



ASIC

Australian Securities & Investments Commission

Regulatory initiatives by ASIC in the cyber age

A presentation by Jillian Segal, Deputy Chair of ASIC, to the Faculty of Law, University of Sydney, "Financial Markets and the Internet Conference", Sydney, 31 May 2001.

Introduction

Professor Coffee, in presenting his American perspective on the difficulties of adapting an old statute to new technology, sums up the SEC approach as "two steps forward, one step back".

I would like to argue that ASIC's approach may be characterised as stepping consistently, but carefully, forward, treading lightly and being innovative, but, of course, carrying a big stick.

It is not necessary in this forum to detail the changes we have witnessed in recent years through the growth of e-commerce and the development of the "new economy". Suffice to say, that the business models of today challenge the existing legislative and regulatory framework and impose issues for governments, regulators, industry participants and consumers. Globalisation and the cross-border nature of e-commerce have added a further dimension of complexity.

Three and a half years ago when I first took up a position on the Commission, I established ASIC's e-commerce coordination group to link the different, but growing, aspects of ASIC's business as they dealt with or impacted on e-commerce issues.

We recognised that we needed to respond appropriately to a period of transition. We recognised that it would be foolish to assume that regulatory rules and practices

designed for a non-digital world could easily apply in the e-commerce context. Laws and regulatory rules and practices are deeply rooted in a concept of how business is done – indeed, it might be argued that they must be so, or risk being remote from the very practices they seek to regulate. Therefore, regulators need to adapt existing rules and practices in order to cater for the rapidly developing e-world. However, they must do so without foreclosing the possibility of doing business in a traditional way or making dealing in the non-electronic environment less safe than it has been in the past. We therefore adopted a set of principles to guide our approach to "new economy" issues. These are:

- a) focus on achieving regulatory objectives rather than developing technological solutions;
- b) aim to develop policies that are technology neutral in their outcome to the extent that this is feasible, given the nature of certain online products and services;
- c) ensure that regulatory requirements for e-commerce are no more onerous than those applying to traditional ways of doing business, whilst ensuring consistency with good policy;
- d) ensure that consumers using e-commerce have at least the same levels of protection from the laws and practices that apply to traditional forms of commerce;
- e) provide guidance and a measure of certainty to businesses in new areas;
- f) ensure consistency across the products and services that are regulated by ASIC;
and
- g) pro-actively assess the impact of technological developments on the market and seek input from consumers and industry where appropriate.

ASIC's thinking has thus matured to the point where it has recognised that the online environments special characteristics necessitate a forward thinking approach. As such,

ASIC has taken a "hands on" approach in order to address issues at a stage before they manifest themselves in the form of consumer complaints and relief applications. To do so, we recognised that we needed to be well informed about new practices and products. Some of the questions occupying our minds were – Could we identify in advance some of the obstacles that might exist in the form of legislative barriers or ASIC policy? Could we facilitate new initiatives? And could we provide consumer protection measures before losses are incurred?

One of the first initiatives we took was to ask McKinsey & Co Consultants if they could brief us on developments and initiatives in the "new economy", in order to ensure that we had an accurate picture of developments overseas that were most likely to follow in Australia. We also invited industry groups in and soon learnt that one on one briefings were the key to obtaining meaningful information on initiatives and new directions. I believe it is in response to our facilitative approach that we have found industry to be most forthcoming. In fact, we have most major financial institutions seeking us out to brief us about their new proposals.

In responding flexibly to the challenges of the new economy, at least eight different approaches can be identified in recent ASIC e-commerce related activities:

- 1) Through its policy making approach, ASIC has simply adapted existing policies to the new electronic environment. An example of this was Policy Statement 107 "Electronic Prospectuses", released in September 1996, which focused on electronic prospectuses issued on the internet. In this Policy Statement, ASIC adapted its existing policy in relation to hard copy prospectuses in order to ensure that they could be distributed electronically, if desired. This Policy Statement was further amended in June 1999 to allow hosts of internet websites to act as service providers, and publish electronic prospectuses of third parties on their websites. Of the eight approaches, I would describe this as the least sophisticated one adopted by ASIC in facilitating issues arising out of e-commerce. It involved more of a translation of the old to the new, rather than recognition that a new approach was needed altogether.

