



ASIC

Australian Securities & Investments Commission

Significant regulatory issues facing ASIC and Australian business

**A presentation by Jeffrey Lucy, Chairman,
Australian Securities and Investments Commission
to Australia–Israel Chamber of Commerce**

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Thank-you for inviting me here today.

It is my pleasure to address the Australia-Israel Chamber of Commerce.

Your organisation does a lot to facilitate trade and business between Australia and Israel as well as raising awareness of commercial and regulatory issues in each country, including some that are close to our hearts at ASIC. Another virtue of the AICC is its reputation for providing a forum for speakers to communicate with the Australian business community.

This afternoon, I am very pleased to be able to share with you some of the significant issues I see facing ASIC at the moment, and inevitably, also Australian business.

I want to use this platform today to do two things:

- Firstly, I want to explore with you the job of corporate regulator. That is, "what is it that we are trying to achieve at ASIC?" and
- Secondly, I want to explain how we are going to go about doing this task. In particular, I'll focus on three of our key challenges in the coming years:
 - bedding down the financial services reforms;
 - building on our strong enforcement activities; and
 - improving consumer protection.

I hope that in sharing this information with you as representatives of the business community, we can work together to achieve a stronger and more confident market that will continue to attract capital flows, and in which business and investors will prosper.

The business of regulation

Let me first address the role of ASIC as corporate regulator. It is, I believe, a role that is crucial to the economic prosperity of this country.

ASIC's statutory objectives are determined by Parliament and are set out in the ASIC Act. I will not dwell on the legislation today, however it essentially requires ASIC:

- to ensure that our markets are clean and fair for all participants;
- to protect investors from improper or illegal practices; and
- to maintain and improve confidence in our financial system.

To my mind, effective and clear regulation strengthens market confidence; and economic prosperity results from market confidence.

Effective regulation and a strong financial architecture are vital ingredients for Australia's economic success. Over recent years, our economy and financial system have prospered in the face of considerable international economic and political turmoil, largely because of a sound macroeconomic environment and a coherent regulatory system.

Our **strong, fair** and **balanced** regulatory system provides certainty in the market and ultimately underpins the general confidence and integrity of our markets.

Now I don't want to sound as though I am reading from *Economics 101*, so I'll use the 'regulatory pyramid' to illustrate how we at ASIC see our regulatory role contributing to Australia's market confidence.

Imagine, if you will, a pyramid divided into three layers. The base of the pyramid is the largest layer and, I would hope, includes all of you here today. That is, the 'compliers'. These are the businesses, directors, financial service providers, auditors etc who are choosing to comply with the laws of the Commonwealth. They are the good corporate citizens who have no intention of engaging in improper or illegal behaviour.

ASIC's regulatory role in respect to this group is to provide guidance to help them continue to comply - especially, for example, when faced with new legislation. Our role is also to monitor and police the rest of the market to ensure the system is fair for everyone, including the compliers. No-one should be able to gain a competitive advantage by non-compliance with the law.

The second and middle layer of our regulatory pyramid contains the 'opportunists' – in other words, those seeking economic advantage by pushing the legal and compliance envelope. This group is prepared to bend the rules if they think they can get away with it.

We watch this group closely, monitoring their behaviour and using targeted surveillances and frequently using voluntary or enforceable undertakings to ensure improved compliance with the law. This group responds to ASIC activity that influences their views and conduct.

The third and smallest layer is the pointy end of the pyramid and represents those who debatably engage in improper and illegal behaviour. And as you may anticipate, ASIC uses its full enforcement strength to regulate this group. Many in this group believe they are simply beyond or above the laws of the Commonwealth. Typically, when challenged, they use every means available to delay and frustrate our actions.

To be an effective regulator and achieve our objectives of a clean, fair and confident market, ASIC must be a strong and determined enforcer of the law. But we must also be a fair and balanced regulator that ensures the system works

for everyone, is commercially engaged, and is aware of the issues facing business.

It will come as no surprise to you, of course, that I believe we *do* bring this approach to our role.

ASIC has been and continues to be a strong law enforcement agency that administers and upholds the Corporations Act without fear or favour. Indeed, it is because of our strong enforcement record that we are able to concentrate on working with business and consumers in other areas.

Under my Chairmanship, we will continue to build on ASIC's strong enforcement reputation and will continue to exercise our strength in implementing our enforcement powers to the full extent necessary in circumstances of corporate misconduct.

