ASIC

Australian Securities & Investments Commission

Challenge and change: ASIC's regulatory focuses for 2017–18 and beyond and what risk managers should be thinking about

A speech by John Price, Commissioner
Australian Securities and Investments Commission

Delivered at the Risk Management Association (RMA), Chief Risk Officers Conference

12 September 2017

Introduction

Thank you for inviting me along to your conference today to talk about *Challenge and Change.*

I'm sure you will all agree with me that the world is changing dramatically – and at a very rapid rate.

In the case of the financial sector, it is evolving very rapidly due to a number of factors.

Firstly, **technological advancements**. There's been much discussion of late about the application of artificial intelligence, machine learning and distributed ledger. As some of you may also be aware, the Government is currently looking at how open banking might operate here in Australia.

Secondly, **structural and demographic change**. The growth in the ageing population in Australia and overseas is expected to continue to drive changes in consumption, investment needs, asset allocation and housing requirements, just to name a few.

Last, but not least, **globalisation**. Internationally, the outcomes of recent elections and referendums, coupled by current international events, have increased economic and political uncertainty. These may pose challenges for global trade and capital flows.

In spite of all these factors however, I think the most important thing for all of us here today is …… how we manage and adapt to the challenges and changes we're presented with now and in the future.

How we – collectively – manage and adapt to *Challenge and Change* will be crucial to maintaining investor and consumer trust and confidence and market integrity.

Turning now to the structure of today's presentation …..

Today I would like to talk to about:

- ASIC's vision;
- ASIC's strategy for achieving our vision;
- the long-term challenges and risks to achieving ASIC's vision; and
- some of the key projects ASIC is undertaking in 2017–18 and beyond to address our long-term challenges and key risks.

ASIC's vision

At ASIC, achieving our vision is at the heart of everything we do.

ASIC's vision is to allow markets to fund the economy, and in turn, economic growth. In doing so, we contribute to the financial wellbeing of all Australians.

We do this by:

- promoting investor and consumer trust and confidence;
- ensuring fair and efficient markets; and
- providing efficient registration services.

Each August, we publish our four-year corporate plan.

A core part of ASIC's planning framework is our risk identification and evaluation process.

This is our process for identifying our long-term challenges and the key risks flowing from these challenges that warrant our particular attention for the current year.

ASIC's Emerging Risk Committee (ERC), which I chair, is the key forum for identifying, analysing and evaluating our challenges and risks.

Our ERC takes into account:

- the business intelligence we gather;
- the strategic insights from our regulatory work; and

- feedback from our consultation with our advisory panels and industry experts.

ASIC's ERC is also responsible for:

- the ongoing monitoring of new trends and risks; and
- developing measures to respond to changes in key risks and emerging risks.

ASIC's strategy for achieving our vision

I'd like to take a few minutes now to walk you through ASIC's strategy for achieving our vision.

There are 3 core elements…..

The first element is our '**detect, understand and respond**' approach.

So what do we mean by 'detect, understand and respond'?

Essentially, it is our risk-based approach for identifying and addressing misconduct.

Firstly, we detect misconduct by:

- undertaking surveillances that target areas with the highest risk to investors, consumers and markets;
- using information from breach reports, industry whistleblowers, complaints and reports from the public;
- monitoring trends and emerging risks;
- leveraging stakeholder knowledge to better understand the market and industry; and
- working with academics, industry, consumer groups and other regulators – local and international.

To 'understand' the risks we see, we analyse intelligence to assess those risks early and respond quickly. For example, we use our:

- technology, data and analytics capabilities; and
- our behavioural insights and research capabilities.

Last but not least, we need to appropriately prioritise and 'respond' to risks.

We 'respond' in several ways, depending on the circumstances and the level and extent of the risks involved.

Our risk-based approach ensures our actions are targeted and proportionate to the risk to investors, consumers and markets.

For example, we may respond by:

- taking enforcement and other regulatory action to hold gatekeepers accountable;
- providing guidance to individual firms and industry to drive behavioural change;
- engaging with local and international stakeholders;
- providing policy advice to government and driving the implementation of law reforms;
- influencing international policy and participating in global standard setting; and
- promoting sound risk management systems and controls among our regulated populations.

Our risk-based approach is also reflected in how we facilitate innovation and cross-border activities.

For example, through ASIC's Innovation Hub, we are facilitating innovation to enable investors and consumers to benefit from fintech, while managing the risks from digital disruption.

Another important measure is about helping to build the financial capability of Australians through a range of MoneySmart initiatives.

The second element of our strategy is around **building our internal capabilities** to better position us to meet the ongoing challenges to achieving our vision. For example, we are:

- standardising processes and modernising technology by building an integrated digital platform;
- further developing expertise in data management, analytics and the application of new technology-based regulatory techniques and tools; and
- implementing our strategy to make ASIC a more data-driven law enforcement agency.

The third element of our strategy is about **taking specific actions** to address the long-term challenges and risks to achieving ASIC's vision.

ASIC's long-term challenges and 2017–18 risks

As I mentioned earlier, the long-term challenges we face shape our risk outlook and strategy.

