Address to International Centre for Financial Regulation

Speaking notes for address by Greg Medcraft, Chairman, Australian Securities and Investments Commission

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Introduction

Thank you to Barbara Ridpath and the International Centre for Financial Regulation for inviting me to meet with you today.

I'm particularly pleased to be back in Europe, where I spent many years as an investment banker before I joined ASIC (in early 2009).

This is a great opportunity for me – on my first visit to Europe as Chairman of ASIC – to get a better understanding of the major institutional and other regulatory reforms underway in the UK and more broadly in Europe and to see how they may inform our thinking in Australia.

I'd also like to take this opportunity to share with you my vision for ASIC and the approach I intend to take as Chairman.

A preliminary comment on ASIC. ASIC is a corporations, markets and financial services regulator.

We share responsibility for the regulation of the financial system with APRA (which has responsibility for the prudential regulation of deposit takers, insurance firms and pension funds) under arrangements set up in 1998.

We have a very broad set of responsibilities.

- We supervise Australia's financial markets.
- We regulate the conduct of all financial service and credit providers (through licensing, and setting and enforcing standards).
- We register companies, regulate their activities (such as fundraising, disclosure, reporting and oversight of directors' activities), and license and supervise auditors and liquidators.
- Those we regulate touch almost every Australian in some way.
    - We have 1.8 million companies on our books.
    - 4,900 Australian Financial Service licensees.
    - 6,000 credit licensees.
    - 6,000 registered auditors and liquidators.
- In the past year, our public registers were searched over 65 million times, while we handled over 1 million public enquiries and facilitated almost 2 million registry updates.

On taking the reins as Chairman, I did not see a need to dramatically restructure the organisation or reprioritise its objectives. In the two years I spent as Commissioner I felt that ASIC – along with other parts of our regulatory framework – withstood the challenges of the Global Financial Crisis pretty well and did not need a major overhaul.

What I did see, however, was a need to tighten our focus on three key outcomes taking into account our learnings from the Crisis. These are part of our new Strategic Framework.

They are:

Outcome 1: Confident and informed investors and financial consumers.

Outcome 2: Fair and efficient financial markets.

Outcome 3: Efficient registration and licensing.

There are four main factors guiding our approach to setting these priorities:

- Our legislative responsibilities – what we are required to do under the Corporations Act;
- Addressing systemic and regulatory risk – which is about promoting resilience in our capital markets;
- The gap between what we are delivering and what our stakeholders expect; and
- Government policy objectives.

I see us delivering on our priorities using a suite of approaches or drivers building on the more traditional tool kit of regulators. These include:

- Engaging with industry and stakeholders through our stakeholder teams;
- Surveillance – in particular focusing more on risk-based pro-active surveillance to check compliance and mitigate possible issues
- Providing guidance – providing formal guidance through regulatory guides and supporting industry associations in providing their own guidance;
- Education;
- Deterrence –
    - We will continue to take on the big cases and pursue wrong-doers.

  - We engage with industry and identify misconduct through surveillance before taking the appropriate action.
  - ASIC is considering releasing a high level guide on our enforcement approach to help the public understand how and why we respond to particular types of breaches of the law in different ways.
  - We also intend to issue periodic reports detailing recent ASIC investigations and reflecting how they align with the public enforcement policy.
- Policy advice to Government.

Today I want to focus on two aspects of the Strategic Framework in more detail:

- The first is how we achieve our outcome of confident and informed investors and consumers;
- The second is the role systemic risk plays in guiding our regulatory approach.

Both are areas in which I think we've learnt from the Global Financial Crisis.

- The Crisis highlighted, for instance, that relying on disclosure at the point of sale as the main tool in delivering consumer and investor protection outcomes is flawed.
- The Crisis also highlighted the need to take a more preventative and proactive approach in identifying and mitigating risks – 'an ounce of prevention is worth a pound of cure'. It also highlighted that we needed to better understand and address systemic risks.

It is interesting to note these are also ideas which are being considered by authorities in the UK in developing the approach of the new Financial Conduct Authority.

Topic 1: Confident and informed investors and consumers: beyond disclosure

Our financial system and regulatory approach is based on investors and consumers being responsible for their decisions. Our role as regulators is to arm them with the skills and knowledge they need to make confident and informed decisions.

Our approach to doing this has three elements:

- education;
- holding gatekeepers to account; and
- ensuring regulation is based on an understanding of consumer behaviour.

Firstly, *education*:

Financial literacy means understanding money and finances and being able to confidently apply that knowledge to make effective decisions. We need to help consumers understand money and finances and improve their access to tools that help them make sound financial decisions. Understanding risk–reward trade-offs and the benefits of diversification is paramount.

Our focus is on providing information on these basics across a number of channels and in innovative ways:

- Money Smart – with over ½ million visitors in 6 months;
- Helping Our Kids Understand Finance initiatives in schools. This involves embedding financial literacy in the national school curriculum from Kindergarten to Year 12 in over 6,000 schools;
- Use of new media to get the message across – in particular Twitter and Facebook and now with 24 YouTube videos.

Secondly, *gatekeepers*:

We need to ensure that those intermediaries who provide or assist in providing investors with the information they use to make decisions are competent, act with integrity and are held to account.

We take a wide view of *gatekeepers*. They include accountants, directors, advisers, custodians, product manufacturers, market operators and participants.

In this area, Australia is pursuing major reforms to the financial advice industry, which parallel some aspects of the UK's Retail Distribution Review. These reforms aim to address concerns about the quality of advice in three main areas:

- restoring confidence and trust in financial advice;
- raising levels of competency in the industry, and
- introducing a new standard of professional and ethical behaviour in the industry.

And thirdly, ensuring regulation reflects *consumer behaviour* and how consumers make decisions:

I want to expand on this third point further.