We have a successful track record in prosecuting market and corporate misconduct. Having said that, very few global regulators, including ASIC, are funded to a level where they can take on every initiative they'd like. To make best use of the resources we have, we need to reconsider our priorities on an ongoing basis to ensure that our enforcement activity continues to ensure the credibility and competitiveness of our markets.

There is more to ASIC however, than simply making rules and punishing offenders. The real value of ASIC is in creating a fair environment in which you are able to do business to the best of your competitive ability, and in which the people who invest in your business and buy your products and services will also have confidence.

Naturally, this can be achieved in part by weeding out illegal behaviour. However, we also aim to balance this approach with an understanding of your commercial activities and imperatives.

Much of what we do at ASIC involves working with businesses - whether it be in discussing areas of regulatory uncertainty, reviewing corporate finance proposals including fundraisings, mergers and acquisitions, or encouraging better disclosure.

In the last financial year, \$45 billion in major corporate restructures and initial public offerings were able to proceed, following ASIC's consideration of waivers or modifications to the law.

By being alert to emerging business practices and being commercially engaged, we are better able to see and understand the commercial perspective before deciding the appropriate balanced regulatory response. The better we understand your business, the better we can do our job as the regulator.

At the other end of the spectrum lies quite a different issue that we see as crucial to improving market confidence. Helping to educate Australian consumers of their rights and obligations in the market - be they retirees with their life savings invested in managed funds, or average Australians investing in the stock market – is necessary to ensure the system is fair for everyone, particularly in the face of new and increasingly sinister scams.

Bedding-down financial services reform

To give you a more specific sense of where we are focusing our efforts in the regulatory landscape, I'd like to turn your attention to one of our most recent reform programs, the Financial Services Reform regime.

As most of you probably know, the Financial Services Reform Act has been in full effect since 11 March this year following a two-year transition period.

It is fair to say that FSRA is one of the most ambitious regulatory programs ever undertaken in this country.

Its aim is to apply a single set of rules to all financial services and financial products and to provide a competitively neutral system that allows all financial service participants to compete on the same consistent regulatory playing field. This is to promote opportunities for business. At the same time, FSRA promotes confidence by delivering robust protection for consumers, and market integrity for all.

With the FSR regime still in its early stages, bedding-down this legislation and ensuring it works for all involved is now one of the major challenges facing ASIC. The legislation itself is the backdrop for Australia's funds management industry which manages more than \$719 billion for over 9 million Australians¹.

And, with many Australians having their life savings invested in financial products including retirement accounts, superannuation and managed funds, the success of the FSR regime is of interest to all of us.

From a regulatory perspective, the introduction of the FSR regime was a massive undertaking, increasing both our jurisdictional reach and our workload.

We have issued almost 4,000 Australian Financial Services Licences and considered over 1,000 FSR-related applications for relief from the law.

Indeed, up until March, much of the focus was on licensing and industry's readiness to engage with the new regime. Whereas now, it is on delivering outcomes and achieving the positive half of the cost-benefit equation.

¹ <http://www.ifsa.com.au> - IFSA industry statistics, 27 July 2004.

We know however, that industry is still grappling with some FSR issues, and we expect this will continue until the industry comes to grips with the practicalities of the new regime.

Ensuring adequate disclosure is one area in which the industry seems to be having particular difficulty at the moment.

FSR challenges industry to disclose everything consumers need to know to make sound decisions in their own interests; and to do so 'clearly, concisely and effectively.'

Long and complex documents – including those 100 page statements of advice that we've all heard about - are unhelpful to consumers, and are certainly not in a licensee's best commercial interests.

We have been in discussion with industry groups on these issues for some time, and in the past fortnight we have issued further guidance on how we expect licensees to prepare their statements of advice and statements of *additional* advice.

We will continue do what we can to assist industry on this matter, but industry must do their part to ensure that information is not overly long or complex. Real success here ultimately depends on action taken within the industry itself.

In this respect, ASIC has recently seen statements of advice that are down to 30 pages and contain all relevant information as required by the legislation. Industry needs to continue testing these documents in the market and take action to reflect the needs of consumers. Ultimately, it is my expectation that competitive and commercial pressures will dictate shorter, clearer disclosure documents.

Superannuation choice

I might just pause here to speak very briefly about the challenges for both ASIC and the financial planning industry associated with the introduction of the new Choice in Super legislation.

After long debate, the Parliament has now decided Australians should be given a choice over which super fund they invest in – recognising that exercising one's own buying power is an important asset for consumers and is appropriate in a society that is focused on funding its own retirement.

