



ASIC

Australian Securities & Investments Commission

Setting the reform agenda in a changing regulatory landscape

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Introduction

Thank you for the introduction, and for the invitation to speak at the Risk Australia conference.

I was asked to talk to you today about ‘Setting the reform agenda in a changing global regulatory landscape’. This led to me reflect on what is a ‘changing global regulatory landscape’. Particularly, what has changed for ASIC and the Australian financial market, and what has stayed the same.

I will start by being a little controversial, and say that the environment we operate in has not changed in its fundamentals. Markets by nature will innovate, compete, and adapt to change – and regulation has evolved to keep up with innovation and change.

So what is different? Compared to the period before the financial crisis, is it the intensity of regulatory oversight, pace of regulatory reform, or is it also coming from new technology and innovation?

Let me start by giving you my perspective on the global regulatory landscape. Then, at the end, I will bring this back to you – the market participants and market infrastructure operators – with a couple of closing questions.

ASIC’s perspective

My perspective is that, in today’s global environment, the speed of change – including regulatory change – is likely to continue.

These days, it is almost a truism that markets are increasingly globalised. This may be because of the type of products, how they are traded, or the global investors that our domestic markets attract.

As a market and conduct regulator, ASIC has a broad population of regulated entities. Many offer services or financial products cross border, on financial markets in Australia and overseas. This reflects that we have an open and globally-connected economy and financial markets.

Our open economy informs how we work as a regulator. It also affects the business commercial decisions made by Australian entities that have cross-border businesses.

Some Australian entities have felt the impact of overseas regulation in recent years, and will continue to do so. One example is the major Australian banks, which have registered with the US Commodity Futures Trading Commission (CFTC) as ‘swap dealers’ under the *Dodd–Frank Wall Street Reform and Consumer Protection Act* (US).

In response to new regulation, we have seen overseas participants or market infrastructure come into Australia, to offer services like trade reporting or central clearing.

Then there is change driven by technology and industry innovation, such as new ways of making payments, trading financial products, raising capital or managing collateral. Topical examples include peer-to-peer lending and crowd funding.

New regulation

Let’s talk about new regulation. We often think of overseas entities’ activities occurring on our domestic markets, under our national rules. But, sometimes, it may be more accurate to say we are part of a bigger global market, and our national rules have to work with other countries’ rules.

For regulators like ASIC, this means that we cannot do our job in isolation. If all regulators only looked at their domestic markets, we would live in a world of inconsistent national rules.

Increasingly, there are international standards and principles on how activities, entities and financial products should be regulated. Australian regulators have been involved in the international bodies that provide these standards and principles. These standards are often in specific areas of regulation. They can help to harmonise regulation and oversight. Examples are:

- The Committee on Payments and Market Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO) *Principles for financial market infrastructures*. These standards apply to payment, and clearing and settlement systems. They seek to ensure that the infrastructure supporting global financial markets is more robust and well placed to withstand financial shocks.
- The IOSCO *Principles for financial benchmarks*, aimed to create an overarching framework of principles for benchmarks used in financial markets – and the recommendations for foreign exchange (FX) benchmarks issued by the Financial

Stability Board Foreign Exchange Benchmark Group, which was co-chaired by Guy Debelle of the Reserve Bank.

- The Basel Committee and IOSCO's joint standards on margin requirements for non-centrally cleared derivatives.

Some of the international work is thematic. For example, IOSCO is currently doing some really interesting work on cross-border regulation, and on a 'toolkit' for oversight of cross-border activity.

Some of the work is industry-driven, where IOSCO members work together to understand the impact of market changes and financial technology (fintech).

You have probably seen IOSCO's *Principles for dark liquidity*, and its work on high-frequency trading, in 2010 and 2011. Auto-advice, retail structured products, and crowd funding are some current examples that come to mind.

This shows international standards can play an important role as markets evolve, even as change challenges regulators – and bodies like IOSCO – to be proactive and forward-looking, and to be responsive to market developments.

ASIC places a lot of importance on international standards, because they have become a 'common language' between regulators. As I said earlier, international standards have the goal of promoting consistent oversight on a global basis. Because of this, these standards help to mitigate the risk of regulatory arbitrage. They help regulators to better understand when a foreign regulatory regime imposes similar requirements and achieves comparable outcomes.

Having a 'common language' can help regulators to work together on emerging issues or risks, and also identify opportunities for cooperation, information sharing and regulatory deference – I'll come to this later.