Our regulatory approach has traditionally assumed that the documents we require consumers to receive have the information consumers and investors need, are read and are influential in their decisions. These assumptions are flawed and don't necessarily reflect the way consumers and investors make decisions.

ASIC is targeting three main areas in this regard:

- best practice in advertising;
- effective communication of risks; and
- product suitability.

Advertising

Experience has told us that advertising is central to investor decision-making – often more so than formal disclosure documents.

We are currently consulting on best-practice guidance for advertising financial products and services.

We would like those preparing advertising to actively work to present a balanced understanding of the product or service, including its risks. They should also ensure that advertising is not targeting an audience for which the product is unlikely to be suitable.

Our expectation is that advertising should help, not hinder, the decision-making process. Advertising should do more than just meet the minimum standards, it should support sound decision-making.

Our proposed guidance also contains real examples of where we have raised concerns with promoters of financial products or services and as a result their advertisement has been changed.

Consultation ends 25 October. Submissions are welcome.

Effective communication by product issuers

Product issuers have a role to play in improving their communication to investors and consumers.

Part of this is improving formal disclosure documents. We have now used the 'if not, why not' model of disclosure for a number of products. We have asked issuers to state whether they take certain measures to mitigate risk and if not, why not.

However, communication about risks should also be made through a variety of channels including new media, so that different investors and consumers can access the information in a way that best suits them.

Product suitability for retail investors

We would also like to raise the question of whether issuers can do more to ensure products are not unsuitable for retail investors.

One of the proposed 'if not, why not' benchmarks for OTC CFDs is aimed at ensuring that investors have a good understanding of the product before they are able to open an account to trade. For example, whether they understand the concepts of leverage and margins.

Investors who thoroughly understand the features and risks of a product are less likely to get into difficulties down the track.

Although our approach and that of our UK colleagues share a similar philosophical starting point, the FCA's new product intervention powers go one step further. We will watch with interest the effectiveness of that approach.

Topic 2: Systemic risk and the role of securities regulators

One of the drivers of our Strategic Framework is ensuring we address the systemic risks the markets and firms we regulate pose to the broader financial system.

We see systemic risk as the risk of major disruption to the flow of finance (whether credit intermediation or securities and derivatives markets) which in turn threatens significant disruption to economic activity.

Addressing systemic risk is for us about playing a key role in building resilience into financial markets and the financial system. It is an area in which securities regulators have not traditionally been seen as having a role – with regulators and central banks seen as the primary guardians of stability and resilience.

The Crisis highlighted the role that markets play in transmitting disruptions from other parts of the financial system through to the real economy and also the disruptions that can be created by firms we are responsible for regulating. It highlighted that securities regulators do have a role to play.

At an international level, the International Organization of Securities Commissions, of which both ASIC and the FSA are members, recognised this when it adopted two new principles to guide the design of approaches to securities regulation:

- The first requires regulators to identify, manage and mitigate systemic risk.
- The second requires regulators to review the regulatory perimeter, assessing whether the regulator’s existing powers, structure and regulations are sufficient to address emerging risks, and to make or propose any necessary changes to regulation.

IOSCO also published a discussion paper earlier this year which underscored the need for securities regulators to develop our own approaches to identify, monitor and mitigate systemic risk.

- The paper emphasised that although we can learn from the monitoring techniques used by central banks and prudential supervisors – our starting point should be using our traditional tools and thinking differently about when, where and how we use them.
- The paper also emphasised the importance of monitoring and keeping on top of product innovation.

IOSCO has also established a new Standing Committee to bring together economists and researchers from member securities regulators (including the FSA) to help develop ways of identifying and flagging the systemic risks we should be concerned about.

Financial stability and systemic risk issues are also important drivers of proposed institutional reforms in the country, and will be a key focus for each of the new regulatory bodies.

For example, I read that the FCA's market supervision will concentrate on those markets which have a clear and direct link to wider confidence in the financial system.

In Australia, systemic risk issues across the financial system are addressed through the Council of Financial Regulators, which brings together the heads of our Central Bank (RBA), our prudential regulator (APRA), the securities regulator (ASIC) and the Treasury. It is a relatively informal grouping. The forum is an opportunity for us to

- share information,
- discuss regulatory reform issues, and
- coordinate responses in financial stability issues.

This arrangement served us well through the crisis, allowing us to develop coordinated approaches quickly and effectively.

At ASIC we are taking a proactive approach to identifying and addressing systemic risk in the same way that we are managing our other risks.

Emerging Risks Committee

A key element of our approach is the Emerging Risks Committee which I established when I became Chairman earlier this year.

This internal committee has met monthly since July. For each sector that ASIC regulates, it considers developments such as innovation in financial products, emerging market practices both in Australia and offshore, and international regulatory developments. It examines the thematic and systemic risks these developments pose to investors, consumers and markets as well as to the financial system more broadly, trying to look a year or more ahead. It assesses the effectiveness of current regulatory settings and recommends action.

Some of the issues the Committee has addressed have included:

- the possible impact of market events in Europe and the US on Australia and the risk of a GFC II;

- the risks posed by technological innovation in our markets; and
- the risks posed by OTC derivatives markets.

Some of these risks appear serious and may warrant some trade-offs regarding the conventional goals of fairness and efficiency held dear by securities regulators.

Conclusion

So in winding up, my vision for ASIC is one which challenges some traditional assumptions about the role securities regulators play in the financial system and the tools they use.

My key points have been that:

- Securities regulators do have an important role to play in ensuring financial system resilience.
- Effective investor and consumer protection requires regulators to be more creative about the tools we use and to understand the limitations of traditional approaches to disclosure.

I look forward to any comments you may have.