The Financial Services Reform regime provides the bedrock for the Choice in Super legislation. Without the levels of disclosure and protection provided to consumers under the FSR regime, super choice wouldn't work. And, it is vital that we get this right.

This is particularly highlighted by the \$596 billion² of super assets in Australia, representing 26 million member accounts. Millions of dollars of fees, charges and commission are also paid to the industry.

Australia has learnt from the UK pension mis-selling disaster and is determined to ensure that that it is not repeated here. Strong legislative protections are in place through the FSR regime and super choice will be a major focus for ASIC over the next few years.

Indeed, industry will have a huge responsibility to make sure that consumers' rights to choose are not abused. For our part, we will be monitoring 'switching advice' to ensure that it is given in accordance with the FSR regime.

Super choice advertising and poor advice about switching will be major priorities for ASIC going forward and we will not hesitate to take enforcement action against those who seek to abuse consumers' trust – be they big or small players.

Last year's ANZ financial literacy survey highlighted the need for Australian consumers to be more engaged with their superannuation and better understand it. In ensuring that superannuation choice delivers fair and appropriate opportunities for Australian workers we, along with the ATO, will also be focusing on consumer education.

We want to ensure that consumers know the questions to ask and the things to consider before making any decision to switch funds or remain where they are. Industry too has a significant role in consumer education and awareness.

Education, combined with significantly improved disclosure and a tough enforcement approach will, I believe, help to ensure that choice delivers real benefits to Australian consumers.

Enforcement

As I have said, a crucial and major priority for ASIC under my Chairmanship is to uphold the various laws that we are charged with administering through direct and vigorous enforcement action. In cases of corporate misconduct, we will use all the remedies and tools that Parliament has given us to sustain public confidence in the integrity of our financial system.

Indeed, the community tends to judge us on our enforcement record. Many of you would have no doubt heard a great deal about some of our more high-profile enforcement cases in the press. You may be surprised to hear however, that the majority of ASIC enforcement activity has a much lower profile.

² <http://www.apra.gov.au>. 2 August 2004.

We have a strong and enviable record. In the last financial year:

- 67 people were convicted from briefs prosecuted by the Commonwealth Director of Public Prosecutions;
- 51 civil proceedings were commenced, resulting in orders against 118 people or companies, \$101 million in recoveries, compensation and fines, and \$11 million frozen;
- 22 people were banned or removed from directing companies, and 42 people from offering financial services; and
- 13 company auditors and liquidators were disciplined for misconduct.

In addition, 469 people were prosecuted for 894 offences following public complaints of misconduct. A further 277 matters are currently before the courts.

ASIC has sometimes been criticised for not being serious about its enforcement and consumer protection role. But the record does not bear this out. Few regulators can point to this volume or range of successful enforcement activities.

It is appropriate however, that both ASIC and the community have a reality check on what a regulator can actually do in the market. No-one can expect the regulator to take on every single matter. A regulator cannot be everywhere at once. We try hard to get maximum impact for what we do, but any agency that is budget funded has to establish priorities – which simply means it cannot do everything.

Going forward, we will be paying particular attention to our liaison with international regulators, improving our information gathering and intelligence systems upon which we build our cases, and strengthening our liaison with the Australian Crime Commission and other regulatory and law enforcement bodies.

CLERP 9

Following recent law reform, ASIC's other major policy focus is on the implementation of CLERP 9. The CLERP 9 legislation strengthens the existing audit regulation and is a crucial step in improving Australia's approach to corporate governance and disclosure.

Specifically, CLERP 9 contains a new general requirement that auditors maintain their independence. We believe that maintaining independence is crucial given the important role auditors fulfill in monitoring and supervising management and the Board.

CLERP 9 also introduces a new and much debated remedy for breaches of the continuous disclosure obligations. ASIC now has the ability to issue an infringement notice (following a hearing) if it has reasonable grounds to believe

that a disclosing entity has not disclosed materially price-sensitive information to the market operator.

The payment of an infringement notice however is not a final determination of liability. It provides a manner in which the issue may be dealt with, without engaging in lengthy and expensive court proceedings. Payment of a fine specified in any infringement notice issued is not an admission of guilt, or a conviction.

Infringement notices, we believe, provide an appropriate remedy for failure to comply with continuous disclosure obligations that is proportionate to an alleged low-level breach. The matter will be dealt with quickly and effectively while maintaining the integrity of the market by ensuring transparency and equal access to information relevant to all market participants. ASIC's ability to use civil penalty or criminal remedies in more serious cases however, still exists.