As a result, we at ASIC often use international standards as a starting point when reviewing our domestic regulation. We are also interested in how international standards are adopted in key overseas markets.

ASIC has sometimes adopted a 'fast follower' approach when it comes to implementing international standards. We have looked for ways to align our regulation with key overseas regimes, while still doing what is appropriate for the Australian markets.

This alignment makes it easier for businesses to operate cross-border, while also ensuring risks in the Australian market are identified and managed. I will give you a case study of how we have implemented over-the-counter (OTC) derivatives reforms in trade reporting and mandatory clearing.

In writing our trade reporting rules, we looked at the rules that were being implemented in the United States and the European Union. We adopted a broad-based reporting regime, in part because our rules needed to be credible and have sufficient coverage to get recognition from key overseas regimes. One result is that the European Securities and Markets Authority (ESMA) has assessed our reporting rules as fully equivalent. When the

Australian regulators advised the Government to implement mandatory clearing, the recommendation reflected the cross-border impact on overseas clearing requirements.

Supervision and licensing

Now, I will talk about licensing and supervision. This is where the rubber hits the road, and regulation is applied.

ASIC has built on different ways of cooperating with overseas regulators to supervise cross-border entities and activities. An important tool for cooperation is our memorandums of understanding, or MOUs.

ASIC is a signatory to the IOSCO multilateral MOU on enforcement. We have a large number of MOUs with overseas regulators, including MOUs with the CFTC and ESMA, with our Asian-Pacific neighbours, such as China, Singapore, Hong Kong, Japan, and other IOSCO members such as Canada.

These cooperation arrangements can help regulators to defer to each other when supervising cross-border businesses – using the concept of regulatory deference. ASIC may decide to defer to an overseas entity's primary or 'home' regulator, rather than undertaking full supervision of its Australian activities. Similarly, overseas regulators may defer to ASIC's oversight of an Australian entity, instead of imposing full regulation under its own regime.

Recently, there has been a lot of focus on regulatory deference, particularly in OTC derivatives markets. But ASIC has had a history of cooperating with foreign regulators to avoid conflicting regulation. This is one reason ASIC was well equipped to meet the challenges posed by OTC derivatives reforms and other global reforms. Using regulatory cooperation, we helped Australian entities to continue their cross-border businesses. We also facilitated overseas entities to conduct business in Australia.

In the past couple of years, foreign central clearing counterparties (CCPs) and trade repositories have been licensed to operate in Australia. Since ASIC and the Reserve Bank of Australia (RBA) assessed that they are subject to sufficiently-equivalent regulation in their home jurisdictions, we deferred to their home regulators in a number of areas.

For domestic entities, ASIC and the RBA worked with US and EU regulators, so that the ASX Group CCPs can offer services to EU and US participants. In fact, earlier this week, the CFTC exempted ASX Clear (Futures) Pty Limited from registration as a derivatives clearing organisation (DCO) in the United States. This was the first DCO exemption order issued by the CFTC.

ASIC and the Australian Prudential Regulation Authority (APRA) worked with the CFTC on substituted compliance for Australian swap dealers, so that the CFTC deferred to ASIC and APRA regulation in some areas.

This means we are also well equipped to respond to change, including identifying potentially harmful developments here and overseas, and responding to them early in our market.

For example, up to early-2013, there was a growing trend to use broker dark pools for smaller trades instead of transparent public markets. This was harming price formation. It was also unfair for dark orders to step ahead of transparent orders at the same price.

In May 2013, ASIC introduced the meaningful price improvement rule and lowered block trade thresholds. This has shifted some of the smaller trades back onto transparent markets, and dark trading is transitioning back to its original purpose - to manage the market impact of large orders.

So, being proactive allowed us to manage this market development. Let me give you some other examples of cooperation:

Data access – ASIC’s trade reporting rules allows foreign reporting entities to use non-licensed trade repositories. We have established data access agreements with overseas regulators that give ASIC access to data held in those trade repositories. The Government has made regulations that allow some overseas regulators to access data held in Australian-licensed trade repositories.

In the recent account hacking cases, ASIC worked very closely with overseas regulators, in particular the UK Financial Conduct Authority (FCA) and the Danish Finanstilsynet (FSA). This was imperative to achieving the two most important outcomes:

- immediate closure of the suspect account to prevent any further account hacking, and
- freezing the proceeds of hacking activity to prevent hackers from receiving any profits.