In more recent times, ASIC has recognised that new e-commerce products may not easily fit into categories described in existing policy. An approach which

seeks to define parameters through the use of examples may permit greater flexibility for new and innovative products and services. Our PPP on "Advice and Dealing", issued in the first tranche of FSRB policies released last month, is an example of this approach, where we discuss the giving of advice in different circumstances and the use of portals to provide information to consumers.

- 2) Reflective of a much more pro-active approach, ASIC has gathered representatives of industry and consumer groups together and, through effective chairing, has managed to have such a group agree a voluntary code governing behaviour that is presently outside the legislative regime – chairing the review of the Electronic Funds Transfer Code of Conduct (EFT Code) is an example of this.
- 3) Another approach has been to identify a new product or service, conduct detailed surveillance on its use within industry, both domestically and internationally, and then issue a discussion paper seeking comments on a number of regulatory issues. The aim of this approach being to facilitate discussions with those affected, and to develop appropriate regulatory responses to such issues. Our efforts in relation to account aggregation and online trading are examples of this approach.
- 4) ASIC's approach to Internet Discussion Sites (IDS's) reflects an unusual approach to policy guidance. Interim Policy Statement 162 "Internet Discussion Sites" (IPS 162) specifies standards of behaviour, which, if complied with, effectively creates a "safe harbour" from ASIC's licensing requirements. That is, the statement provides guidelines for the operation of IDS's without a licence. For instance, where IDS's are conducted by non-professionals and there are appropriate disclosures about the potential risks for consumers in relying on opinions posted on the site, IPS 162 gives relief from the present legislative licensing requirements of the Corporations Law.
- 5) A fifth approach is the development of Policy Statements based on agreed international principles. For example, Policy Statement 141 "Offers of Securities on the Internet", which was drafted pursuant to principles agreed by the IOSCO Internet Taskforce, represents an approach consistent with that adopted by other jurisdictions including the United States and the United Kingdom. It was released

in February 1999 and sets out when ASIC will regulate offers, invitations and advertisements of securities that appear on the internet and can be accessed in Australia. It is based on the agreed international approach of asserting jurisdiction only in the absence of meaningful, jurisdictional disclaimers.

- 6) Another initiative has involved releasing discussion papers (in conjunction with individual academics or academic institutions) to raise new issues for comment, for example, multi-media prospectuses, electronic proxy voting, and to engender debate about the best mix of regulatory and legislative responses. For example, in February 2000, ASIC, together with Dr Elizabeth Boros from the Centre for Corporate Law and Securities Regulation at the University of Melbourne, released a discussion paper on multi-media prospectuses and, at the same time, Dr Boros released a discussion paper on online corporations. Both discussion papers arose out of a joint research project between ASIC and the Centre for Corporate Law and Securities Regulation, in order to address the issue of how the administration of corporate and securities law in Australia might need to change as a result of developments in electronic communications.
- 7) Another non-policy approach to dealing with issues raised in relation to e-commerce is, of course, ASIC's educational initiatives. I will not go into great detail today about these initiatives. However, it is fair to say that ASIC's April Fool's Day Millennium Bug Insurance Cyber Scam in 1999 achieved front-page newspaper and prime-time television coverage, bringing the message home to many consumers that the internet can potentially be used to scam investors. In May 2000, ASIC won the gold award from the International Public Relations Association for this campaign, said to be the best public relations campaign run in the world in 1999. Through its website, ASIC also delivers "gull" awards featuring cautionary tales of money and deceit, and through its specialised consumer website, FIDO, ASIC provides internet safety checks, consumer alerts and bulletins alerting consumers to e-commerce issues and potential risks.
- 8) The "stick" ASIC carries is, of course, ASIC's e-enforcement initiatives. Again, I will not dwell on these today. However, as many of you no doubt know, ASIC has established an electronic enforcement unit, which acts as a specialised cell of

investigators and technical experts, to ensure that ASIC's enforcement teams are appropriately equipped and trained to identify, and deal with, inappropriate internet based activities. ASIC has successfully managed to detect and institute legal proceedings in order to stop investment advice being offered by unlicensed persons over the web, to force compliance with continuous disclosure obligations in relation to online offerings, and to prosecute spamming and "pump and dump" schemes (a successful investigation run in conjunction with the US SEC).