Consumer protection and education

We have acknowledged that ASIC has a serious role to play in enforcing the law and removing illegal activity from the market. This does much to protect consumers and increase investor confidence in the integrity of the Australian market.

ASIC also aims to help consumers by arming them with the knowledge and confidence they need to choose investments that are in their best interests and to avoid scams.

Indeed, with hundreds of billions of dollars invested in the Australian funds management industry, and with more and more Australian consumers choosing to invest in financial products, including through the superannuation choice legislation, there is hardly a more important time for consumer education and protection.

I believe it was a recent UK financial literacy survey that found that 50% of people do not understand what 50% means. With statistics like this (which incidentally, are not confined to the UK), it is not difficult to see how important consumer education is in today's society.

I personally find it deeply disturbing to see how easily some consumers fall for the many outrageous scams out there. They range from the overseas cold calling scams to various outlandish claims of high market yields.

To raise awareness of these scams and to encourage consumers to be aware of their own circumstances, we endeavour to target our consumer education campaigns directly at specific 'at risk' consumers so that our message gets to those who need it most, at the time they need it most, and in a manner they will fully consider.

In doing this, we recognize that consumers are not all 'peas in a pod', and it is not possible to have a single approach to education across the myriad of financial products and services.

In the past few weeks, ASIC has taken action to protect Australian consumers against three wealth creation seminars where we were concerned about references to financial product advice made in the promotional materials, including representations about making money through the stock market. None of the promoters of the seminars held Australian Financial Services Licenses and so were not entitled to provide such advice under Australian law.

While I understand that no financial product advice was ultimately given at these seminars, the actual seminar content was changed to comply with Corporations Act requirements. This may explain why one particular seminar finished abruptly, with the final session becoming a sing-along led by the presenter's daughter, followed by a hard sell to buy the young lady's newly released CD.

Recently, there has been some media coverage regarding the jurisdictional divide between ASIC and the ACCC in this area. The reality is that ASIC and ACCC do work together and there is regular enforcement dialogue between our two agencies.

Ultimately, what I think is important is not how the responsibilities for consumer protection are divided up, but that the interests of consumers are advanced and protected. It is my aim to generate good, solid outcomes for consumers which will help them decide on investments that are in their own best interests.

For example, in May we published a report on the disclosure of soft dollar benefits paid to financial advisers. Our intention was to improve disclosure about soft dollar benefits and to bring the existence of these benefits to public attention so that consumers could rationally exercise their key power – the power to decide what product to buy.

We therefore welcome recent steps taken by industry bodies (FPA and IFSA) that have issued their own code of conduct restricting the use of certain benefits. We will follow up on this issue through surveillance and if necessary enforcement action this year.

Other focuses for ASIC

This afternoon I have talked in some detail about our work in financial services, consumer protection, CLERP 9 and enforcement. However it would be remiss to not mention in passing two other significant regulatory issues facing ASIC.

On the international front, ASIC is continuing to actively liaise with fellow regulators internationally. This is vital in the current climate of increased international capital flows and free trade agreements, and regrettably, because of

an increase in international crime. We are working to ensure that regulatory overlap is minimized, that standards are both high and comparable and that global enforcement actions are possible.

Of particular interest is the interaction of CLERP 9 and the Sarbanes Oxley legislation in the US. In coming weeks, we will be consulting with major companies in Australia and our US counterpart, the Securities Exchange Commission, to ensure that our regulatory regimes are fully understood and to minimize the extra costs on business when complying with each international set of laws.

Closer to home, discussions between Australian and New Zealand authorities have focused on a proposed mutual recognition regime that would see streamlined compliance obligations for issuing entities. These entities currently need to issue two complying disclosure documents. However, the proposal would require issuers to only meet the requirements of the regulator in the country of origin, while still retaining reasonable safeguards to prevent inadequate disclosure.

ASIC is also taking an active role in relation to the introduction of international financial reporting standards on 1 January 2005. The adoption of these standards will provide increased transparency and comparability in financial reports prepared by Australian companies and will promote investor protection and market confidence. We will be monitoring compliance with these new standards. We are also exploring better ways to use all of the financial information provided to us in the financial reports from companies.

Conclusion

I hope that today I have given you a taste of ASIC's role as Australia's corporate regulator.

We do not regulate to be a spanner in the cogs of commerce or target high-profile villains. We do our job to ultimately provide a clean, fair market, to protect investors and to provide a confident financial environment in which legitimate businesses will flourish.

Thank you.