The challenges facing ASIC over the next decade

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

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Introduction

Hi everyone.

It's great to be back speaking to AMCHAM members.

I last addressed AMCHAM members about a year ago in Adelaide and I wanted to reiterate my recognition of the chamber and the work you do.

As this audience well knows, AMCHAM is Australia's largest international Chamber of Commerce and is arguably the country's premier international business organisation.

As someone who has spent nearly a decade working in the United States, I'm acutely aware of the importance of a strong business dialogue, especially between two close allies like Australia and the US.

And what is especially important is AMCHAM's breadth and reach, with 1,700 corporate members right across Australia.

So thank you for having me along today.

Ladies and gentlemen, today I will speak to you about the key challenges facing ASIC over the next decade.

I can then respond to any questions you might have.

There are three key challenges facing ASIC over the next decade to build resilience in the Australian financial system. These are:

- Growing regulatory perimeter: The growing regulatory perimeter, particularly with the exponential growth in superannuation (1.4 trillion to 3 trillion to 5 trillion) – this means more products, more investors and greater investment funds and therefore increased risk in the financial system;
- Complexity: The increasing complexity of the financial system – products, information channels and financial markets are all increasing in complexity which also increases risk in the system;
- And most importantly, proactive regulation: Leveraging ASIC’s resources to be a proactive regulator. Benjamin Franklin ‘an ounce of prevention is worth a pound of cure’. Stakeholder engagement, surveillance, education and guidance are all part of ASIC's proactive approach in order to maintain confidence in Australia’s financial system.

1st challenge – The growing regulatory perimeter

Superannuation is expected to grow to $3 trillion over the next decade, and to $5 trillion the following decade. It will grow at twice the rate of the economy. This will increase ASIC's regulatory perimeter as more investors come into the system and invest more money.

This is a shift of savings out of the banking sector into the superannuation/funds management sector.

The typical superannuation fund invests in equities, fixed income, property and cash. These are all products that that are regulated by ASIC.

With the growth in SMSF (currently 33% of superannuation, growing to 40% in the next five years), investors will be targeted with a range of products including structured products. Again, regulated by ASIC.

This growth in super will also impact financial advisors, superannuation trustees, investment managers, custodians, research houses, credit rating agencies, auditors and accountants.

They all play roles in supporting investors in superannuation funds and are all regulated by ASIC.

There will also be a greater need for consumer education and financial advice due to changing demographics as baby boomers move to the retirement phase and switch to more conservative assets.

Also, a larger financial system will invariably generate more complaints and breaches.

As you can see, ASIC is significantly impacted from the growth in super. With more stakeholders and investment products, ASIC’s workload will increase. It will be a key challenge to ensure our regulation is sufficient and remains effective so that overall risk in the system is contained.

2nd challenge – Increasing complexity in the financial system

While the regulatory perimeter is growing, the complexity of the financial system is increasing. This is at a time when the level of financial literacy in Australia is fairly low.

There is product complexity, complexity of technology and market complexity.

Product complexity

Today, a super fund has a much wider range of investment products to choose from.

In addition to plain vanilla products such as equities and bonds, super funds can invest in complex products such as ETFs, CFDs, hybrids, as well as investments in hedge funds.

There is also more scope to invest overseas, including in emerging or frontier markets. More complex products means greater risks and greater potential losses for Australian investors.

The increased risks in complex products are not just faced by retail investors. The GFC provided clear examples where non-retail investors (universities, councils, endowment funds etc) incurred severe losses from investing in structured credit instruments they did not understand.

Complexity of technology

Investors now have much more choice as to how to conduct their business.

Advances in technology and systems enable investors to buy securities on exchange or through dark pools. They can choose to use automated or algorithmic forms of trading, or lend their securities to earn income.

They can access a huge range of products, information and research on the internet and make investment decisions in a few mouse clicks.

Cyber crime

Advances in technology have also led to crime moving online.

Hacking into online equity trading accounts to sell their shares or for market manipulation purposes

Sophisticated scams are emerging that use fake websites combined with cold calling.

The ever-growing range of products and investor operations means the regulator needs to be much more vigilant and proactive. This process of increased complexity is likely to continue in the future, especially while equity markets remain volatile and investors look for yield.

Market complexity

The operations of markets themselves are increasingly technical and complex.

Trades have moved from taking one or two seconds to milliseconds to microseconds. High frequency traders using this new technology have added to exponential increases in global order books.

In the USA, this new type of trader is estimated to be responsible for 50% to 60% of market trading. The ability to undertake high speed transactions was a factor that led to the "Flash Crash" in May 2011 where US$1 trillion of shareholder equity was wiped out in minutes.

ASIC needs to keep pace with these rapid changes in technology to ensure markets are fair and efficient and investors get a fair price when trading on an exchange.

Innovation will continue and this will lead to increased complexity in products, information channels and the financial markets. This will heighten risk and the potential for loss in the financial system. It will require a proactive regulator that is 'on the ball' and forward-looking. This leads me to my next point.

3rd challenge – Leveraging ASIC's resources to maintain proactive regulation

Following the GFC, the environment for regulation and has changed dramatically. Regulators need to be on the front foot.

Rather than being reactive and arriving at the scene of the accident, regulators need to be cops on the beat, helping to prevent and deter accidents.

This is a major challenge for ASIC, particularly with our limited resources.

ASIC must spend a certain amount of resources on its core responsibilities: registration and licensing, and reactive regulation – i.e. investigating breaches and potential misconduct, and fulfilling our statutory mandate such as registration and licensing.

The remainder of ASIC's resources can then be used for proactive regulation.

Proactive regulation involves engagement with stakeholders, surveillance (desk-based and onsite), investor education and regulatory guidance.

These actions build resilience in the financial system as each participant in the system (investor, product manufacturer, distributer etc) meets a higher standard of conduct and understanding.

The system then becomes more resilient to shocks, and when a market failure does occur, hopefully less money is lost.

To be proactive, you need to be able to identify which sectors pose the greatest risk. Identifying risks requires a detailed understanding of the sector – understanding that is only gained through stakeholder engagement and surveillance.

So you can see that this is self-reinforcing. The more proactive and involved in the market, more effective the regulator is at identifying emerging risks.

Being proactive also has a deterrent effect, in that people will think twice if they know they'll be held to account.

Getting the message out there is a good way of leveraging ASIC's resources. Take insider trading, for example. We've been pushing the message that ASIC has the systems, the people and the powers to catch insider traders. If you get caught, it's likely that you'll go to gaol.

In fact, we're seeing more people cooperating and pleading guilty in the hope for leniency in sentencing. This is a tactic used quite successfully by the US SEC.

ASIC needs to maintain a high level of engagement with industry and continue its risk-based surveillances so that it can continue being proactive and forward-looking.

This comes at a time when our regulatory perimeter is expanding and complexity in the system is increasing.

I hope that's given you a feel for the key challenges that ASIC is facing.

Are there any questions?

