



ASIC

Australian Securities & Investments Commission

Engaging WA stakeholders

Future challenges and opportunities

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

27 August 2013

CHECK AGAINST DELIVERY

I'd like to extend a special welcome to the Chief Justice, the Honourable Wayne Martin, and the Attorney General, the Honourable Michael Mischin MLC.

I'd also like to introduce you all to Cathie Armour. Cathie became a Commissioner in June 2013. This is her first time joining us in Perth.

Speaking of Perth, it's great to be back in this city, where I lived for a short period of time many years back.

Our cocktail functions in Western Australia are on their way to becoming an annual event. I can already see some familiar faces.

Tonight, I want to focus on the road ahead for ASIC. Before doing this, I'll comment on the importance of the WA economy and ASIC's WA office.

The WA economy

Western Australia is home to 43% of ASX listed entities; 78% of these companies are in the resources and energy sector.

Western Australia also has approximately:

- 11% of the national population
- 16% of the national gross domestic product (GDP)
- 9% of Australian financial service licence holders
- 13% of credit licensees
- 8% of registered auditors.

The WA economy has been the best-performing economy in Australia for some years when measured against a combination of factors. This includes economic growth, retail trade, employment, and population growth.

The WA economy is now moving from a very strong and lengthy investment cycle to a production cycle. At ASIC, we have noticed a lot less activity in the capital-raising space in Western Australia in the last six to nine months.

ASIC's WA office

Our WA office basically mirrors ASIC nationally. It has nearly all of ASIC's stakeholder and enforcement teams. The office contributes significantly to ASIC's outcomes. These are based on achieving our strategic priorities of ensuring:

- confident and informed investors and financial consumers
- fair and efficient financial markets
- efficient registration and licensing.

I'm also proud to say that our WA staff are active in the ASIC in the Community Program. ASIC in the Community encourages staff to support charities such as the Red Cross Breakfast Club, Guide Dogs WA and the Cancer Council, to name a few.

The road ahead for ASIC

Moving on to the main topic for tonight: the road ahead for ASIC. As always, our road ahead is focused on achieving our strategic priorities that I mentioned earlier. That is:

- confident and informed investors
- fair and efficient markets
- efficient registration and licensing.

When I think about what's ahead, I see three challenges for ASIC:

- the shift towards market-based financing
- innovation-driven complexity
- globalisation.

While these are challenges, they also present opportunities to fund economic growth. We need to harvest the opportunity and mitigate the risk.

I am also Chairman of the International Organization of Securities Commissions (IOSCO).

Interestingly, these challenges are also challenges at the global level. They also present a global opportunity to harvest the opportunity to fund economic growth while mitigating the risks.

Market-based financing

There is a significant structural shift that is occurring, towards market-based financing. That is, using debt and equity capital markets instead of traditional bank lending. Market-based financing provides an opportunity to fund future economic growth in both developed and emerging markets.

When we harvest this opportunity, any risk to financial stability must be mitigated.

Many businesses are turning to market-based financing to source their capital. This is because of a decreased access to, and increased cost of, debt.

The increase in activity in our capital markets will have a flow-on effect for gatekeepers such as financial advisers, investment managers, custodians, stock exchanges, auditors and accountants.

Market-based financing presents new business opportunities for these gatekeepers; but they also have a role in mitigating the risk.

For ASIC, we've got to be forward looking and proactive. One way we do this is by having a good dialogue with industry, so we can understand what's happening in the market. Being close to the market, both in Western Australia and the rest of Australia, is important to achieve our strategic objectives.

Innovation-driven complexity

The second challenge for regulators is keeping pace with innovation-driven complexity.

It's a constant struggle for regulators to monitor new developments and respond in a way that doesn't unfairly restrict people's ability to harvest the opportunities arising from financial innovation. Financial innovation can add complexity and risks, which must be mitigated.

I see financial innovation-driven complexity in three areas:

- products
- markets
- technology.

Tonight, I'll focus on complexity in financial products. A good example of innovation-driven complexity in financial products is hybrids. We have highlighted this in our report *Hybrid securities*, released last Tuesday.¹

ASIC is focusing on the sale of hybrids for three key reasons:

- *Possible misleading conduct* – We are concerned about the possibility of misleading conduct in selling hybrids. This could occur through:
 - suggesting that hybrids are simple debt products
 - unwarranted comparison of hybrid returns to fixed income products or indexes
 - spruiking the returns of hybrids and the brand of the companies issuing them without being upfront about the risks involved.

¹ Report 365 *Hybrid securities* (REP 365).

- *Pricing* – Most primary market buyers for hybrids are retail investors. This suggests that retail investors don't understand and can't value the risks involved. This is because institutional investors aren't prepared to buy hybrids at the offer price.
- *Self-managed superannuation fund (SMSF) risk* – Two-thirds of the 75,000 investors in hybrids are SMSFs. This is concerning if those investors are depending on regular payments from their hybrid investment or that their investment will be redeemed after a short period. Generally, there is no guarantee that this will happen with hybrids.

As we have noted in our recent report, there are three main things we are doing to mitigate the risk:

- *Labelling* – Hybrids should have a more accurate label, such as 'capital notes'. This is something we are looking into.
- *Increased surveillance* around how hybrids are sold.
- *Investor education* – Exploring what tools can be used so that investors can check their understanding of hybrids before investing in them. We have already provided investor warnings and education on our MoneySmart website (www.moneysmart.gov.au).

Hybrids present new opportunities for business, especially for those that need to raise regulatory or rating capital. However, the risk to investors, particularly retail investors, needs to be mitigated.

Globalisation

The third and final opportunity and challenge is globalisation.

The opportunity to be harvested from globalisation is allowing the free flow of capital across global markets. Globalisation raises a number of opportunities and challenges. Today, I wanted to talk about the interoperability of markets.

By interoperability of markets I mean having a level playing field across markets to allow the free flow of capital internationally. In this respect, IOSCO has a pivotal role to play in arriving at the ideal solution – harmonised rules; in particular, having a global rule book to drive harmonisation.

IOSCO has already achieved this in the regulation of credit rating agencies and setting financial benchmarks. If harmonisation is not achieved, there will be fragmented rules around the world. Where markets are global, law makers are left with trying to knit everything together.

For example, this is what happened with over-the-counter (OTC) derivatives where regulators are focused on attempting to rely on other jurisdictions though substituted compliance or equivalence arrangements.

Globalisation is here to stay, and global issues require a global response. We need to think globally, while acting locally. Organisations such as IOSCO have a key role to play in promoting harmonisation and facilitating cooperation between regulators.

ASIC is also playing a key role in developing a global approach to market regulation. We are involved in IOSCO's new task force on cross-border regulation to develop a tool kit of measures to facilitate mutual recognition where needed, to facilitate cross-border capital flows.

Conclusion

I hope you now have a feel for the work the Perth team is doing here in ASIC and what we see as opportunities to fund economic growth and the challenges that lie ahead.

We all need to work together to harvest the opportunities to fund economic growth while mitigating the risk.