EFT Code

In the examples referred to in Professor Coffee's paper, it was a case of having to deal with new realities within an existing legislative framework. Sometimes, however, new technologies fall outside the existing legislative framework and it may be more appropriate to contemplate a code of practice to regulate behaviour in this context. Clearly, it is essential that the regulator be in a position to be proactive. One of the tools we have found to be invaluable when dealing with emerging products, where industry understands the issues much better than the legislature, is the development of an industry code or best practice guideline by the regulator.

Our approach in relation to the EFT Code and Account Aggregators are two examples of such an approach.

Long before ATMs and EFTPOS were invented, the common law developed rules to distribute loss when banks acted on forged mandates – that is, if someone forged a signature on a cheque or passbook withdrawal. In brief, a forged signature was a nullity, giving the bank no authority to withdraw customer funds. Consequently, customers were entitled to a full refund.

With the development of automatic teller machines, no signature was required to withdraw cash and there was no need to verify the identity of the person withdrawing the cash. All that was required was the anonymous entry of a PIN number. The common law rules no longer applied and many financial institutions sought to place all liability upon consumers for unauthorised transactions.

This was clearly an unsatisfactory state of affairs and both government and regulators responded in the mid 1980s by developing the EFT Code of Conduct which, amongst other consumer protection initiatives, set in place rules for a fairer allocation of liability in the event of unauthorised transactions. Against a background of needing to engender consumer confidence in the new technology, and a threat that the government may respond legislatively (which had happened in the United States), all Australian financial institutions offering ATMs signed up to the Code.

Unfortunately, the Code was not written in technology neutral language. Its application was dependent upon the need for a card and a PIN to make transactions. Thus, as new technologies, such as computer and telephone banking and stored value products emerged, the regulatory regime covering unauthorised funds transfers also quickly became dated. The rules in the EFT Code did not apply and it was left to institutions to make their own liability allocation rules. These rules varied between institutions.

The Treasurer therefore asked ASIC to review the EFT Code with a view to ensuring that there was an adequate and consistent consumer protection regime in place for these new forms of electronic funds transfers. In 1999, ASIC convened a working group of industry, consumer and government representatives to consider the issues and revise the EFT Code.

The review process can be seen as having two parts:

- dealing with the already emerged products of telephone and internet banking; and
- dealing with stored value products which were still very much in their infancy.

It is the stored value part of the process I want to focus on today since there was never any real dispute about the need for the EFT Code to cover computer and telephone banking, and it was really just a matter of when and how the Group would work its way through the large number of technical issues that arose.

With stored value products, however, the case was different. While there had been a number of small-scale trials in Australia in the mid 1990s of stored value products,

which could be used to purchase a range of goods, they were not yet commonly available except in single purpose forms such as prepaid telephone and transport cards. Industry objected strongly to covering these products in the EFT Code. The most they wanted to contemplate was non-binding guidelines. They argued that a Code would stifle product innovation and that there was no need to regulate as there was as yet no evidence of problems.

ASIC took a different view and pointed to the types of problems which emerged during the 1990s trials to justify the need to have protections in place before problems emerged on any large scale. Issues we were concerned about included the ability of consumers to redeem unused stored value and the ability to inform themselves of how much unused stored value remained on a facility at any given time.

When the revised Code was launched earlier this year, I am pleased to say that it included a part which specifically covered stored value products. I believe that it is the first such regulation of these products anywhere in the world. Importantly, however, when the revised Code was launched it was not accompanied by protests from industry about the inclusion of stored value products. I do not think that this was because we, the regulator, crushed them! Rather, I believe it was the result of a concerted effort on our behalf to adopt strategies and processes that brought industry on board, even if their preferred position remained unchanged at the end of the day.