In this year's corporate plan, we highlight five key challenges:

- culture and conduct;
- building financial capability;

- digital disruption and cyber resilience;
- globalisation; and
- structural and demographic change.

I'd like to spend a few minutes to talk about each of these challenges, including:

- the key risks flowing from these challenges; and
- some actions we are taking to address our challenges and risks.

1. Culture and conduct

Our first challenge is: culture and conduct.

As most of you are aware, this is something that ASIC has been focusing on for a couple of years now.

A lot of work still needs to be done – too many times we are continuing to see poor culture driving poor conduct.

For example, we continue to see conflicted remuneration structures in financial firms resulting in poor outcomes.

Good culture should be at the heart of industry practice – to improve conduct and outcomes – but also to promote firm reputation and brand loyalty, which are vital to long-term business success.

In this year's corporate plan, we have updated our views on 'what good looks like' for each sectors we regulate.

I encourage you all to take a look at that.

So what are some of our focus areas for culture and conduct in 2017–18?

We are continuing to look at the quality of financial advice. This year, we are focusing on advisers who we have identified as having a high risk on non-compliance from our previous review of the big five financial advice firms.

We are also looking at firms' programs for remediating consumers, including in relation to the provision of non-compliant advice and for fee-for-no service breaches.

In terms of the credit sector, we will continue to focus on responsible lending practices. For example, we are reviewing the practices for payday loans and consumer leases. We are taking a close look at the home loans market. This includes:

- practices among brokers and lenders with high proportions of interest-only loans;
- financial hardship practices of loan providers; and
- loan fraud.

We are also reviewing the breach reporting practices in large banks.

For the insurance sector, we are reviewing the selling practices within the direct channel for life insurance. We are also looking at insurers' governance for the design and distribution of add-on insurance products available through car dealerships.

Turning now to the superannuation and managed funds sector, we will continue to focus on disclosure practices that may mislead investors and consumers or affect their understanding of the risks, fees, costs, features and performance of financial products and services.

We will review higher-risk responsible entities and superannuation entities, focusing on their culture, incentives and compliance arrangements.

We will also review the practices of superannuation trustees, including the provision of advice, fee-for-no service, and disclosure of benefits and inducements.

In the markets space, we are focusing on:

- governance issues that may affect market integrity, including the management of conflicts of interest by corporations, market infrastructure providers, market intermediaries, accountants and auditors and insolvency practitioners;
- the professionalism, independence and ethical standards among accountants, auditors and insolvency practitioners;
- market misconduct across wholesale and retail financial markets; and
- the accuracy and timeliness of disclosure and reporting of financial information to investors and the market, including exchange market operators' monitoring and enforcement of listed entities' compliance with their continuous disclosure obligations.

We are also looking closely at illegal phoenix activity and issues impacting the small business sector. We have formed internal working groups to better coordinate the work we are undertaking in these two areas.

2. Building financial capability

Our second challenge is about enhancing financial capability and inclusion.

Building financial capability complements our regulatory activities by empowering investors and consumers to have greater confidence and to make better informed financial decisions.

ASIC delivers a comprehensive financial literacy program to build capability. It includes a few key areas:

- leading the National Financial Literacy Strategy;

- engaging with the formal education sector to build capacity in the teaching workforce;
- engaging with the formal education sector to develop resources for primary, secondary and tertiary students; and
- providing free and impartial information, predominantly through ASIC's MoneySmart website. For example, this year, we are delivering new tools and resources to help consumers calculate their insurance needs, track expenses and buy their first home.

Product design and sales and distribution practices remain a concern to ASIC. For example, culture and remuneration in the life insurance sector have affected consumer outcomes.

Therefore, in addition to enhancing financial capability and inclusion, we also think it is important to use the right nudge to encourage providers to:

- create and sell a range of products and services with features that better meet consumers' needs and deliver value for money; and
- not exploit people's behavioural biases.

The first area we are focusing on is the practices of credit, general insurance and retail structured products providers.

We are looking at inappropriate products being sold, people being sold products that are not aligned with their risk appetite and people buying products they do not understand. For example, we are reviewing:

- the inappropriate sale of consumer leases, sale of goods by instalment and funeral and life insurance products, including to vulnerable consumers; and
- sales and distribution practices for hybrids, including investors' understanding of the risks involved in investing and trading hybrids.

Secondly, we are focusing on practices of life insurance providers that may lead to adverse outcomes. For example, we are reviewing insurance in superannuation, including complaints handling, management of conflicts of interest between trustees and life insurers and disclosure practices relating to group cover in superannuation.

The third area is the practices of superannuation and managed fund trustees and responsible entities. We are reviewing disclosure practices relating to fees and performance to ensure people are not being misled about product outcomes and can make appropriate comparisons.

Fourth, we are focusing on the quality of financial advice. We will test the quality of advice to consumers who have set up self-managed super funds. This includes compliance with FoFA best interests and related obligations.

3. Digital disruption and cyber resilience

Our third challenge is digital disruption and cyber resilience.

We are living in a technology-driven world with innovation happening at an unprecedented pace.