ASIC continues to work closely with US and Canadian regulators to keep abreast of any new forms of cyber misconduct which could affect Australian markets. These are some real life examples of cooperation between ASIC and overseas regulators. These cooperation arrangements – and ongoing liaison – are really important to make sure that cross-border regulation is effective. And because cooperation arrangements allow us to defer to overseas regulators in some areas, it means we can focus our resources on key issues in our markets.

Pace of change and innovation

At this point, you may be asking me, ‘Cathie, when does it all finish?’

As I said earlier, I think the pace of change will continue. Markets will innovate, compete and adapt, not just because of regulation, but to find business opportunities. We have seen significant changes in OTC derivatives markets, with greater use of centralised market infrastructure.

Technology can improve traditional business-customer relationships, or disrupt existing business models and channels. It can also raise questions about conduct and what it means to have fair, orderly and transparent markets. There is the potential for new ways of creating and sharing value, for example, with peer-to-peer lending, auto-advice, crowd funding and digital currencies.

In this environment, a regulator's job involves keeping track of change, so we adapt and continue to fulfil our mandates of market integrity, conduct, and investor trust and confidence.

To be outward and forward-looking, we aim to use our regulatory tools in a way that adapts with the market. We are not only fighting the last crisis, but trying to detect the next risk, which may contribute to the next failure.

We just need to look at the scope of recommendations from the Financial System Inquiry, and before that the Wallis Inquiry, to see that regulation needs to change and adapt with market developments. An outdated regulatory regime can slow down or stifle good innovation. It can make it more difficult for regulators to respond to emerging risks. It can also make Australia out of step with key overseas regimes.

So, an outdated regime can have real consequences for us in our effectiveness as a regulator, and for participants, if they become subject to inconsistent requirements here and overseas.

ASIC has taken a pragmatic approach where we saw a case for regulation to be adaptable. One example is our preparedness to grant waivers under our trade reporting rules to help industry to implement an ambitious regime. The result is we are now better equipped to conduct surveillance of the OTC derivatives markets and market conduct.

We also encourage industry to come to us, and to the Government, if you identify impediments or inconsistencies.

Impact on market participants and FMIs

Before I wrap up, let me bring this back to the audience. If what I've described is our operating environment, what does it mean for the participants and market infrastructure operators?

We have seen the sell-side and market infrastructure operators adapting their businesses to changing regulations or technologies. I have already talked about the Australian entities getting exemptive relief to continue their cross-border businesses, and overseas CCPs being licensed in Australia.

Banks have been taking up central clearing and posting collateral for OTC derivatives, because of capital incentives. Many are building systems so these costs can be reflected in their derivatives pricing, or decisions about where their trades are cleared.

New regulatory regimes for trading venues have led to new trading platforms being established. While a large number of trades are still negotiated by voice brokers, there is more use of other trading methods, even streaming prices onto a limit order book.

As a market regulator with a market integrity and transparency mandate, these developments pose interesting questions about market structure and participant conduct.

Turning to the buy-side, many buy-side entities have also been affected by these changes, directly or indirectly. The response from buy-side has differed. Some have kept up or stayed ahead of the game. Buy-side entities are starting to take more control over their execution decisions, such as by instructing their brokers to avoid trading in small sizes and to avoid interacting with high-frequency traders. Some have developed their own algorithms, so they manage their own execution and bypass broker intermediation.

In OTC derivatives, some entities are ready to use CCPs or to post collateral, if it gives them a tighter price on derivatives contracts or a wider choice of dealers. Some entities chose a trade reporting arrangement as a matter of strategy, not just compliance.

Of course, there is no 'one size fits all' approach to managing change. What is right for a large asset manager may not be right for a boutique fund. But for some, not adapting to change can have real commercial impact, whether it's on their ability to get best execution, choice of counterparties or, potentially, ability to access certain markets.

Further changes may be coming down the pipeline. On the trading platform front, in the United States, a small handful of buy-side firms are joining trading platforms and participating directly in the dealer market. We will be interested in whether buy-side participation on trading venues may increase overseas, and whether we have the conditions for that to happen in Australia – even if it's a couple of years away.

Conclusion

To sum up, many of us – buy-side and sell-side, even regulators – are coming to grips with change. Some entities are still asking why they have been caught up in regulatory change, domestically or overseas. Others are focusing on the 'how', not the 'why'.

If we expect the pace of change to continue, there will be more strategic and commercial decisions to be made by many of you in the audience – and by your competitors, counterparties, dealers and clients.

So let me pose two questions for the audience and for some of today's panels – how have you managed change in recent years? And, do you have reflections on the themes I have touched on today?