I think that the strategies undertaken by ASIC demonstrated a proactive approach to adopting a regulatory (albeit regulator directed and endorsed self regulatory) regime.

- We recognised the complexities of the technologies we were dealing with and employed a consultant, who was a recognised expert in the field, to do the drafting of the revised Code. This meant that industry felt confident that they were talking to someone who understood what they were saying (and we were confident we were well informed about what was and was not feasible);
- We also set as one of our objectives for the revised Code that its language be as technology neutral as possible so that nobody could argue that it would stifle innovation, and so that the revised Code would not date too quickly. It was agreed

that we should have an exemption power in relation to the stored value part of the Code as an additional means of responding to industry concerns;

- We established a technical experts group which examined various drafts of the Code so that they could alert us to any unintended technical consequences;
- Relatedly, we consulted and consulted and listened to the feedback we received so that without compromising policy goals we managed to address many of the specific concerns raised by industry;
- Finally, and importantly, we stuck firmly to our philosophical position that protections are best put in place before widespread problems emerge – not afterwards.

I am confident that the revised Code will provide consumers with a solid foundation of protection for their electronic funds transfers and help ensure that the benefits of these new technologies can be widely enjoyed.

Account Aggregation

The recent emergence of account aggregation in the financial services marketplace is a clear illustration of the speed at which e-commerce developments are brought to market.

Account aggregation is a service that is becoming increasingly prevalent in the United States, although it first came to ASIC's attention in August 2000. At that stage, no account aggregation sites were operating in Australia. Today, a range of institutions in Australia (including major financial institutions and portals) have either commenced offering aggregation services, or have announced plans to launch such services in the near future. Both AMP and Macquarie Bank have already launched their version of aggregator accounts. One source estimated in March 2001 that there were about 5,000 account aggregation users in Australia. The general consensus is that the growth from now on will be exponential.

Essentially, account aggregation allows consumers to view information from their online accounts with a range of institutions on the one web page. This allows the

consumer to have a snapshot of their financial position as a whole, without having to log in separately to the websites of all financial institutions with which they have accounts. Most aggregation services can also aggregate non-financial accounts, such as e-mail and frequent flyer accounts, as well as news and information services. In theory, there is no limit to the type of information that can be collated by an aggregation service, provided the information can be retrieved online. An account aggregation site can therefore become the consumers preferred portal to the net.

To use an aggregation service, the consumer must provide the aggregator with the account details (including username and password) for each of their nominated accounts. The aggregation service then uses these details to retrieve account balances and other nominated information from the designated sites. The information is then collated and displayed on a single web page. The consumer therefore need only remember the one username and password.

Promoters of account aggregation assert that these services provide great benefits to consumers – convenience, flexibility, time and more efficient personal financial management. Research by McKinsey & Co, for example, suggests that consumers who use aggregated services to manage their bill paying, borrowing and investing could save themselves up to \$3,000 a year. It is important to note, however, that account aggregation of financial account information also raises significant consumer issues, including issues of liability, disclosure, privacy and security.

At the moment, account aggregation services are "view only". Services offered in the foreseeable future through aggregation providers might include:

- Online, real-time transaction capabilities;
- Electronic bill notification and payment; and
- Ability to purchase products.

It is also possible that aggregators could ultimately provide:

- Cash management and financial planning services;

- Tailored financial advice;
- Intelligent agents that can complete tax forms, loan applications, and other documents; and
- Automatic financial analysis and decision making, for example, automatically analysing aggregated information and – based on a customer's financial goals and risk tolerance – reallocating assets as needed to maximise value and return.

ASIC's interest in this area arises from its involvement in the EFT Code and its general consumer protection responsibilities in the financial services sector. Account aggregation has no real counterpart in the paper world. As such, an active approach is required from the regulator in order to provide certainty to businesses and protection to consumers.

