



ASIC

Australian Securities & Investments Commission

Opening address

*A speech by Greg Medcraft, Chairman,
Australian Securities and Investments Commission*

ASIC Annual Forum 2013

25 March 2013

Introduction

Thank you, Robynne and Uncle Chicka, for your warm welcome to Gadigal Country.

Good morning everyone, welcome to the ASIC Annual Forum for 2013.

Ladies and gentlemen, on behalf of my fellow commissioners – Belinda Gibson, Peter Kell, John Price and Greg Tanzer – and on behalf of all ASIC staff, I welcome and thank you for supporting this important event.

I think the Annual Forum is an excellent opportunity to discuss what is happening in financial services and the markets, as well as meet people from around the world.

For those of you in Sydney for the first time, I hope you get to enjoy the wonderful sights and experiences this city has to offer.

We are fortunate to have some distinguished speakers lined up over the next two days, and I'd like to give particular thanks to our speakers who have travelled overseas from Canada, France, Hong Kong, Malaysia, Netherlands, Spain, and the United States.

I'd also like to welcome John Price to his first Annual Forum as an ASIC Commissioner. John became a Commissioner in March last year. He is the first ASIC staff member to be directly promoted to Commissioner.

Overview of Annual Forum agenda

The theme for this Annual Forum is 'the new normal'.

The conference will broadly canvass three questions for financial services and markets:

- What is the new normal?
- What does it mean for industry, regulators and policy makers?
- How can we influence it?

Over the next two days, there will be many presentations and panel discussions to explore these questions.

Conference information and services

- Webcast – Each session will be recorded and made available to attendees via webcast.

- ASIC Forum app – I'm pleased to announce you can now download the ASIC Forum app. This is an interactive version of the conference program and has been designed for tablets and iPads.
- Smart-phone PDF – A smart-phone friendly PDF of the program is also available to download to your smart phones. Details about how to access these are included in your satchels.
- Wi-fi will be available throughout the Hilton conference venue.

I'd like to highlight three keynote speeches in our program.

- At today's lunch, the Hon Bernie Ripoll, Parliamentary Secretary to the Treasurer, will be the guest speaker.
- Tonight, we have a special dinner event with a keynote presentation from David Gonski, Chairman of the Future Fund.
- And tomorrow, Glenn Stevens, Governor of the Reserve Bank of Australia (RBA), will give the final keynote speech.

The new normal

Post global financial crisis, we have found ourselves in a new economic environment to which we must adapt. This is 'the new normal'.

Economic growth remains the goal, but it needs to be funded. Funding can come from the banking sector or via market-based financing (i.e. debt and equity capital markets). As one of the major ways to fund economic growth, market-based financing goes to the heart of securities regulation.

In order for market-based financing to be effective, markets must be fair, orderly and transparent, and investors need to be confident and informed. These are the strategic objectives of securities regulators globally.

Last year in my opening address, I outlined the three challenges I saw ASIC facing over the next decade. I'd like to refine these challenges, given developments in the past year, and broaden their applicability to all securities regulators.

That is, what are the major global challenges facing securities regulators in adapting to 'the new normal' in financial services and markets?

Major global challenges facing securities regulators in adapting to the new normal

There are three major challenges as I see it:

- structural change
- ongoing innovation and complexity

- globalisation.

I will go through each of these in turn.

Structural change

The global financial system is currently undergoing significant structural change.

Market-based financing is increasing and is now seen as a key source for funding economic growth. This structural change is being driven by (1) increased banking regulation, and (2) the growth of the pension and superannuation sectors.

New rules to strengthen the banking system are imposing higher capital and liquidity requirements. The net effect of this is often decreased access to debt capital and an increased cost to business. As a result, many businesses are turning to market-based financing to source their funds.

The second driver of market-based financing is the global growth of the pension and superannuation sectors, much of which is invested in debt and equity capital markets. This global growth is expected to continue in the coming decade as:

- governments in emerging markets start or expand retirement savings programs
- in many countries, there is a demographic shift underway as the population ages and people start to contemplate how to fund their retirement.

In Australia, funds invested in superannuation are expected to grow from \$1.4 trillion to \$3 trillion by the end of the decade.

Market-based financing is growing in importance and the challenge for us as securities regulators is to ensure we have the right tools and resources, so that debt and equity capital markets can perform their critical role in funding economic growth.

Innovation-driven complexity

The second challenge facing regulators is keeping abreast of innovation-driven complexity, so we can meet our strategic objectives of ensuring investors are confident and informed, and markets are fair, orderly and transparent.

It's a constant struggle for regulators to monitor the emerging risks and respond in a way that doesn't unduly restrict the benefits that innovation can bring.

But innovation can often add complexity and risk.

We see innovation-driven complexity in:

- products
- markets
- technology.

Complexity in products

Shadow banking is a good example of innovation-driven complexity. In 2008, we saw extremely complex products develop in the form of collateralised debt obligations (CDOs) and CDOs squared. Wholesale and retail investors were unable to understand or value the risks inherent in these products and, as a result, they lost a lot of money.

Complex products, due to their nature, can be difficult for investors to understand. This can lead to them being mis-sold, particularly when investors are searching for yield.

My position on this is clear – those selling complex products to unsuspecting investors need to wise up and do the right thing. They might get away with it for a while, but government and courts will inevitably rule in favour of investors.

