASX and ASIC in corporate governance regulation, and include a clear explanation of the boundaries of “corporate governance regulation”.

An important feature of the proposed MOU would be a clear description of the respective roles of the ASX and ASIC in relation to the regulation of corporate governance, as well as a delineation of the relationship between the two bodies in the context of corporate governance regulation. Setting out the relationship between the ASX and ASIC in this way would emphasise the key responsibilities of these regulators and the initiatives that are desired from each body and from both of them (for example, an educational role in assisting companies to maintain standards of good governance). The MOU would not only contain details of what the ASX and ASIC are required to do, but would also set out what is not expected of these regulators in the wider context of corporate governance regulation. That is, the document would also outline the other ways in which the interests of stakeholders in companies are accommodated in the regulation of corporate governance in Australia—for example, through “soft law” and other areas of law such as industrial law, tax law and consumer protection law.

**Information sharing**

Since the introduction of the ASX Best Practice Recommendations and the enactment of the CLERP 9 reforms to the Corporations Act, there has not been any formal document dealing with information sharing between the ASX and ASIC in relation to corporate governance regulation. Each regulator may, from time to time, obtain information through its regular compliance, supervision and enforcement activities which may indicate a potential breach of a corporate governance rule that primarily comes under the domain of the other regulator. For instance:

• ASIC may come by information about a listed entity contravening a particular company law rule (for example, directors’ duties), which the ASX should be told about (to determine whether the listed company needs to make a disclosure to the market to satisfy continuous disclosure obligations);
• ASIC may discover (during the course of its regular review of annual reports) a possible failure to comply with recommendations under the ASX Best Practice Recommendations, which the ASX should be told about so that the ASX may decide whether it intends to take any administrative or enforcement action;
• the ASX may obtain information about a listed company that is contravening (or possibly about to contravene) corporate governance provisions under the Corporations Act.

Under the MOU, the ASX would be obliged to share information with ASIC about possible breaches of corporate governance provisions under the Corporations Act (provisions that have been made all the more extensive as a result of the CLERP 9 reforms), and ASIC would share information with the ASX about possible contraventions of the ASX Best Practice Recommendations and those ASX Listing Rules that embody key corporate governance principles (e.g. ASX Listing Rule 10, dealing with related party transactions).

**Referral of cases**

The proposed MOU accordingly assumes that, while ASIC is the main corporate regulator, the ASX will continue to have an enforcement role—primarily in relation to its Listing Rules (which encompass the ASX Best Practice Recommendations, by virtue of ASX Listing Rule 4.10.3). With the resources of ASIC already stretched, and the ASX having developed particular expertise in the enforcement of its Listing Rules, we believe that it is not appropriate at this time for the ASX to give up its enforcement function.

**Conclusion**

With the heightening and formalisation of corporate governance “benchmarks” for companies through CLERP 9 and the ASX Best Practice Recommendations, the form of Australian corporate governance regulation is certainly in line with international best practice as embodied in the OECD Principles. However, while the manner of corporate governance regulation in this country is generally good, there is still room for improvement in terms of meeting the criteria for an effective regulatory framework as articulated in the OECD Principles. We believe that if the MOU on corporate governance between the ASX and ASIC that we have proposed in this article was entered into and implemented, the manner and form of corporate governance regulation in Australia would meet (and indeed, go beyond) international best practice.

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3. OECD, note 2 above, p11.
4. OECD, note 2 above, p29.
6. Including the reforms under the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (Cth) (CLERP 9).
7. OECD, note 2 above, p31.