To facilitate discussions, ASIC conducted a website survey of financial institutions and other organisations in order to assess the availability and functionality of aggregation services in Australia, and to identify issues for consumers. The survey was conducted between November and December 2000, and the results were updated in April 2001. To complement this information, ASIC also examined some of the aggregation services offered in the United States for comparison and reviewed additional information and views from aggregation suppliers, industry organisations, consumer organisations, and regulators, both here in Australia and in other jurisdictions (primarily the United States).

We have released today our discussion paper on account aggregation services. This paper presents the results of our research and is likely to be the catalyst for further discussions between regulators, industry groups, financial institutions and consumers about current and prospective consumer protection issues and possible solutions going forward.

In our survey, we identified a range of consumer protection and regulatory issues that are generated by account aggregation services including issues of disclosure, liability for unauthorised transactions and other losses, privacy, security, consumer education, complaints and dispute resolution. Our discussion paper deals with each of these issues and makes suggestions for action by industry to deal with these concerns.

One of the important issues for consumers using aggregation services is adequate disclosure. Consumers need to have access to clear, simple, prominent and upfront disclosure of relevant information about aggregation services including among other things, privacy policies, terms and conditions, liability, risk, and security measures. For example, an aggregator's privacy policy should advise, among other things, who has access to the personal information provided by consumers, and how that information will be used. Aggregators should also provide clear and prominent information about the risks associated with using aggregation services. Whilst our survey demonstrated that most sites do disclose basic information on terms and conditions, privacy and security statements, there is room for improvement in the scope and quality of the disclosure.

There are currently no positive disclosure obligations on aggregators to provide the type of information I have just alluded to. If it is not provided voluntarily, it is worth considering whether or not there might be a role for some form of guidelines or rules – perhaps through an aggregators code of practice. Clearly, early identification of these issues will assist industry groups in allocating resources to such issues and in reviewing their systems.

Another key area of concern for ASIC is whether, and in what circumstances, consumers will be liable for unauthorised transactions or other losses that occur on an account that can be accessed by an aggregation service. Aggregation sites are essentially asking customers to breach the terms and conditions of their bank accounts by handing over their passwords to a third party. By doing so, consumers could indeed be putting at risk their right to limited liability in the event that unauthorised transactions are made on their accounts. Clearly, these issues need to be managed and consumers need to understand how liability for loss will be allocated between themselves, the aggregation service, and financial institutions in the event that losses are incurred due to unauthorised transactions.

ASIC has not yet finalised its thinking on these issues. We have identified some areas that we think need attention, but we are still developing our views through further consultation and research. As well as confirming the scope and nature of any consumer issues, a roundtable meeting, chaired by ASIC, between industry members, consumer

organisations, other regulators and government agencies could be an opportunity to facilitate communication and develop appropriate solutions. Some possible solutions for further discussion include ASIC developing a good disclosure template for aggregators, the inclusion of an aggregator module in the revised EFT Code or the development of a separate aggregators code. ASIC has taken a leading role in its approach to account aggregation, seeking to consult with all interested parties at an early stage of the proceedings in order to facilitate discussions and to generate an optimal outcome. Again, it is worth noting the small, but determined, steps we have taken to respond to new developments:

- We sought to understand the new product at a very early stage through market research, discussion with industry and surveillance;
- We consulted with other regulators to understand their concerns and perspectives. In this case, we involved APRA, Austrac, RBA, ACCC and the Privacy Commissioner's office;
- We researched the position overseas; and
- We raised the issues to stimulate a consultative discussion process.

Conclusions

The financial services industry continues to be a key area of technological innovation, e-commerce activity and product development. Consequently, ASIC's approach to regulation has evolved in a way that attempts to develop a regulatory framework that is robust, yet flexible enough to support new business models emerging within the e-commerce forum.

I have already spoken about some of our regulatory initiatives including our efforts in revising the EFT Code and our response to the newly emerging area of account aggregation. These initiatives, among others, are a clear illustration of our commitment to take a leading role in identifying, at an early stage, the range of consumer protection issues associated with products of the “new economy” and in facilitating discussion about the possible solutions to such issues.