Our challenge is that fintechs do not generally adopt traditional business models, which means many of them do not fit within established regulatory frameworks.

In March 2015, ASIC launched its Innovation Hub to support innovation by helping fintechs navigate our regulatory framework.

To date, we have assisted around 162 fintech businesses, covering digital advice, marketplace lending, crowd-sourced funding, payment and remittance and consumer credit.

This year, we will continue to finalise our implementation of the new crowd-sourced funding regime for public companies. We will also work with Government on extending the crowd-sourced funding regime to proprietary companies.

From the work of ASIC's Innovation Hub, it is clear we recognise the potential benefits from fintech and innovation.

But as a regulator, we need to make sure we also address the potential risks from digital disruption, for example:

- people not understanding what they are buying;
- new products and services testing regulatory boundaries;
- increased market fragmentation and complexity; and
- cyber threats, as new business models rely on digital delivery.

We are managing the risks from digital disruption by monitoring emerging technologies, promotional methods, delivery channels and business models.

We are also monitoring the impact of digital disruption on financial reporting and audit quality. For example, the impact of digital disruption on the earnings forecasts and asset values of established businesses, including the timeliness of their disclosure to the market.

In terms of markets, we are developing our market surveillance and enforcement approach and capability for:

- misconduct that is undertaken through or facilitated by digital or cyber-based mechanisms; and
- misconduct enabled by the increased automation and interconnectedness of systems in wholesale markets.

Technology and cyber resilience are crucial to maintaining trust and confidence in the financial sector and the integrity and reputation of Australia's financial markets. This means businesses need to ensure they have appropriate systems and controls for managing technology risk and cyber threats.

Cyber threats remain one of the main risks facing the financial sector, and the economy more broadly.

Cyber threats do not just pose risks to business operations, they can also:

- damage your firm's reputation;
- result in direct client losses; and
- threaten customers' personal information.

With the phenomenal growth in data over the last 20 years, the way in which data is collected and stored has also evolved rapidly.

This creates new opportunities and risks.

On one hand, the increased data flow between consumers and providers creates opportunities for developing products and services that are better aligned with consumers' needs.

On the other hand, firms need to ensure their data storage and sharing arrangements are secure and private. They need to ensure their customers are confident that their personal data cannot be accessed inappropriately or used without their permission.

4. Globalisation

It goes without saying that our modern financial system is global in nature.

Globalisation has increased the interconnectedness of markets. This means that we are more likely to feel the effects of specific political, economic and market events offshore.

We consider risks regarding globalisation to be two-fold:

- Firstly, protectionist sentiment has increased following major elections and referendums in 2016. This may lead to reduced global trade and capital flows. It may also lead to a shift towards fragmentation in the global system, for example, as a result of differences in regulatory approaches.
- Secondly, there has been an overall increase in the level of global political and economic uncertainty.

ASIC's strategy for addressing this challenge is to continue to foster cross-border trade and capital flows while managing uncertainty.

We will do this by continuing to cooperate with international agencies. For example, we will:

- contribute to the work of international bodies, such as IOSCO;
- support key initiatives, such as the Asia Region Funds Passport and corporate collective investment vehicles;
- support equivalence assessments with counterpart regulators;
- exchange enforcement information with international regulators;
- negotiate and implement bilateral and multilateral agreements, including fintech-related agreements; and
- prepare for upcoming and potential changes to international financial market regulatory requirements, for example in Europe.

This year, we are continuing our review of the ASIC relief for foreign financial service providers that engage with Australian wholesale clients but are located outside Australia or regulated by certain foreign regulators.

We are also focusing on cross-border market misconduct. For example, we are broadening our surveillance and enforcement approach for fixed income, currency and commodities markets. This includes developing a framework for international engagement on FICC market supervision.

5. Structural and demographic change

Our final challenge is structural and demographic change.

The growth in the proportion of Australians aged over 65 raises issues of fundamental and strategic importance to the financial services sector, the community and economy.

There are generally well known issues affecting older Australians.

- Retirement planning is complex and requires people to deal with difficult, long-term decisions.
- As people age, they may face cognitive decline and a reduced ability to make sound decisions.
- Older Australians may also be more vulnerable to scams and elder abuse.
- Lastly, they may be less familiar with the technology that is increasingly being used to deliver financial products and services.

Internally, ASIC has established a special working group to reflect our focus on the impact of ageing on the financial needs and outcomes of older Australians.

This work will enable us to better understand and address the issues that may arise in each major stage of the retirement and ageing process.

Specifically, we are focusing on:

- older Australians' use of financial products and services, for example financial advice on transition to retirement;
- their ability to make complex financial decisions and the associated risks; and
- product and selling practices that target older Australians. For example, we will undertake a review of reverse mortgages, focusing on selling practices that target older Australians and those approaching retirement.

Conclusion

As I mentioned during my introduction, the world in which we live and work is changing dramatically at an ever increasing pace.

Without a doubt, some of the changes may challenge trust and confidence and market integrity.

But I am confident that – collectively – if we manage and adapt to *Challenge and Change* well, we can all contribute towards enhancing the financial wellbeing of all Australians.

Thank you, I look forward to the panel discussion.