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Australian Securities & Investments Commission

The major challenges for regulators to maintain trust and confidence in the financial system

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Introduction

What are the major challenges for regulators to maintain investors' trust and confidence in the financial system? What else should we do to further enhance the resilience of the global financial system?

I will be short and to the point in answering the questions posed.

I see three major challenges for regulators to maintain trust and confidence in the financial system:

1. structural change
2. ongoing financial innovation, and
3. continued globalisation of markets and products.

What do I mean by this?

Three major challenges

Structural change

The financial system is currently undergoing significant structural change. Funds are shifting from the banking regulatory perimeter to the securities perimeter.

Business is turning to market-based financing for their funds as banks are restricted in their lending due to increasing capital requirements. Small business has been affected the most. So-called shadow banking is on the rise.

Securities markets continue to grow in size, particularly in developing countries.

In many countries, there is also a demographic shift as the population ages, and superannuation or pension markets grow in importance. In Australia, funds invested in superannuation are expected to grow from \$1.4 trillion to \$3 trillion by the end of the decade.

As securities markets grow in importance, securities regulators will have more responsibility. This is our first challenge.

Innovation and complexity

The second challenge facing regulators is keeping abreast of innovation and complexity.

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

Innovation can also add complexity.

We see complexity in:

- products – complex or structured products
- markets – dark pools and high frequency trading
- technology – cybercrime: hacking into trading accounts and online scams.

Innovation and complexity increase risk in the financial system.

Globalisation

The third challenge facing regulators is globalisation. Globalisation of markets and products is continuing. Markets are becoming increasingly integrated and products are being distributed on a global basis.

Inconsistencies or differences in regulatory frameworks can create opportunities for investors. However, they also add to the costs of investing and doing business. This can hinder economic growth.

How do we address these challenges?

Structural change

The increased importance of securities regulation means securities regulators have greater responsibility. They need to have the right tools and resources to fulfil their mandate.

We need to ensure the tools we have and the ways they are used don't reduce the level of protection for investors.

So we are likely to see more prudential-type requirements being implemented in the securities space, particularly where shadow banking is prevalent.

Strengthening capital requirements will be a common theme as regulators seek to reduce the regulatory arbitrage between prudential and securities regulatory perimeters.

With expanding responsibilities, but limited resources, securities regulators need to ensure that they have clear priorities and a strategic direction. It's important that the structure of the organisation is aligned with the strategic

priorities. Regulators need to use their limited resources in the most effective and efficient manner.

Innovation and complexity

How should regulators deal with continued innovation and increasing complexity?

We need to be forward looking and proactive. A standing committee which draws on experts from across the organisation should be used to identify potential risks over the horizon.

It's also important that regulators have staff with industry experience and expertise so they have a better understanding of the market.

Maintaining a close dialogue with industry is fundamental in this respect so that the regulator knows what is happening in the market.

Finally, thinking outside the box and encouraging industry to use new tools such as new media can overcome inherent weaknesses in traditional disclosure methods.

- For example, a YouTube video explaining the features and risks of a product to an investor is an effective form of communication. It's immediate, relevant and personal.
- The internet is a powerful tool and we should be taking full advantage of it.

However, it's also a two-way street. While regulators need to be proactive in order to keep pace with innovation, product manufacturers and issuers also have a role to play.

The more product issuers ensure their products are appropriate for the investor, the better. Products that are mis-sold are dangerous for investors because investors don't understand the risks. But it's also bad for the product issuer because their reputation is on the line. Issuers are likely to pay when a product is mis-sold – either to protect their reputation or due to legal action.

It's not a sustainable business model if your customers don't understand the product and lose money.

Globalisation

Global issues require a global response. The key is cooperation. Regulators need to work together to ensure that:

- laws and regulations are aligned and administered consistently (i.e. global standards), and
- we cooperate in enforcement matters and investigations.

Global organisations such as IOSCO play a key role in this. Having the right global infrastructure in place is critical to developing a global approach.

These global organisations can minimise the potential for regulatory arbitrage and make it easier to do business across borders.

I hope that's given you an overview of what I see are the main issues facing regulators. I would be happy to take questions during the panel discussion.