Globally, the International Organization of Securities Commissions (IOSCO) is looking at this and is developing a regulatory tool kit that regulators could use in their regulation of complex products.

In Australia, ASIC is exploring ways to best regulate these products. This includes considering the whole of the product life cycle, not just distribution and disclosure.

For example, e-learning modules that explain the key features and risks of a product could be used to educate potential investors about a product. This could overcome the inherent weaknesses in traditional disclosure methods. An online assessment module could then be used to assess the person's understanding before they invest.

Globally and locally, our aim is to reduce the risk of complex products being mis-sold to investors. This is a perennial challenge.

Complexity in markets

In recent years globally, we've seen the rise of dark pools and high-frequency trading. Crossing engines and high-frequency trading are 'the new normal', so we need appropriate regulation and a measured response.

Globally, IOSCO has set high-level guidance to promote market integrity and efficiency, and mitigate the risks posed by technological developments such as high-frequency trading. It's promoting a consistent approach among regulators.

In Australia, ASIC released a report¹ on these issues last week:

- We found dark liquidity has caused spreads to widen for some stocks, but this will be managed via a new rule on meaningful price improvement. We are also recommending new rules to improve the transparency of dark pools.
- On high-frequency trading, we found public concerns appear to have been overstated with no evidence of systematic manipulation by high-frequency traders. In fact, their trading strategies are commonly adopted by the buy-side.

However, we will continue to monitor these issues and consider what is a 'safe level' of high frequency trading. Does it provides phantom liquidity?

As I said before, we need appropriate regulation and a measured response.

Complexity in technology

Advances in technology have led to the rise of cyber crime in the financial system globally. Online scams are promoting bogus investments, and equity trading accounts are at risk of being hacked into and having the investment funds stolen.

At the global level, IOSCO is helping regulators to share information on scams. And in Australia, we're working to educate potential victims and shutdown scams.

Responding to innovation-driven complexity

Innovation-driven complexity of products, markets and technology will continue to raise challenges for securities regulators in meeting our strategic objectives. To meet these, we will need to be forward looking and proactive.

This includes identifying potential risks over the horizon, and maintaining a close dialogue with industry to better understand what is happening in the market.

Finally, thinking outside the box and encouraging industry to use new tools, such as new media, can lead to better outcomes.

It's important for regulators to keep adapting to new developments. Innovation is inevitable and again, we need to ensure that it does not outpace

¹ See Report 331 *Dark liquidity and high-frequency trading* (REP 331).

regulation or compromise our strategic objectives of confident and informed investors, and fair, orderly and transparent markets.

Globalisation

The third and final challenge facing regulators is globalisation. Globalisation raises two issues for regulators.

The first issue is interoperability of markets. To facilitate economic growth via the free flow of capital, markets need to become more integrated. Currently, each market has its own set of rules and regulations; however, securities regulators globally have the common objectives of confident and informed investors, and fair, orderly and transparency markets.

Inconsistencies in regulation can add to costs of investing and doing business, and this can affect economic growth.

Australia, as a net importer of capital, needs to access capital in other jurisdictions. Obstacles to cross-border capital flows can negatively impact our growth.

What can we do about this?

We need to work toward global harmonisation of regulation. Global principles and a global rulebook are a good starting point. This would minimise market fragmentation and facilitate cross-border capital flows. However, policy makers in each country will inevitably take different approaches to implementation for various domestic reasons.

Tools like mutual recognition and substituted compliance can overcome these differences. They recognise that the same regulatory outcomes are being achieved, just in different ways. Equivalence of regulatory outcomes ensures regulation remains appropriate for each market while facilitating cross-border activity.

The second issue with globalisation is global misconduct. The fact that markets are global means misconduct is now occurring across borders.

Ponzi schemes can be based in offshore tax havens with different parties located in different jurisdictions. Regulators will need to cooperate and help each other in both investigations and enforcement matters. This is a real challenge.

While globalisation may wax and wane, it will continue in 'the new normal', and global issues require a global response. Organisations such as IOSCO have a key role to play in promoting equivalence of outcomes, a global rulebook and facilitating cooperation between regulators.

Having the right global infrastructure in place is critical to developing a global approach to market regulation. It's important for Australia to be involved in these organisations and ASIC is well placed to tackle this challenge.

I see these three challenges – structural change, innovation-driven complexity, and globalisation – as the three major global challenges facing securities regulators in adapting to 'the new normal' and meeting our goals of confident and informed investors, and fair, orderly and transparent markets.

Economic growth is critical, and will need to be funded. Market-based financing will have an increasingly important role to play in providing this funding.

This means regulators will need to be alert. We will need to be forward looking and proactive. But most importantly, we will need to cooperate at a global level.

With the right people and infrastructure in place, I am confident that we will be up to the challenge.

Introducing Elisse Walter

Ladies and gentlemen, we have a busy schedule ahead of us over the next two days. It should be a stimulating and entertaining program.

So, without further ado, let us begin with the first plenary session.

It was with great pleasure that I asked Elisse Walter to be our first keynote presenter. Elisse has been designated the 30th Chairman of the Securities and Exchange Commission by President Barack Obama.

She has also served as Senior Executive Vice President of Regulatory Policy & Programs for Financial Industry Regulatory Authority (FINRA) and held the same position at the National Association of Securities Dealers (NASD).

Elisse will set the scene for this conference with her discussion of 'the new normal'.